1. **Introduction**

1.1 The Association of British Insurers (ABI) represents around 400 companies, transacting over 96% of the worldwide business of UK insurance companies.

1.2 ABI members may be purely insurance companies but are often part of large groups. They are providers of many insurance, investment and savings services and products, at both the retail and institutional level.

1.3 As a result of their various business streams ABI members have assets under management of some €1,750 bn (£1,100 bn). This includes some €550 bn (£350 bn), or 20-25%, of UK listed equity. Further details of asset breakdown are given in Annex 1. This illustrates the importance to ABI members of both the UK and other securities markets but also the significance of other asset classes and their respective markets.

1.4 On behalf of our members and their customers we welcome the opportunity to comment on this round of consultation.

2. **Executive Summary**

2.1 We support the overarching objectives of these proposals i.e. investor protection, market efficiency and the creation of a single financial market. The proposed mechanisms by which these objectives are to be achieved receive our general support.

2.2 In particular the focus on high level principles and avoidance of over prescription in primary legislation has our support. However, we are concerned that the proposals will fail to achieve these objectives. A flexible and proportionate regulatory approach to the risks to market efficiency and investor protection is required at all levels. We believe that detail is best determined at Level 3.

2.3 It is recognised that the detailed implementation of the proposals is the key to a successful outcome. We are therefore, concerned that as the proposals pass through the various stages of development, Levels 1-3, due recognition of certain key fundamentals is retained.
2.4 These fundamentals reflect that many financial services sector providers, including ABI members, provide a broad range of products and services to various types of customers in both the retail and institutional markets.

2.5 The contractual relationships between these providers and customers are based on a range of asset classes and wider than direct equity investment which is the primary focus of the revision proposals. The varying levels of product and service provided, which range from the simple to the complex and sophisticated, have particular implications for investor protection and associated Conduct of Business rules.

2.6 This underlines the need to ensure that the proposals, when implemented, do not obstruct the supply of these products and services through a tiered system of investor protection with differentiated Conduct of Business levels which allows customers, whether retail or institutional, to obtain appropriate products and services on a cost effective basis.

2.7 In the UK significant changes in the savings market are in prospect and in particular developments which may help to close “the savings gap”. The closing of the gap is predicated on the availability of affordable advice or ensuring that, through the product and the structure of its selling process, personalised advice is not required and that a simplified process or indeed an execution only basis will still provide the required level of investor protection.

2.8 This tiered approach to the customer and the level of advice required needs to be reflected in the Conduct of Business regulations. Any move away from the flexible tripartite structure of investor classification and associated Conduct of Business rules currently in place in the UK would have significant implications. Such a change, if seemingly a natural consequence of a high level principle Directive (such as contemplated for the ISD), could potentially imply major structural and operational changes in the UK financial services sector.

2.9 We are not averse to radical change but ABI members are client driven and, for long term success, need to service the best interests of their clients. Significant changes should not arise as a result of unintended consequences and should be subject to rigorous cost benefit analysis.

2.10 We are not convinced that equivalent pre-trade transparency across order execution venues can be effectively implemented from both a practical and theoretical viewpoint. Given their commercial weight in the market, ABI members can achieve appropriate quality of execution from providers on the basis of adequate post trade transparency. The imposition of pre-trade transparency obligations on the market might increase costs without any countervailing benefit to the detriment of the returns received by customers.
2.11 We would welcome clarification of “pro-active supervisory policing” of best execution obligation as a replacement for disclosure by execution venues (Overview Paper, Executive Summary, 4. Investment firm regime).

2.12 We concur with the Commission’s view on data consolidation and market solutions; this is certainly our view in respect of the UK market and we anticipate that developments in the major equity markets would extend throughout the EU.

2.13 We recognise the inclusion of advice as a core ISD service but at the same time also recognise the need to ensure consistency between the revised Directive and other Directives such as the IMD.

2.14 The differentiation between execution and dealing is noted. It reinforces our concerns in respect of investor classification and Conduct of Business and we await, with interest, the outcome of the work by CESR.

2.15 We have no particular issue to raise in respect of the application of high level principles to “regulated markets”.

2.16 We regard the area of clearing and settlement as one that offers considerable potential for improving market efficiency, reducing costs and thereby increasing the returns to the ultimate customers. We therefore support the Commission’s guiding principle of broadening options and look forward to responding to the forthcoming Communication.

2.17 We have noted the recent debate on the role of analysts and conflicts of interest and commentary that these issues would be catered for within the revision proposals. In the absence of any firm proposals at this stage we merely note evolving market practice might be more successfully catered for by code(s) of practice rather than a less flexible regulatory framework which may ill suit the cultural practices of various market places.

3. **General Comments**

3.1 We agree with the over-arching regulatory objectives of investor protection, market efficiency and creation of a single financial market that underpin the proposed revisions to the Investment Services Directive (ISD). We urge the Commission to adhere to its stated intention of revising the ISD based on:

   - clarity of regulation, both in respect of order execution venues and other matters
   - use of high level principles
   - avoidance of over-prescriptive obligations in primary legislation
ensuring technical, detailed requirements are responsive to evolving market conditions and supervisory practice.

3.2 Financial services markets are dynamic and in the UK the retail market, particularly in Conduct of Business, distribution and advice terms, is entering an advanced stage of regulatory development. In this retail arena there appears to be widespread recognition that a radical response is needed to help close the “savings gap” (which is defined as the shortfall in the working population’s annual savings required to generate an acceptable retirement income). Research undertaken by Oliver, Wyman and Company for the ABI, published in September 2001, has identified this savings gap in the UK and quantifies it at €42.5 bn (£27 billion) per annum. Current annual savings would have to increase by 54% to close this gap.

3.3 Facilitators to this gap closing include increasing accessibility to the market by a combination of consumer education and the lightening of current UK retail Conduct of Business rules. We are concerned therefore that proposed and prospective reforms in the UK are not curtailed by wider European requirements. Our comments on these matters are expanded in sections 5 and 6 below.

3.4 We are also pleased to see the Commission’s objective for a proportionate, yet effective, means of promoting the objectives of market efficiency and investor protection. The revision of the ISD should focus only on high-level principles and avoid imposing over-prescriptive obligations on firms, whether in primary legislation or in regulations. Thriving market economies must not have disproportionate or unjustifiably costly requirements imposed on them or ones designed for either other asset classes or other national markets which do not translate across markets without detriment to those other markets.

3.5 Commission requirements, of necessity, can only be at the level of setting out principles given the different product, distribution and consumer demands within and across Member States. Our objective of closing the “savings gap” would be readily achieved if home state, local, regulators are left empowered to interpret high level principles in the detailed regulatory requirements so that they suit particular markets and economies.

3.6 In drafting its proposals, the Commission must guard against unintended consequences. For instance, while the extension of ISD core services to include investment advice is limited to the financial instruments in the revised ISD, any prescription could seep into other markets where investment advice is given. This may be inappropriate to those other markets and products and render them less cost efficient for no purpose or gain to the customer.
3.7 We have in mind in particular products within the scope of the Life Directives and the Insurance Mediation Directive. For this reason we strongly support the Commission’s recognition (Section 3 p.19 of the Overview Paper) that the ISD revisions should “also allow competent authorities to take account of any current authorisation to provide equivalent services (of giving advice in respect of multiple products) in respect of closely related (life) insurance and unit-linked products under the Insurance Mediation Directive”.

3.8 The potential dangers of over prescription are further illustrated when we consider that the revision proposals appear predominantly concerned with securities and the protection of the private direct investor. The variable contractual relationships between insurers and other financial services providers and their customers, the vast majority of whom are small savers not directly accessing the equity markets, underlines the need for differentiation in regulatory treatment.

4. **Detailed Comments: Sections 1 and 2**

4.1 Order Execution Venues and Transparency

In the absence of the theoretical ideal of a single market and 100 per cent transparency ABI members take a pragmatic attitude to the issues surrounding venues and transparency. Their key requirement is execution quality appropriate to meet the requirements of their underlying beneficiaries and the varying product and services for which the latter have contracted.

4.2 In practical terms ABI members will frequently be dealing in larger than normal size and with the objective of an immediate reasonable confirmed price, rather than best at some unspecified time, particularly if the deal is part of a chain transaction. In these circumstances they welcome the availability and varying capacity of competing venues. ATS’s, for example, are generally considered to have brought a welcome stimulus to the securities markets.

4.3 Whilst welcoming competition between venues ABI members are naturally aware of the issue of fragmentation of markets and its possible implications on price formation. Transparency provides a safeguard, especially for institutions such as ABI members given their commercial weight, but the cost of transparency obligations has to be commensurate with its benefits.

4.4 Market practices vary in respect of transparency as between the USA, the UK and the rest of Europe where many off-market or cross border trades are not reported to the market. Similarly the attitude to large trades differs. Generally speaking there is a trade-off between transparency and willingness to commit capital and deal in large positions, as recognised by the Commission. If trades have to be reported promptly then the cost, particularly in the UK environment where the market will work against a firm with a large position, will be
higher. We generally favour a regulatory framework which encourages various players to commit capital to the markets for intermediation purpose. We view this as likely to benefit the long term returns received by customers. Deferred reporting is therefore essential.

4.5 We have noted the argument by some that rigorous pre-trade transparency would be likely to invalidate the commercial viability of ATSs. Indeed this underscores our doubt as to the practicality of full pre-trade transparency given that market users will fear that disclosure will lead to offsetting price movements to their detriment.

4.6 The value of post trade transparency is recognised, particularly from the viewpoint of allowing investors to assess whether or not they have achieved best or appropriate execution. Such assessment might well be assisted by a consolidated tape but ABI members are generally of the view that publication and dissemination of trade data should be provided through market-led solutions unless, as a matter of public policy, a central source is established.

4.7 Our perception of current UK practice throws into question the value of reporting virtually all completed trades. It is not clear to us that the costs incurred provide commensurate benefit. Fund managers in the UK are currently required to lodge certain data with the regulator (the FSA) but it is unclear whether this is of any value. The value of such a requirement, at EU level, needs careful study.

4.8 In summary, to provide appropriate and cost effective service to their customers, we consider a combination of fiduciary obligations, post trade transparency and ‘best’ or appropriate execution as the relevant safeguards for investor protection purposes.

4.9 We note the comment that, in due course, pre- and post trade transparency obligations could be extended to other asset classes. We believe that any such consideration in the foreseeable future is unlikely to provide value to our customers.

5. **Detailed Comment: Section 3**

**Investment Activities Covered by ISD**

5.1 We recognise the need for advice to be impartial and objective by the effective disclosure of inducements (including commissions) and for there to be organisational arrangements to manage conflicts of interest.

5.2 We believe that it is essential, as discussed in paragraph 3.7 above, that the revised orientations allow the national regulators to take account, in giving advice for multiple products, of requirements under the Life Directives and the IMD which have been developed with the life and pensions market in mind. This will help to ensure more focussed detailed regulations suitable to the life and pensions market, including scope for radical developments as they appear.
5.3 In their research on the future regulation of UK savings and investment, Oliver, Wyman and Company estimate that in 2001 11 million households suffer a form of financial exclusion, an increase of 3 million, or 38%, since 1994. Action by the UK government and financial services industry is needed to reverse this trend. EU policy which facilitates this process is essential.

5.4 Research shows that the cost of UK regulation has been driven up to the point where it is only economically attractive to firms to provide advice to higher income households, thereby creating a form of social or financial exclusion to lower and middle-income customers. So it is essential in helping to close the savings gap, not only that a form of retail investment advice continues to be available to those currently enjoying it, but that access to savings products and services is extended across the income groups. We have in mind, in particular, the lower and middle income groups where the savings gap is largest and provision of investment advice and access to basic financial services products is at its most marginal.

5.5 Detailed rules for the regulation of investment business, including that envisaged under the ISD, but also with the IMD in mind, can only realistically be set by national regulators who are best placed to recognise the requirements and constraints of home markets and the differing needs of customers.

5.6 In the case of the UK retail savings and investment market, FSA in their recently published paper ‘Financing the Future – Mind the Gap’, examine various regulatory tools for helping to ensure that consumers and providers are better prepared for the ageing population. These range from consumer education initiatives ensuring that customers are better equipped to make informed decisions, product standards and the potential for the development of a market for fixed fee advice. The UK industry is also developing ideas around workplace advice as a cost-effective means of encouraging savings, in particular pension provision.

5.7 The UK experience confirms that "one size does not fit all" in terms of retail Conduct of Business regulation. A Europe wide regime can only be set at the level of principles if potential damage to national markets is to be avoided. Potential concerns in the proposals surround suitability (Annex 1 para. 2.3.1(5)) suggesting excessive know your customer requirements where less than full financial advice is required or execution only sales are appropriate. Separate consideration, and requirements, should be applied to execution only business and to developments around simplified processes and via the workplace, in contrast to requirements where business is written in association with full investment advice. There should also be correlation with any equivalent Distance Marketing Directive requirements.

6. Detailed Comments: Section 4
**Investment Firm Regime**

6.1 In dealing with obligations to customers under the Conduct of Business (COB) regime in terms of the provision of investment advice, we agree these should be set at a high level, leaving detailed interpretation to national regulators (see also paragraph 5.2 above). This would provide for differentiation in requirements for different investment services, including between sales on an execution only basis and those resulting from investment advice services, including those of a simplified nature which are under consideration in the UK.

6.2 The COB regime must allow modulation to particular market operations, not impede market efficiency but still within the context of adequate investor protection.

6.3 We note that CESR is developing level 2/3 COB requirements to apply to a revised ISD. While there is merit in fleshing out to a limited extent, the principles they should not go so far as to prevent national regulators from delivering a cost efficient, proportionate and relevant COB regime for the differing markets. It should also be made clear the level(s) at which CESR is pitching its proposals and any inter-action with the role of national regulators.

6.4 It would be helpful to have greater clarity around the duty of care expected of firms and advisers (see “Know Your Customer Standard”, CESR).

6.5 In placing obligations on firms employing tied agents, these need to recognise the responsibility taken by the employer or principal. We agree that the investment firm needs to verify that its tied agents meet some general requirements, in line with those reflected in the Common Position reached on the IMD, regarding tied agents before they are employed. Any requirements set also need to take into account the regulatory requirement imposed on firms/principals so that there is no duplication or lack of clarity or conflict of requirements.

6.6 With proposals to dismantle the polarised advice regime in the UK, the concept of multi-ties must not be hindered by too strict a definition of tied agents, and must also accord with IMD arrangements. The development of multi-ties has the potential to bring greater access to investment advice and products to a wider part of the population and this should be supported at the European level.

6.7 It would be helpful to have clarified that any registers of tied agents can be kept by those responsible for the agents’ actions, i.e. the regulated principal investment firms rather than with the national regulator.

6.8 In the Overview Paper, Section 4: Investment Regime, Obligations when acting on behalf of/providing services to clients, subsection (3) indicates that consideration is being given to a counterparties regime.
In this respect it is important to note that the tripartite regime in the UK, retail, intermediate and market counterparty and the ability to opt between different levels, is deeply embedded in the operational characteristics of the sector. Changes to this structure affecting the ability to deliver various levels of COB obligations might potentially have significant implications for customers in terms of cost and/or the type of service and product provided to them.

6.9 In 2.3.1 of Annex 1 Revised Orientations, subsection (8) lays down various reporting requirements including “where relevant the performance of portfolios managed by the firm on behalf of the client”. No definition is given of performance. In its absence we believe that performance should be as described in contractual arrangements or product details.

6.10 It would be appreciated if the proposal (2.3.2 Annex 1 Revised Orientations p19) to prevent tied agents from handling money owed by the client to the investment firm or vice versa is clarified. We assume it does not include cheques made payable to the investing institution. This has important implications for operational procedures in the UK.

7 Detailed Comments: Sections 5 and 6
High Level Principles for Regulated Markets. Clearing and Settlement

7.1 We have no detailed comments to make on Section 5.

7.2 We anticipate responding to the forthcoming Commission Communication on clearing and settlement. Greater efficiency in this area holds the prospects of reduced costs and thereby greater returns for customers.

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31 May 2002
## Annex 1

**Investment Holdings of ABI Members 2000**

Total Long-Term and General Insurance Investment Holdings £1,147 bn

of which:

- UK public sector securities (including gilts) £146 bn
- Overseas public sector securities £49 bn
- UK ordinary stocks and shares £391 bn
- Other UK company securities £112 bn
- Overseas ordinary stocks and shares £145 bn
- Other overseas company securities £49 bn
- Unit trusts £77 bn
- Property £61 bn
- Other investments £116 bn