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## **AFG CONTRIBUTION TO THE WORK OF THE HIGH LEVEL EXPERT GROUP ON EU FINANCIAL SUPERVISION**

*Executive Summary:* Based on the long experience of European legislation and practices developed by asset managers, AFG thinks that after the high level of European integration reached today in legal terms, it is now time to achieve such an integration in reality through *the setting up of European sectorial single regulators, and particularly for securities and asset management by giving real powers to CESR – above national regulators*. From an external perspective, such a setting up of European sectorial single regulators would also help reinforcing the dialogue with non-European regulators, which is so crucial today with the recent crisis.

### **1. Reasons why AFG contribution may be helpful for the work of the High Level Expert Group**

The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. Our members include 409 management companies, which are entrepreneurial or belong to French or foreign banking or insurance groups. AFG is registered under the number **5975679180-97** in the European Commission's register of interest representatives.

The French asset management industry is *the leader in Europe for the financial management of EU on-shore investment funds* (with nearly 1500 billion euros managed, i.e. 22% of all EU investment funds assets under management), wherever the funds are domiciled in the EU, *and is ranked second at worldwide level after the US*. In terms of mere domiciliation of EU on-shore funds, France is number two after Luxemburg.

Speaking on behalf of the buy-side, we think that AFG may bring some added value to the current regulatory debate in the EU – and beyond:

- Asset managers are one of the most prominent categories of “buy-side” players

- Asset managers act exclusively on behalf of their clients (retail and institutional investors), towards which they have a fiduciary duty and build a long-term confidence relationship
- Asset managers are at the cross-roads of many different areas of financial regulation: on products, intermediaries, markets, issuers, credit rating agencies among others
- Being the first one in the EU and second one in the world for the financial management of on-shore investment funds, the French asset management industry represented by AFG has been involved for a long time in the actions regarding European and international regulatory financial supervisions, at the level of European institutions (Lamfalussy Report, InterInstitutionalMonitoringGroup Reports), CESR (Himalaya Report), IOSCO, FSF.

## **2. Our main assessments on the existing situation and the ways to explore**

N.B.: in the comments below, we have not kept the narrow meaning of ‘supervision’ used in the official mandate delivered by President Barroso to the Group. If applied too strictly, the notion of ‘supervision’ would only lead to references regarding banking *supervisors* and insurance *supervisors*. From our perspective, we consider that the topic must be assessed in a wider context, which includes securities *regulators* as well – where in fact progress at EU level might be made more easily as compared to the two other areas, taking into account the longer track record of CESR (formerly FESCO, created as soon as 1997) as compared to the two other Level 3 Committees.

### *a) Main assessments on the existing situation*

Based both on the daily experience of asset managers and on the legal implementation of European legislative texts, our main assessments are the following:

- Undertakings for Collective Investment in Transferable Securities (UCITS) experience:
  - The leading European investment fund type is the UCITS. Thanks to the UCITS Directive adopted as early as 1985, we have benefited from a pan-European product. *In terms of production*, the Single Market has become a reality: until now, the UCITS fund is the most harmonised type of financial product across the EU
  - Tremendous legislative progress has been recently made in December 2008 through the political orientation found between ECOFIN and the Economic Committee of the European Parliament on the revision of the UCITS Directive, allowing for many new cross-border schemes: cross-border fund mergers, cross-border master-feeder funds, setting up of a real ‘management company passport’ among others (although the list of eligible assets for UCITS remains rigid and the lack of EU framework for alternative investment funds still harms the development of EU alternative investment funds within the Single Market and worldwide; in addition pan-European defined-contribution products are still lacking a European framework)
  - However, *in terms of distribution*, although the UCITS Directive provides for a so-called ‘product passport’, the cross-border distribution of funds remains a permanent difficulty: *keeping powers for cross-border registration in the hands of host national regulators, although understandable from an investor protection perspective, creates difficulty to get a Single Market for distribution and can be suspected of national protectionism in some cases*

- Conversely, it is clear that some home national regulators are tempted by a very ‘flexible’ application of European texts as compared to other regulators. Such a *national regulatory dumping (usually done in practice, rather than through national regulations themselves)* creates distortions of competition which are not compatible with the Single Market and with the general rules of competition. More importantly, *it endangers investor protection as well, as products can be legally sold throughout the EU afterwards* (these investor protection concerns explain to some extent the resistance by some host national regulators as shown right above).
      - Another example of this situation is the case of UCITS depositaries: although they are given a key monitoring and asset safeguarding role by the UCITS Directive, their real obligations differ very markedly from one European country to another.
    - Credit rating agencies (CRAs) experience:
      - The world-leading credit rating agencies are American, but many European and national regulations in Europe introduced official references to ratings
      - How to solve the issue of mandatory registration of CRAs in the EU, for rated securities which are used by the buy-side? The Commission proposes CRAs to be registered by a national securities regulator – in the country where the registered office of the CRA is
      - This national regulator approach seems dangerous, especially as this regulator would have potentially an undue power on securities issued abroad, and without legitimate reason to be more competent than other national regulators which could be appointed on the basis of other criteria (e.g. location of the issuance, location of the issuer, etc.)
      - For instance, *in the case of sovereign debt issuances, letting a pan-European power to a mere national regulator does not seem appropriate as it will cast a doubt on the political neutrality of the relevant regulator vis-à-vis such foreign debt issuances*
    - Markets in Financial Instruments Directive (MiFID) experience:
      - There was an exceptional effort from the Commission to get adoption of many harmonised measures at Level 2
      - *In spite of that, many national discrepancies remain in the interpretations of Level 1 and Level 2 measures by national regulators – creating major uncertainties for the main users of financial markets that we are*
    - Short selling experience:
      - In the autumn 2008, national regulators in the EU decided to take decisions in order to prohibit or limit short selling
      - No coordination was organised among them apparently – without even speaking about EU coordination with the US SEC
      - *The result, for users of financial markets that we are, is a difficulty to trade cross-border on financial markets as the rules are different from one Member State to another – and as these rules are instable in time too.*

A general conclusion based on such cases (which could be multiplied) is that – at least in the field of securities – the lack of a European empowered entity above national regulators leads

to practical discrepancies at national level in implementation of European provisions, in spite of the progress done through the existing Lamfalussy Level 3 committees, as we will see below.

b) *The ways to explore*

- The three existing Lamfalussy Level 3 Committees have already made significant progress since 2001, such as:
  - Adoption of many Level 2 technical advice and Level 3 standards, as well as independent advice on Level 1 - including at qualified majority, such as for CESR on the 'Management Company Passport' regarding the UCITS Directive in October 2008
  - Adoption of mediation mechanisms
  - Systematic and rather satisfactory public consultations
- However, the Level 3 Committees and European institutions themselves recognised officially that Level 3 committees needed to be reinforced to give more efficiency to the whole Lamfalussy approach:
  - through sources of financing independent from the mere financing by their national regulator members. Such independent financing sources would allow both for increasing the budget of Level 3 committees and also for giving them more political neutrality vis-à-vis their members
  - through official statements in regulators' missions to require cross-border cooperation with each other
  - through the development of cross-border training and secondment programmes
  - through the systematic voluntary cross-border delegation of tasks between regulators
- The current crisis shows clearly, beyond the examples mentioned above, that there is now an urgent need to go beyond, and to set up the following framework:
  - For each of the three financial sectors (i.e. securities, banks and insurance), *the setting up of three single sectorial European empowered entities based on the existing Level 3 committees above (and not instead of) the existing national regulators* would allow for:
    - *A single interpretation of Level 3 guidance, contrary to the current situation*
    - *And therefore a level playing field, reducing the room for national regulatory dumping – or protectionism - in practice*
    - *Taking individual decisions in a limited number of areas, for which the pan-European dimension of activities is obvious and national decisions would create potential conflicts of interest for national regulators (e.g. pan-European licences of credit rating agencies)*
  - Keeping national regulators below the three sectorial single regulators would still allow for a better practical knowledge of local players and markets (as it is currently the architecture for ECB plus NCBs, and as this architecture appeared as very successful in the recent crisis events)

- Improving the involvement of professionals in the decision process (in addition to more reasonable consultation periods for instance) is necessary
- Such EU single regulators should be kept *sectorial* at this stage, for three reasons:
  - *There was no significant failure of cooperation between CESR, CEBS and CEIOPS until now*, although the case could be made for a self-standing regulator dedicated to pensions
  - We have to act on a step-by-step approach, while remaining ambitions for Europe
  - Not all Member States have a single national regulator covering the three areas.
- In addition to this central request, we want also to recall our wish that asset managers join the CEIOPS consultative panel (as defined-contribution schemes are part of the world of pensions)
- *Last but not least, the external dimension of the EU financial supervision is crucial: establishing an empowered European single regulator for each sector would significantly help the growing worldwide discussions surrounding the financial area.* For non-European regulators, facing a single European regulator would obviously facilitate discussions – especially if this regulator has its own set of powers. Conversely, when facing non-European regulators, a European single regulator would appear to be stronger. Currently, the Level 3 committees do not appear to be similar to important national non-European regulators, because of a lack of powers, and this situation may currently harm the quality of discussions and dialogue. The recent financial crisis shows even more importantly today how this external advantage of getting European sectorial Single regulators would be beneficial not only for the EU but also for all parts of the world.

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We thank the Commission very much for taking into consideration our comments and remain at your disposal for any further questions.

*In particular, we would be very happy to express our views in person to the members of the Group, in case you would organise informal hearings.*

Please feel free to contact myself at +33 1 44 94 94 01 (e-mail: [a.leclair@afg.asso.fr](mailto:a.leclair@afg.asso.fr)), our Director General Pierre Bollon at +33 1 44 94 94 14 (e-mail: [p.bollon@afg.asso.fr](mailto:p.bollon@afg.asso.fr)) or our Head of International Affairs Stéphane Janin at +33 1 44 94 94 04 (e-mail: [s.janin@afg.asso.fr](mailto:s.janin@afg.asso.fr)).

Yours sincerely,

Alain Leclair