

## **EU Commission Green Paper on Financial Services Policy (2005 – 2010)**

### **Response by Prudential PLC**

The Prudential Group is a leading international financial services group providing retail financial services and fund management in its chosen markets in the UK, the US and Asia. Our EU cross border business is primarily undertaken by Prudential International Assurance and M&G International Investments.

### **Summary**

1. Prudential fully commends the Commission on the political objectives outlined in the Green Paper to:

- Consolidate existing legislation, with few new initiatives;
- Ensure the effective transposition of European rules into national practice;
- Continuously evaluate ex-post the application of these rules in practice.

2. We are particularly reassured that the agenda largely reflects the extensive detailed consultations which have taken place between the Commission and market participants in the period leading up to the publication of the Green Paper. In particular, the recommendations of the Expert Groups on Insurance and on Asset Management (May 2004).

3. We have seen the submission of our trade bodies, notably the Association of British Insurers and the Investment Management Association which have covered a number of the major issues with which we broadly agree. In this paper we have sought to identify specific areas of interest to highlight.

#### **4. *Key priorities for Prudential***

- Promotion of practical better regulation; once a barrier to market integration has been identified the Commission must be able to demonstrate first that regulatory intervention has a role to play in its removal, and also that the inevitable costs associated with this are outweighed by the gains to be achieved or can be justified by some other compelling arguments
- Completion of Solvency 2 (and related international work on accounting standards).
- We note the opening of the pension debate in the Green Paper on Investment Funds but important contributions will be needed to be made from the existing providers of life and pensions products.
- One new area we would like to highlight is the role of financial literacy. There has rightly been a focus at the EU level on ensuring adequate disclosure and this dates back to the Life directives in the case of insurance. These rules have been supplemented over the years with additional rules and there is now a reasonable suggestion from the industry that these rules be simplified. However, disclosure should not be seen as an end in itself and the question has been raised in the Green Paper whether more can be done to raise the level of financial literacy to benefit consumer choice.

5. We will be responding separately in more detail to the recent Green Papers on investment funds and mortgage credit (notably in the area of equity release products) where more detailed potential actions at the EU level are outlined.
6. Prudential would welcome the opportunity to further assist the Commission in finding practical ways to implement the objectives as set out in the Green Paper.

## **Response to issues raised in the Green Paper**

### **1. KEY POLITICAL ORIENTATION**

***The Commission would be interested to hear from stakeholders:***

***Whether they agree with the overall objectives for the Commission's policy over the next 5 years;***

***Whether they agree with the key political orientation described above***

7. As we note in our introductory comments we fully support the political orientation of the Commission's policy towards the financial services sector over the next five years. However, in view of the current uncertainty around the European Constitution, alternative arrangements must be found to safeguard the call-back procedure, as an essential element of the Lamfalussy process. Market circumstances change and implementing measures should keep pace. The potential delay or rigidity that could result from any deletion of the comitology provisions must be avoided.

8. We support Commissioner McCreevy's recent call at the Exchange of Views on Financial Services Policy conference for the Member States, the Commission and the European Parliament to start work now to find a solution.

### **2. BETTER REGULATION, TRANSPOSITION, ENFORCEMENT AND CONTINUOUS EVALUATION**

***The Commission would be interested to hear from stakeholders:***

***whether they agree with the priority measures identified;***

9. Prudential supports the priorities as set out in the Green Paper.

## **New measures**

10. Better regulation principles should be applied at the earliest part of the policy process before regulatory measures are proposed and ideas become fixed and significant resources deployed.

11. It is important that the application of better regulation principles becomes standard practice across the Commission because our industry is affected by the action of a number of DGs including Employment, Consumer Affairs and Taxation. We fully support the Commission's position that these better regulation disciplines should be applied by the European Parliament and the Council to avoid evidence based Commission proposals being "mushroomed into unnecessary, sapping complexity." However, it is clear that significantly more work is needed to determine

the most effective mechanisms to enable this to happen in a coordinated, transparent and timely manner. We recognise the priority must be at the level of Commission activities as they are primary initiators of legislation.

### **Existing measures**

12. Any ex-post evaluations should also apply to existing non FSAP measures such as earlier '1992' single market directives which underpin the framework in which our life insurance business operates. These may need updating or simplifying. Ten years after the Third Life Directive the reality of European insurance is still far away from representing a highly integrated market. This is confirmed in the recently published Commission "Financial Integration Monitor Background Document" (2004).

### ***which additional measures should be taken to foster consistent application and enforcement of European legislation;***

13. We welcome the extension of the Lamfalussy arrangements to the insurance, pensions and investment management areas.

14. The network of regulators, given time, should help with the convergence of standards and practices. We believe that this would offer the most timely solutions to any problems regarding transposition and implementation.

15. Given the early stage of development of these new mechanisms it is difficult to make judgements on the efficacy of these processes.

16. For those measures which are adopted we believe it is for the Commission to use its enforcement powers to bring actions against those Member States who fail to implement the regulations in the most market friendly way.

### **3. CONSOLIDATION OF FINANCIAL SERVICES LEGISLATION OVER THE 2005-2010 PERIOD**

***The Commission would be interested to learn from stakeholders: whether they agree with the identified measures where the Commission might decide to take no action, or if there are other concrete areas where the Commission should not bring forward proposals presently in the pipeline or, indeed, areas where the Commission should consider withdrawing;***

17. We do not believe that any new major measures are needed at present but existing measures should be tested to see if they have achieved their objectives. It is only after such an analysis that we can make a decision about whether any measures need to be amended or possibly repealed.

### **Solvency 2**

18. The most important strategic issue for the insurance sector, particularly in terms of its international competitiveness is Solvency 2. In the area of insurance, this is where the Commission's resources should be primarily targeted.

19. While we accept the better regulation agenda, a careful balance will need to be struck to ensure that unreasonable delays are not added to the legislative process.

20. The case for any delays should be tested with market participants to ensure that the quality and benefits of resulting legislation will be better served by any lengthier gestation period. It is widely recognised that the quality of legislation can suffer if an unreasonable, politically determined, timeframe is imposed.

21. The Commission have to be transparent if there is a resource problem in this area which results in slippage in the timing of the directive.

***their assessment if the existing regulatory and supervisory framework is sufficient to tackle the supervisory challenges in the years ahead, what are the gaps and how these can be filled most effectively;***

22. It is still too early to make any definitive judgment over the implications of the Lamfalussy arrangements.

23. Prudential have been engaged in the CESR consultations on MIFID and UCITS where in general we have been impressed by the openness of the debate but are aware that as a new process it will take time for common practices and trust to emerge.

24. The system of consensus in the Lamfalussy committees has yet to be fully tested but we expect difficulties in finding a compromise in bringing certainty to market participants on the issue of eligible assets in UCITS III. There are some concerns that in the cause of building a consensus a reduction of investment freedoms could follow.

25. This is why we believe it is important to explore the idea of a mediation mechanism rather than risk a consensus based on the lowest common denominator solution.

26. We fully support the proposals for transposition groups as implementation is a major area where fragmentation of rules can occur. If supervisors can agree during the transposition phase there is less likely to be incorrect implementation further down the line.

27. CESR is now entering a major new phase in its development as it moves to Level 3 work and greater supervisory convergence. We will be continuing to observe and participate where appropriate in this work.

28. The experience with Lamfalussy in the insurance and occupational pensions area is even more in its infancy.

29. However, we consider it a positive move that CEIOPS is devoting the bulk of its resources to the Solvency 2 project.

30. The recent CEIOPS reports advising the Commission on possible modifications to the Insurance Groups Directive and the Financial Conglomerates Directive are useful indications that possibly some competitively important implementation inconsistencies may have taken place and will need to be resolved. We hope that this will merit full consultation with the industry as the reviews get underway. This will also apply in the case of the implementation of the Institutions for occupational retirement provisions (IORPs) directive, if in particular the freedom to appoint an asset manager on a cross-border basis is to be realised. Consistent

interpretation across the EU of the 'prudent person' principle will be key to the efficient functioning of this directive. This is important work in terms of creating a level playing field in the EU and in assisting the global competitiveness of EU based financial institutions.

31. The above views further reinforce our position that the Commission concentrate on existing measures and the programmed reviews rather than engage on any new major initiatives.

***what are the objectives, sectors to be covered and the priority areas in regulatory and cooperative activities on a global scale.***

32. It is important to continue to raise the profile of the importance of external relations bilaterally with key developed and developing states.

33. While it is important to continue to participate fully in the multi-lateral WTO negotiations we believe that these can be usefully complemented by bilateral talks. Such dialogues can increase mutual trust and offer opportunities to share best practice and develop co-operation.

34. The recent progress on EU-US dialogue is important in the area of accounting rule equivalence. We would welcome the extension of dialogues to other OECD countries and the developing nations, specifically China and India where Prudential already operates. Such bilateral relations can go beyond the market access requests usually mediated through WTO negotiations to allowing much broader cooperation where the EU is able to offer expertise, funding and training to develop the necessary infrastructure for a sound and competitive domestic financial services sector.

***4. POSSIBLE, TARGETED NEW INITIATIVES AREAS OF POSSIBLE FUTURE ACTION***

***The Commission would be interested to learn from stakeholders:***

***whether they agree with the new identified priority areas;***

**Green Paper on an EU Framework for Investment Funds**

35. In the case of asset management our priority is the issue of UCITS notification which CESR are now looking at. Again we believe this is a useful practical test of whether these problems of interpretation and implementation can be resolved in a timely way between supervisors without engaging in an additional lengthy legislative process.

36. In the longer term we recognise the need for a full debate on the role and significance investment funds can have on the provision of sustainable pensions in the EU.

**Green Paper on Mortgage Credit in the EU**

37. The Green Paper is of particular interest to us as it notes the emergence of new products such as equity release, which the Green Paper says “merit careful assessment with regard to both their potential risks for consumers, their perceived ability to offer new sources of finance to EU citizens, in particular with a view to addressing the pension financing problems which current and future generations will inevitably have to face.”

38. We note that the Green Paper does not propose any concrete measures at this stage and none will be taken until after the conclusion of the consultation process and completion of a cost benefit analysis in line with the better regulation agenda. We look forward to taking a full part in these consultations in this important new area.

39. We will be commenting in more detail separately on the Green Papers on investment funds and mortgage credit.

### **Retail financial services**

40. The general retail financial services agenda is less convincing although we note the intention of the Commission to carry out further targeted studies. The Expert Group on Insurance made a valid point that much has been achieved in creating a single market at the wholesale level but for many (often valid) reasons retail markets particularly in the life and pension area remain largely national. For instance language, culture and loyalty remain largely immune to legislative resolution. In addition the key area of tax treatment remains politically highly sensitive. This situation is unlikely to change in the near future therefore most cross-border business is done by companies establishing a physical presence in the host market. It will be necessary to ensure that any measures proposed to enhance cross-border trade in services do not add burdens to business conducted through branches.

41. Nevertheless we also believe that the Commission should, where possible, facilitate the maximum use of the passport provided by the existing Life directive as there may be some scope for developing more cross-border business based on the Freedom of Services (FOS) model. Even where the use of FOS may be restricted to specific ‘niche’ customers and products it would be useful to remove any abusive use of ‘general good’ provisions which can obstruct cross-border sales. Such a feasibility study could also highlight where barriers remain so entrenched that FOS business might require other approaches possibly including a separate 26<sup>th</sup> regime. We share the Expert Group on Insurance caveat that measures should only be taken where there is real market potential and where the danger of introducing additional costs for minimal benefits should be avoided.

### ***what are the (dis)advantages of the various models for cross border provision of services, whether there is a business case for developing a 26th regime, and which business lines might benefit;***

42. It is still far from clear what is meant by the 26<sup>th</sup> regime. A feasibility study to clarify the issues could be helpful, in particular to see if it could support FOS sales.

43. It has been suggested that UCITS could act as a model for a 26<sup>th</sup> regime but we see this as a flawed model. The UCITS regime does not cover the whole of the value chain leaving considerable powers with the host regulator regarding marketing. Any true 26<sup>th</sup> regime would have to cover all aspects of the value chain.

***how to enable consumers to deal more effectively with financial products and whether this means more professional and independent advice, improved education or financial literacy training are needed;***

### **Financial Literacy**

44. The annex to the Green Paper makes an interesting point with regard to financial literacy which it recognises is principally a national issue at present.

**This is an area which we believe deserves further consideration.**

45. Considerable attention has been placed on pre-contractual information disclosure and advice in directives such as the Third Life directive, Insurance mediation, IORP pension directive, Distance marketing directive, and UCITS III (simplified prospectus). In addition, we will also have the impact of MIFID on conduct of business rules (the FSA have indicated that this will likely cover financial products outside the scope of MIFID in the UK regime). It is difficult to see how much further it is possible to go in this respect (other than seeking to simplify and avoid duplication/overlapping requirements).

46. We therefore consider it timely to begin looking at the state of financial literacy in the EU.

47. A significant element of our corporate responsibility programme is our ongoing investment in financial literacy. One of the key strategic aims of the programme is to place financial education on the international policy agenda. As consumers demand increasingly tailored products to help them meet their individual needs, the variety and complexity of products and their interaction with changing state provision around the world inevitably grows. Prudential continues to work closely with a range of partners, including consumer organizations, government and regulatory bodies in the UK, Vietnam and China, to develop solutions that enable people to find their way through this maze.

48. We would like to draw the Commission's attention to work being undertaken by the OECD. Prudential is financing the OECD's first major financial education research programme. Responses to the early research affirm the importance and timeliness of the project. The countries surveyed by the OECD recognize the necessity for consumer financial education and are grappling with the most efficient and cost-effective ways to provide it. Research findings from phase one will be published later this year as guidance for policy makers and regulators around the world who have the task of implementing financial education strategies.

***whether they agree with the issues identified in the above list of retail products, or if they would suggest other areas where additional action at EU level could be beneficial;***

49. We refer the Commission to our comments made in paragraphs 40 & 41.

50. Removing obstacles as an end in itself may not necessarily be beneficial in all cases (see paragraph 40).

51. Further work will also need to be done on developing a better understanding of the real issues which retail investors face in each member state and analysis of consumer needs. This will help focus on whether there is a real consumer need for cross-border products.

29 July 2005