



20 August 2013

European Banking Authority
Tower 42 (Level 18)
25 Old Broad Street
London
EC2N 1HQ

By email: EBA-CP-2013-11@eba.europa.eu

Dear Sirs,

Re: BVCA Regulatory Committee response to the EBA Consultation Paper on 'Draft RTS on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile under Article 90(2) of the proposed CRD'

This response to the EBA's Consultation Paper on the '*Draft RTS on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile under Article 90(2) of the proposed CRD*' (the "**Consultation Paper**") is made by the Regulatory Committee of the British Private Equity and Venture Capital Association (the "**BVCA**").

The BVCA is the industry body for the UK private equity and venture capital ("**PE/VC**") industry. With a membership of over 500 firms, the BVCA represents the vast majority of all UK-based PE/VC firms and their advisers. Its members have invested £33 billion in over 4,500 UK companies over the last five years. Companies backed by UK-based PE/VC firms employ over half a million people and 90 per. cent of UK investments in 2012 were directed at small and medium-sized businesses.

In order to focus our response appropriately, we have considered only those parts of the Consultation Paper which we think raise issues relevant to PE/VC firms. Given that a number of our comments and concerns are not linked to particular questions posed by the Consultation Paper ("**Consultation Questions**"), but are instead of a more general nature, we have structured our response such that a series of general comments precedes our answers to the Consultation Questions.



We stand ready to provide whatever further contribution to this work the EBA would find helpful. In particular, we would be delighted to attend a call with the EBA to discuss the issues raised in our response.

Yours faithfully,

A handwritten signature in black ink, appearing to be 'M Chamberlain', written over a faint horizontal line.

pp Margaret Chamberlain
Chair - BVCA Regulatory Committee



**EBA CONSULTATION PAPER – 'DRAFT RTS ON CRITERIA TO IDENTIFY
CATEGORIES OF STAFF WHOSE PROFESSIONAL ACTIVITIES HAVE A
MATERIAL IMPACT ON AN INSTITUTION'S RISK PROFILE UNDER ARTICLE
90(2) OF THE PROPOSED CRD'**

PART A: GENERAL COMMENTS AND CONCERNS

1. We would like to begin by expressing our general concern that the current draft RTS appear to be based on an assumption that the proposed criteria for identifying staff who have a material impact on an institution's risk profile ("**Identified Staff**") are equally suitable for credit institutions and investment firms, despite the fact that their respective sizes, operating models and other characteristics are often fundamentally different. For reasons which we set out below, we do not consider that this assumption is valid and we believe that it is necessary to have at the very least modified criteria which govern the classification of Identified Staff within investment firms, and in particular PE/VC firms, as distinct from credit institutions.
2. Notwithstanding the application of the AIFMD regime and Article 4(2)(c) CRR, a relatively small number of BVCA member firms are likely to remain CAD investment firms from 1 January 2014. PE/VC firms (in addition to other types of investment firms) will fall within the new rules either due to their presence in a consolidation group or due to them undertaking certain non-excluded MiFID activities.
3. Remuneration and job titles within PE/VC firms and other in-scope investment firms differ considerably from the typical credit institution. Rules designed to catch only senior individuals with material risk profiles in the latter type of institution risk being too wide ranging for sensible application to the former. In particular, we note that certain rules in the draft RTS seem to envisage there being a large hierarchical pyramid personnel structure, typical of a large credit institution, with material risk presumed inevitably to reside with certain senior job titles or in certain remuneration bands. Such a model is not applicable to many PE/VC firms which are generally considerably smaller, may be less hierarchical in nature and may not have the same typical divisions of responsibilities amongst staff. We would also challenge the assumption made in the draft RTS that individuals whose activities have a material impact on a firm's risk profile can be identified by reference to absolute remuneration figures.
4. Due to the inherent variation in the types of investment firms that may fall within the scope of CRD IV, we would propose that the scope of Article 4 of the draft RTS should be widened for investment management firms so as to include all criteria in Article 3, rather than only those criteria in Article 3(2)(a) and (b). This would allow firms to apply the rules on a proportionate basis, excluding those individuals inadvertently brought



within scope due to the current widely drafted provisions. We believe that this would be more appropriate to support the underlying policy objective of the RTS, which is to identify material risk takers, and would mitigate the risk of an unjustified and indiscriminate widening of the regulatory net which risks capturing the wrong individuals.

5. Accordingly, we would propose that the first line of Article 3(1) of the draft RTS should be redrafted as follows:

"Subject to Article 4, staff shall be identified as having a material impact on an institution's risk profile if they meet one or more of the following criteria:

...."

We would also propose that the first paragraph of Article 4 should then be redrafted as follows:

"Where a member of staff is identified as having a material impact on an institution's risk profile as a result of the application of either or both of the criteria in points (a) and (b) of Article 3(2) (or, in the case of an investment firm, the application of any of the criteria in Article 3), the institution may treat the professional activities of that staff member as not having a material impact on the institution's risk profile if each of the following conditions is met:*

- a. the professional activities of the staff member are not considered to have a material impact on the institution's risk profile pursuant to the institution's internal identification process carried out in accordance with Article 2 (other than as a result of the application of the ~~criteria in points (a) and (b) of Article 3(2)~~ relevant criteria in Article 3);*

...."

- * We recognise that this revised drafting might include investment banks within the scope of the proposed modification. If this is considered undesirable, we would propose adding a new definition of an investment management firm instead, which could then exclude a firm dealing on its own account from taking the benefit of the modified provision.



PART B: RESPONSES TO CONSULTATION QUESTIONS

Question 1 – Is the list of specified functions listed appropriate or should additional functions be added?

6. We consider that the list of specified functions automatically comprising Identified Staff in Article 3(1)(e) of the draft RTS is not, on its own, an appropriate reflection of positions within an organisation which will invariably entail material risk implications for that organisation. We are concerned that the specified functions represent an overly generalised and simplistic assessment of functions which would impact on a firm's risk profile. The list of functions appears to have been drafted by reference to staff positions which might carry material risk implications in a large credit institution (and even in that case, we are doubtful that all positions identified will inevitably involve material risk to the institution), but we do not think that the same assumptions about risk profiles can be applied unquestioningly to PE/VC firms.
7. For example, we recognise that the head of human resources may have been included in the list on the basis that he or she would be responsible for managing remuneration issues and controlling the terms of employment of staff who would be subject to the CRD remuneration rules. However, while this may be true in some firms, we note that in certain PE/VC firms, the head of human resources may lack the authority to make an offer of employment to a member of staff who would be subject to the remuneration rules (or, for example, may first be required to obtain the approval of the head of legal). He or she may in fact be a relatively junior manager, primarily responsible, for example, for issues such as the oversight of HR administration, formal work appraisal processes, dealing with absence procedures and considering part-time working requests. Decisions as to whether to employ or dismiss staff may be the responsibility of other more senior management. In that context, it would be inappropriate to characterise the head of human resources as exercising a function which has material risk implications for the relevant firm.
8. Similarly, the head of IT may exercise a critical role in ensuring the efficient operation of trading and settlement systems in a bank and might therefore be characterised as an individual whose activities have material risk implications. However, in many PE/VC firms, the head of IT may often have a more limited role, involving primarily administrative duties such as general oversight of staff user accounts, organising the distribution and maintenance of hardware and testing and updating relevant software. In the latter case, the activities of the head of IT seem unlikely to entail material risk in the context of the firm's operations.



9. In adopting a rigid, formalist approach relating to specified positions within a firm, the proposed list in Article 3(1)(e) risks being over-inclusive in scope. We think that this "one size fits all" approach to determining risk functions will lead to undesirable results in relation to certain firms (particularly smaller investment management firms whose risk profiles and operational models differ considerably from the paradigm example of a large credit institution), imposing additional compliance burdens without leading to a reduction in risk. This would undermine the policy objectives of the draft RTS, the purpose of which is to identify those individuals whose activities have an actual material impact on the firm's risk profile, rather than those whose formal roles are simply presumed to do so.

Question 2) Can the above criteria [in Article 3(1)(f)] be easily applied and are the levels of staff identified and the provided threshold appropriate?

10. We are concerned about the use of a percentage of a firm's Common Equity Tier 1 ("CET1") capital as the threshold for designating staff members as Identified Staff. We consider this to be a prime example of where the proposed RTS attempt to apply blanket concepts which might be appropriate to a credit institution to investment firms, which clearly require a modified regime. Since the CET1 capital requirements of many PE/VC management firms are likely to be considerably lower than credit institutions and are calculated on a different basis to address different types of risk, the threshold of 0.25% of CET1 capital is clearly inappropriate and would potentially catch a large number of individuals whose activities do not represent a material risk to the firm. It is plainly inapt to apply the specified threshold to PE/VC management firms who are not exposed to the risks of proprietary trading.
11. We also note that the criteria in Article 3(1)(f) of the draft RTS are not subject to the ability of a firm in Article 4 to carve-out certain individuals where those staff members' activities are not considered to have a material impact on the institution's risk profile. To the extent that individuals are therefore caught inappropriately by the very low threshold in Article 3(1)(f), there would be no ability to modify this classification to include only individuals whose activities do represent a genuine potential risk to the firm.

Question 3) Can the above criteria [in Article 3(1)(g)] be easily applied and are the levels of staff identified and the provided thresholds appropriate?

12. For the reasons we have set out in paragraphs 10 and 11 above, we do not consider that the thresholds in Article 3(1)(g) are appropriate in the context of PE/VC management firms.



Question 4a) Is this criterion [in Article 3(2)(a) of the draft RTS] appropriate to identify risk takers?

13. We do not believe that the criterion relating to variable remuneration in Article 3(2)(a) is appropriate, given that certain individuals in PE/VC firms may be remunerated primarily by way of variable remuneration without a corresponding increase in their risk profiles.

Question 4b) Are the thresholds set in the criterion [in Article 3(2)(a) of the draft RTS] appropriate?

14. The figure of EUR 75,000 fails to reflect the difference in remuneration levels between credit institutions and investment firms, or between different geographic locations and industry sectors. We also query the rationale for the choice of a threshold of 75% of the fixed component of remuneration. Both figures appear to be arbitrary, with no clear logic underpinning why they would lead to the identification of genuine risk takers within firms.

Question 5a) Can the above criterion [in Article 3(2)(b) of the draft RTS] be easily applied?

15. While we note that the consultation question does not specifically ask whether the criterion is appropriate, we nonetheless think it is important to express our serious concerns with how the provision might be applied in practice. In particular, we note that there is a serious risk that Article 3(2)(b) could operate to catch a very large number of staff members (and potentially all staff) in a situation where a member of senior management did not receive any remuneration (or received only a nominal or greatly reduced level of remuneration). This could occur where, for example, a senior manager in a PE/VC firm chose to waive all or a large part of his or her remuneration for investor relations reasons following disappointing investment performance.
16. We are also concerned that as the list of individuals covered in Article 3(1) of the draft RTS is extensive, the total remuneration awarded to certain individuals within that category may be at a comparatively low level – for example, remuneration paid to a non-executive director. This would result in a very low threshold being applied when determining which staff members fall within the scope of Article 3(2)(b) and are therefore Identified Staff.
17. We recognise that Article 4 of the draft RTS allows individuals caught by Articles 3(2)(a) and (b) to be excluded from the definition of Identified Staff where the firm's internal identification process indicates that the relevant individual does not have a material impact on the firm's risk profile. However, our observations in paragraphs 15



and 16 above indicate that there is a risk that Article 3(2)(b) starts with an inappropriate over-inclusive presumption which will not give effect to the policy objective of catching those whose activities represent a material risk to the firm.

Question 5b) Would it be more appropriate to use remuneration which potentially could be awarded as a basis for this criterion?

18. While it is difficult to comment on this suggestion without further clarification of the precise definition of "*remuneration which could be potentially be awarded*", we nonetheless note that this would not address our concerns in paragraph 16 above relating to certain senior individuals who may receive comparatively low levels of remuneration. We would also query whether it would be possible to formulate a suitable definition of the remuneration which could "*potentially be awarded*" in the context of variable remuneration which is dependent on the future performance of investment portfolios.

Question 6 – Can the above criterion [in Article 3(2)(c) of the draft RTS] be easily applied and are the threshold and the levels of staff identified appropriate?

19. We are concerned that the fixed value of EUR 500,000 in Article 3(2)(c) is another example of a "one size fits all" approach which fails to take into account the variation in geographic location and industry sectors between different entities which may become subject to the final RTS.
20. We also have concerns about the apparent rationale for selecting a threshold figure of EUR 500,000. We note that paragraph 26 in Section 5.1 of the Consultation Paper indicates that the EBA's focus appears to have been primarily on the number of staff that would fall within the definition of Identified Staff if the absolute threshold were set at different levels. We do not consider that such a number, on its own, is useful in determining whether the correct individuals are within scope, since it does not provide any meaningful assessment of whether such individuals undertake activities which have a material impact on a firm's risk profile. The mere fact that the average total remuneration for reported risk takers in 2011 was EUR 508,000 is not, in itself, instructive because: (a) there could be a substantial degree of variation between individual component figures making up that average, evidencing that one absolute figure is inappropriate; and (b) if the primary purpose of the new regime is to ensure that the correct individuals taking material risks are within scope, using an average figure from the existing regime as justification for the threshold chosen is illogical and does not address the underlying policy issue.