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Frankfurt,
18 February 2022

BVI[1] position on Consultation Paper on Draft Regulatory Technical Standards on Pillar 2 add-ons for investment firms under Article 40(6) of Directive (EU) 2019/2034

In general, we agree with the proposed approach based on different steps and general metrics for competent authorities to assess, determine and, where necessary, update the amount of additional own funds the investment firms should hold to cover relevant risks. As we understand the proposal, the assessment mentioned in the draft RTS does not provide detailed requirements (such as specifications in euro amounts) how a competent authority uses these metrics to determine additional own funds in individual cases. We welcome such an approach because the determination of a concrete amount of additional own funds will then be at the discretion of the competent authority having regard to the specific case. However, we see a need for further clarifications and improvements which are specified in our answers to the questions raised in the consultation paper as follows.

Question 1. *Do you have any comments on the structure and elements included in this Consultation Paper for the computation of Pillar 2 add-ons?*

Article 1(3) Draft RTS (recovery plans): The requirement in paragraph 3 could be misunderstood to mean that all investment firms must have recovery plans in place and available information on recovery action and governance arrangements should then be considered by competent authorities. According to Article 63 of the IFD, the scope of the Directive 2014/59/EU (BRRD) and thereby the obligation to implement recovery plans is limited to certain investment firms which are subject to the initial capital requirements laid down in Article 9(1) of the IFD. This only includes those that are authorised under MiFID to engage investment activities listed in points (3) and (6) of Section A of Annex I to Directive 2014/65/EU and must maintain initial capital of €750,000 for this purpose. All other investment firms (such as portfolio managers), not covered by the BRRD, are not obliged to draw up corresponding recovery plans. We therefore suggest clarifying that information on recovery actions and governance arrangements should be only considered if it is required by law.

Articles 2 and 3 Draft RTS (material risks): Even if the heading refers to material risks, the requirements in Articles 2 and 3 of the Draft RTS should also be limited to material risks only. Here, the wording could give the impression that all risks are to be assessed. However, Article 40(1)(a) IFD is explicitly limited to material risks that are not or not sufficiently covered by the own fund requirements.

Articles 2(2) subparagraph 2 and 3(2) subparagraph 2 Draft RTS (facilitations): We welcome the proposed facilitation for investment firms subject to an initial capital requirement lower than the requirement laid down in Article 9(1) of Directive (EU) 2019/2034. The draft requires that where more granular quantification is deemed by competent authorities as not feasible or as overly burdensome, the measurement needs not be performed at the level of each risk category but on an aggregate level. However, it should be clarified additionally that material risks that cannot be limited (e.g. certain

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset Managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 116 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

operational risks) must be taken into account when determining the overall risk profile on the basis of a plausibility check.

Article 3(2)(b) Draft RTS (interest rate calculation): We suggest clarifying that there is no obligation for investment firms to introduce interest rate risk calculations for non-trading book activities unless they are already required by legal text already in force. While it was confirmed during the public EBA hearing on the SREP Guidelines that no new obligation is to be introduced, it would be beneficial to implement this caveat in the legal text.

***Question 2**. Do you agree with the proposed indicative qualitative metrics? Are there any other aspects or situations not sufficiently taken into account in this proposed approach?*

The parameters listed in the Draft RTS that the supervisory authority is to use in its assessment (e.g. indicative qualitative metrics) seem not appropriate in any case to quantify the desired outcome of additional own funds. In particular, the proposed metrics for measurement of the risk-to-client (**Article 6(2) of the Draft RTS**) are not appropriate and should be replaced by a general approach such as: are the current own funds sufficient to cover the existing overall risks and resulting potential liabilities (e.g. claims for damages due to professional liability claims, implementation of faulty processes)? The focus should therefore rather be on the criteria on risks of losses or damage caused by a relevant person through the negligent performance of activities for which the investment firm has legal responsibility and which are not already covered by the statutory own funds. As an example, Articles 12 and 13 of the Delegated Regulation (EU) No 231/2013 provide such a principle-based approach with a list of examples of risks and qualitative requirements such as a historical database which should be considered. This approach would be much more effective than picking out individual losses and risks whose risk consideration may shift over time. This applies, in particular, to the following points:

- This applies to the amount of assets under management (**Article 6(2)(c) of the Draft RTS**). It is not clear why the mere amount of assets under management should be able to provide an indication that could lead to higher risks that would have to be covered by additional funds. This leads the requirement to hold own capital based on a K-factor AUM ad absurdum. The same approach applies to the remaining amounts, which are already covered by the individual K-factors (such as the amount of client money held or of assets safeguarded and administered for clients).

- Moreover, we strongly disagree with the concept to qualify ICT risks of portfolio managers (or execution brokers) as such as special risks which are not covered by the already established capital requirements of the IFD and IFR framework (**Article 6(2)(f) of the Draft RTS**). ICT risk management is already part of the overall risk management of the investment firm. This means that the investment firm is required to implement processes which cover all relevant risks (including ICT risks if they are relevant). Moreover, with the new European framework on digital operational resilience for the financial sector (DORA), a new Regulation will require all supervised financial institutions how to implement internal governance rules and ICT risk management processes as part of the already existing internal processes. DORA therefore will lead to more effective operational resilience to cover ICT risks, but does not require additional own capital.

- Moreover, the mere number of '*unsuitable investment advices*' (**Article 6(2(g) of the Draft RTS**) seems not appropriate. The inherent risks of advice do not justify stronger capital requirements: The new framework of prudential capital requirements shall enhance the ability of the investment firm to achieve a more 'orderly wind-down' in the event of failure. In this context, it is of utmost importance to clarify that an advisor only gives a recommendation to its clients. The final decision

whether or to which extent to invest in a financial instrument will be taken by the client. A client of an advisor may only suffer losses where an investment firm provides inadequate investment advice on which basis the client has made an investment decision. From a prudential perspective, the advisor has to ensure that the firm is well organised to avoid such inadequate recommendations and that the firm has sufficient own capital to cover legitimate claims resulting from this liability only. Therefore, and as an alternative, any number of inadequate investment advice must be linked to the question of whether this is based on a lack of internal standards.

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