.BVI

Frankfurt am Main,
4 September 2020

**BVI[1] Position on the EBA's consultation paper (EBA/CP/2020/06) on Draft Regulatory Technical Standards related to implementation of a new prudential regime for investment firms on:**

- **The reclassification of investment firms as credit institutions under Article 8a(6) of Directive 2013/36/EU**
- **The prudential requirements for investment firms under Articles 7(5), 9(4), 13(4), point (a) to (c) of Article 15(5) and Article 23(3) of Regulation (EU) 2019/2033**
- **The prudential requirements for investment firms under Article 5(6) of Directive (EU) 2019/2034**

We take the opportunity to present our views on the proposed Draft Regulatory Technical Standards presented in the first consultation paper of the EBA related to the **prudential requirements**.

Germany represents about 700 MiFID investment firms, accounting for nearly one quarter of all European investment firms affected by the new IFD/IFR framework. The vast majority of these firms (about 600) is only authorised to provide MiFID services such as portfolio management, investment advice, reception and transmission of orders in relation to one or more financial instruments or execution of orders on behalf of clients without a licence to hold client money or securities belonging to clients or to deal on own account. According to the EBA's analyses of the population of all concerned firms by category there are a total of about 870 investment firms in the EU with such a limited licence. Therefore, Germany is the biggest market in this field (about 70 per cent of such limited licence firms in the EU). It is of utmost importance to carefully analyse whether the proposals applicable to firms with such a limited licence is workable, effective and proportionate, even in cases where they are classified as Class 2 firms which do not meet the conditions for qualifying as small an non-interconnected investment firms set out in Article 12(1) IFR.

Because these limited licence firms are not affected by the rules for reclassification of investment firms as credit institutions (Article 62(6) IFD/Article 8a(6) CRD, Article 62(3) IFR/Article 4(1)(b) CRR), by the criteria for subjecting certain investment firms to the CRR (Article 5(6) IFD) or by the proposed Draft RTS to specify adjustments to the K-DTF coefficients (Article 15(5)(c) IFR) and questions 3 to 5 of the consultation paper, we limit our response to **general remarks on the timetable**, to the proposed Draft Regulatory Technical Standards on the prudential requirements for investment firms under Article 13(4) IFR (**fixed overheads requirements**), point (a) of Article 15(5) IFR (**K-factors),** point (b) of Article 15(5) IFR **(segregated accounts**) and Article 7(5) IFR (**prudential consolidation of investment firm groups**) as follows:

## I. Challenging timetable

As an introductory and general remark, we would like to express our view that we consider the timely and full implementation of the new IFR/IFD framework for investment firms in the remaining period until

[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 114 members manage assets more than 3 trillion euros for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 23%, 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.

26 June 2021 to be extremely challenging. In early June 2020 and with some weeks of delay EBA published a roadmap for the high number of the Level 2 measures needed, accompanied by a first round of four consultation papers laying out proposals for extensive RTS and ITS on prudential supervision, supervisory reporting, disclosure, remuneration and other areas. We certainly understand the delay in the publication in light of the COVID-19 crisis. The German financial industry is just as affected by the additional regulatory challenges that derive from the crisis.

This is why we have approached the European Commission end of June and asked for a postponement of the application date of the IFD/IFR framework and the Level 2 measures. The European Commission saw – as of today – no need to comply with this request. Although we acknowledge that the EBA has no mandate to postpone the applicability of the new IFD/IFR framework (incl. the Level 2 measures) and related CRD/CRR amendments, we kindly ask you to continue monitoring the market developments and, together with the European Commission, remain open and supportive given the challenging implementation tasks ahead for the European asset management industry as a whole.

## II. Draft RTS to specify the calculation of the fixed overheads requirement and to define the notion of a material change (Article 13(4) of the IFR)

### 1. Specifying the calculation of the fixed overheads requirements (FOR)

We are supportive of the proposed 'subtraction approach' as outlined under Article 13(4) IFR with a non-exhaustive list of 'items for deduction', and **we agree with the legislator's view expressed in Article 13(4) IFR that this approach requires further clarification on the definition of fixed overheads** based on experience in the application of the existing rules under the Delegated Regulation (EU) 241/2014 amended by the Delegated Regulation (EU) 2015/488 currently applying for investment firms. **Therefore, we very welcome the Draft RTS to specify the calculation of the fixed overheads requirements (FOR) and to provide additional items for deductions. This applies in particular for the following clarifications and items:**

- **'Distribution of profits' (Article 1(1) of the Draft RTS)**: We support the proposal to adopt the current approach under Article 34(b)(2) of the Delegated Regulation (EU) No 241/2014 that firms shall calculate their fixed overheads by subtracting certain items from the total expenses after distribution of profits. This is in line with the definition of the 'expenses' of the International Financial Reporting Standards which does also not include distribution of profits.

- **'Payments related to contract-based profit and loss transfer agreements' (Article 1(6)(e) of the Draft RTS)**: We expressly support the approach that 'payments related to contract-based profit and loss transfer agreements' shall also be deducted from the total expenses. Distribution of profits and contract-based profit transfers are comparable models for sharing profits, the amount of which is dependent on the performance of the subsidiary entity. Just like dividends, profit transfers are based on the residual of the companies' income and expenses. Only in cases of yearly profitability (all or parts of) profit to the parent company may be transferred. If the subsidiary entity makes no profits, no payment to the parent company is required. To the contrary: In cases of losses, the parent company as owner of the subsidiary entity is obliged to vouch for the loss. Therefore, contractual profit transfer agreements work both ways, i.e. result in the obligation to transfer profits in good times and to receive financial backing from the parent company when the firm is loss-making.

- **‘Expenditures from taxes’ (Article 1(6)(c) of the Draft RTS):** For the same reasons we support the proposed approach to deduct expenditures from taxes where they fall due in relation to the annual profits of the investment from the total expenses. The respective taxes only occur if the company is profitable and thus create no additional risk for the company.

However, the wording ‘items for deduction’ in Article 13(4) IFR already specifies the calculation method and indicates that it is based on a ‘subtractive method’ which is already established under the Delegated Regulation (EU) 241/2014 amended by the Delegated Regulation (EU) 2015/488, but not defined in the IFR or the Draft RTS. According to the ‘subtractive approach’, variable costs items are deduced from the total expense as calculated according to the applicable accounting framework. For a better understanding, the subtractive method should be explicitly defined in Article 1(1) of the new Draft RTS, for example as follows:

> “(1) For the purposes of Article 13(1) of Regulation (EU) 2019/2033, ***firms shall calculate their fixed overheads of the preceding year, using the*** ‘figures resulting from the applicable accounting framework’ and ~~***shall***~~ referring to figures of an investment firm’s most recent audited annual financial statements ~~***after distribution of profits***~~ or of ~~***in***~~ annual financial statements where audited statements are not available. ***The calculation shall be made after distribution of profits and by subtracting at least the items defined in Article 13(4) of Regulation (EU) 2019/2033 and in paragraph 6 of this Article.”***

## 2. Defining the notion of a material change

We welcome the clarification of the notion of a material change in the Draft RTS where the competent authority may adjust the amount of capital based on the FOR. We support the proposal that objective thresholds based on the projected fixed overheads should be established for the purpose of specifying the notion of material change.

However, as firms vary in their size and their figures of capital, we would like to propose some adjustments. For very small firms or firms in a start-up phase it would be unnecessarily burdensome to impose adjustments in their own funds requirements, given that changes are bound to be frequent for them. Minimum thresholds should be established so that those firms are exempted from the adjustments in own funds requirements if their own funds requirements fall below the threshold. We therefore propose to amend Article 3 of the Draft RTS by adopting rules which apply under Article 34c of the Delegated Regulation (EU) 241/2014, as amended by the Delegated Regulation (EU) 2015/488.

Moreover, the threshold of only EUR 2 million could be not appropriate for investment firms with higher capital, because this limit can be exceeded very quickly in the case of larger projects with additional short-term personnel or IT expenditure (e.g. implementation of new legal requirements etc.). We therefore propose to remove “either of” in the first sentence and add a second subparagraph as follows.

We propose to adjust Article 3 of the Draft RTS as follows:

**“Article 3**

**The notion of material change for the purposes of Article 13(2) of Regulation (EU) 2019/2033**

***1.*** A material change referred to in Article 13(2) of Regulation (EU) 2019/2033 shall be considered to have occurred where ~~***either of***~~ the following conditions are met:

(a) a change, either in the form of an increase or in the form of a decrease of the business activity of the firm results in a change of 30% or greater in the firm's projected fixed overheads of the current year; ***and***

*(b)* a change, either in the form of an increase or in the form of a decrease of the business activity of the firm results in changes in the firm's own funds requirements based on projected fixed overheads of the current year equal to or greater than EUR 2 million.

***2. By way of derogation from paragraph 1 of this Article for firms referred to in Article 12 of the Regulation (EU) 2019/2033, a change in the business of a firm shall be considered material where the change in the business of the firm results in a 100 % or greater change in the firm's projected fixed overheads.***

***The firms referred to in the first subparagraph shall be those that meet either of the following conditions:***

*(a)* ***their current own funds requirements based on fixed overheads are equal to or more than EUR 125 000;***
*(b)* ***their own funds requirements meet both of the following conditions:***
  *(i)* ***based on current fixed overheads, they are less than EUR 125 000;***
  *(ii)* ***based on projected fixed overheads, they are equal to or more than EUR 150 000.***"

## III. Draft RTS to specify the methods for measuring the K-factors (Article 15(5), point a) of the IFR)

***Q1:*** *Is the proposed articulation of the K-factors calculation methods, in particular between AUM and CMH and ASA, exhaustive or should any other element be considered?*

We agree with EBA's assessment in recital (1) of the Draft RTS that some of the K-factors in the IFR do not require further specifications, whereas for other K-factors such as AUM, CMH, COH, ASA and DTF, the methods for measuring those factors would benefit from further clarifications. However, we would like to highlight two specific points in this context:

### 1. Advisory arrangements of an on-going nature (Article 2 of the Draft RTS) and delegation of management of assets to another financial entity

We acknowledge that according to point (27) of Article 4(1) and Article 15(2) of the IFR the term "assets under management" or "AUM" includes not only assets that an investment firm manages for its clients under discretionary portfolio management but also those related to nondiscretionary arrangements constituting investment advice of an ongoing nature.

In our opinion, however, it is not adequate and necessary to treat the investment services "portfolio management" and "investment advice of on ongoing nature" equally in the methods for the K-factor calculation.

It is without doubt that the legislator differentiates between these two types of services, above all by formulating a different programme of legal obligations attached to the services (with a much broader scope of legal obligations in case of portfolio management services). Paragraph 51 of the consultation paper acknowledges the necessity to distinguish between "portfolio management" and "nondiscretionary advisory arrangements of an ongoing nature". Since an investment advisor only gives a recommendation to its client, the final decision whether or to which extent to invest/divest in a financial instrument will be taken by the client. A portfolio manager, on the other hand, makes own decisions in selecting

financial instruments on behalf of a client and executes these decisions in its own authority, but in the name of and for the account of the client.

This demonstrates that the (operational) risk resulting from investment advisory services versus portfolio management services is different. Recital (24) of the IFR explicitly states that K-AUM in the context of portfolio management services shall capture the risk of harm to clients from an incorrect discretionary management of client portfolios or poor execution and provides reassurance and client benefits in terms of the continuity of service of ongoing portfolio management. Operational risks resulting from poor execution, however, do not occur in the context of investment advice of an ongoing nature.

In considering the limited inherent risk of investment advice to create an event of failure which justifies additional own capital requirements, we think it is appropriate to reduce the amount which should be included within the AUM amount that relate to non-discretionary advisory arrangements of an ongoing nature. **We therefore propose an approach that is linked to a percentage of the amount that relate to non-discretionary advisory arrangements.**

Moreover, we would like to clarify that – in line with the MiFID definition of investment advice – it is required that a personal recommendation to a client is in respect of one or more transactions relating to financial instruments (see Article 4(1)(20) of the IFR) by replacing the term “assets” by the term “financial instruments”.

Article 2(2) of the Draft RTS would then read as follows:

‘Article 2

Methods for measuring the AUM in cases of non-discretionary advisory arrangements of an on-going nature

1. […]
2. Where an investment firm is providing non-discretionary advisory arrangements of an ongoing nature, it shall include within its AUM referred to in Article 17 of Regulation (EU) 2019/2033 ***a percentage of [30] of*** any amounts of ~~***assets***~~ ***financial instruments*** that relate to those non-discretionary advisory arrangements.

On a general note, we would like to emphasise the following point in that context: **The delegation of portfolio management of collective undertakings such as UCITS or AIF to an investment firm providing portfolio management does not qualify as a practice *‘to promote ‘avoidance’’* of own capital requirements.** However, such an impression could arise when reading paragraph 50 of the ’Background and rationale’ section in the consultation paper.

## 2. AUM in case of discretionary portfolio management (Article 3 of the Draft RTS)

Not being financial instruments, cash positions should be excluded from the calculation of the AUM in case of discretionary portfolio management. This approach would be also in line with the proposed Recital 2 of the Draft RTS that refers to financial instruments in the context of calculation of AUM. Moreover, according to the definition of the investment service portfolio management in the MiFID II, portfolio management means managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments. This means that only financial instruments are in scope. Therefore, we propose to amend Article 3 of the Draft RTS as follows:

‘Article 3
Methods for measuring the AUM in case of discretionary portfolio management

For the purpose of Article 17 of Regulation (EU) 2019/2033, the measurement of total monthly assets under management shall be made in accordance with all of the following:

(a) the calculation shall include the value of financial instruments calculated at fair value in accordance with the applicable accounting standards;
(b) financial instruments with a negative fair value shall be included in absolute value;
(c) the calculation shall ~~***include***~~ ***exclude*** cash ~~***except any amounts covered under CMH in accordance with Article 4***~~.’

## IV. Draft RTS on the definition of segregated account (Article 15 (5) point b) of the IFR)

***Q2:*** *Are the requirements for notion of segregated accounts sufficient? Are there issues on segregated accounts which need to be elaborated further?*

We agree with the proposed requirements for notion of segregated accounts which comply with the MiFID requirements. We do not see the need for further adjustments.

## V. Draft RTS on prudential consolidation of investment firm groups (Article 7(5) of the IFR)

***Q6:*** *Do you have any comment on the elements included in this Consultation Paper for the application of the aggregation method?*

**We strongly disagree with the scope of group constellations in Articles 2 to 5 of the Draft RTS as the approach taken by EBA goes beyond the scope of delegation.** Such an extension is not covered by the mandate given in Article 7(5) IFR which states that the EBA shall develop draft RTS to specify ‘*the details of the scope and methods for prudential consolidation of an investment firm group, in particular for the purpose of calculating the fixed overheads requirement, the permanent minimum capital requirement, the K-factor requirement on the basis of the consolidated situation of the investment firm group, and the method and necessary details to properly implement paragraph 2*’ of Article 7 IFR. That mandate limits the EBA to develop details on the scope for prudential consolidation within the given definitions and provisions of the IFR. Article 7(5) IFR does not provide for a mandate to define a scope that is – in contrast to Article 18 CRR – not within the scope provided for under the IFR.

Moreover, the scope of the Draft RTS is in considerable contradiction to the approach taken by the IFR definitions in Article 4(1)(11) and (25) of the “consolidated situation” and an investment firm group with the explicit reference to Article 22 of Directive 2013/34/EU. In particular, the cases and scope of application defined in Article 22 of that Directive, especially the non-obligatory character of to Article 22(7) of Directive 2013/34/EU, would be undermined by the proposed Articles 2 to 5 of the Draft RTS. In addition, constellations referred to in Articles 3 and 4 of the Draft RTS go even beyond the scope of Article 22 of Directive 2012/34/EU and thus outside the defined scope of a “consolidated situation” and an

investment firm group under the IFR. Furthermore, Articles 2 to 5 of the Draft RTS considerably deviate from the current regulations on own funds on a consolidated basis for groups consisting of investment firms only (i.e. without any credit institutions) according to Articles 98 and 18 CRR as amended by CRR II. This is not in line with the purpose described in Recital 12 of the IFR to mirror the existing treatment of such investment firm groups under the CRR and CRD. The EBA itself states the need to ensure such a consistency in Recitals 3 and 4 of the Draft RTS. In this context, it is not appropriate to use as blue-print for the IFR a draft RTS discussed under the CRR in 2017 with divergent legal basis that did not enter into force - also due to the justified criticism of the banking industry.

Furthermore, according to Article 7(1) and Recital 12 of the IFR, the parent undertaking of an investment firm group should be required to comply with the requirements of the IFR based on the consolidated situation of the group. **We therefore strongly disagree with defining new responsibilities such as that an investment firm being a subsidiary in an investment firm group (for instance as part of a holding structure) should ensure that other entities within the group that are not subject of the IFR implement arrangements, processes and mechanisms to ensure proper consolidation without regard to its available legal means. Notwithstanding the above, we urge the EBA to clarify that such obligation for the parent undertaking of an investment firm group pursuant to Article 7(1) sentence 3 IFR does not go beyond and is limited by the boundaries applicable to a subsidiary under the laws of the country it is established under e.g. data protection or corporate law rules of such country.**

Additionally, while we agree that accounting consolidation in financial statements provides no justified basis for prudential consolidation, it should be ensured under the Draft RTS that the methods of consolidation (Articles 6 and 7 of the Draft RTS), in accordance with provisions of the IFR, do not unnecessarily diverge, resulting in significant undue burden for investment firm groups. Such is currently the case as the Draft RTS in its choice of full consolidation as default method of consolidation disregards the aggregation method as equally suitable default method – in many cases for prudential consolidation due to its conservative approach even more.

In fact we have expected the Draft RTS to deal with principles regarding consolidation methods within the clear boundaries set by the IFR, considering its rationale to more suitably addressing specific risks and vulnerabilities inherent to investment firms on a group level in contrast to such risks addressed under the CRR (IFR Recitals (2) and (3)). In this context we welcome the Draft RTS emphasising the scope of prudential consolidation of an investment firm group according to the IFR, as not extending beyond undertakings other than investment firms, financial institutions, ancillary service undertakings and tied agents. However, specifications on special features of group members like management companies licenced under the AIFMD or UCITS Directive, as well as clarifying emphasis on the non-relevance of investment funds such as UCITS or AIF (neither classifying as “financial institutions” nor as “ancillary service undertaking”) and clear distinctions to outsourcings sufficiently addressed in the current regulatory framework, are completely missing in the draft RTS.

**More specifically, we suggest the following amendments to the Draft RTS:**

1. **Article 2(1) of the Draft RTS: Group of undertakings which meet the conditions set out in Article 22 of Directive 2013/34/EU**

**We urge the EBA to delete Article 2(1) of the Draft RTS which refers to group constellations of *paragraph 7* of Article 22 of Directive 2013/34/EU.** Such an approach would not be in line with the definition set out in Article 4(1)(25) IFR. According to that definition, a group of undertakings which

consists of a parent undertaking and its subsidiaries or of undertakings which meet all the conditions set out in **Article 22 of Directive 2013/34/EU** (without expressly referring to those of paragraph 7, cf. Article 18(3) CRR) should be qualified as an investment firm group. First and foremost this involves cases where Member States require to draw up consolidated financial statements and a consolidated management report if a parent undertaking fulfils certain conditions as stipulated in Article 22(1) to (6) of Directive 2013/34/EU (the legal successor to Articles 1 and 2 of Directive 83/349/EEC as referred to in the CRR) such as having a majority of the shareholders' or members' voting rights in a subsidiary undertaking.

Moreover, and much more importantly, the approach proposed by the EBA in Article 2 of the Draft RTS ignores that the conditions in paragraph 7 of Article 22 of Directive 2013/34/EU depend on the non-obligatory choice of implementation by the Member state in its national law. According to Article 22(7) of Directive 2013/34/EU, a Member State **may require** any undertaking governed by its national law to draw up consolidated financial statements and a consolidated management report if certain conditions are fulfilled (such as non-related undertakings are managed on a unified basis in accordance with a contract). Therefore, the EBA approach set out in Article 2 of the Draft RTS would lead to the situation that these undertakings would be qualified as an investment firm group which are required to comply with certain rules of the IFD and IFR on a consolidated basis in any case and in disregard of the Level 1 backed choice of a Member State not to implement Article 22(7) of Directive 2013/34/EU. In contrast to Article 18(3) CRR, also no explicit reference is made to Article 22(7) of Directive 2013/34/EU in Article 7 IFR and therefore the scope of an investment firm group pursuant to Article 4(1)(25) IFR does not extend beyond the obligatory provisions of Article 22(1) to (6) of Directive 2013/34/EU to be implemented in a Member State. Furthermore, based on the information available to us, a large majority of Member States have opted not to exercise the discretion pursuant to Article 22(7) of Directive 2013/34/EU, which can be interpreted as evidence that the perceived usefulness of consolidated financial data obtained for such groups is limited either in absolute terms or in relative terms compared to the efforts required to prepare such consolidated financial data. Article 2 of the Draft RTS goes thus beyond what is covered by the IFR and the regulations referred to and should – as well as its relationship to group entities qualifying as parent undertaking and subsidiaries as per Article 4(1)(42) and (51) IFR – be reconsidered by the EBA.

**2. Articles 3 to 5 of the Draft RTS: Extending the definition of an investment firm group**

**We urge the EBA to delete Articles 3 to 5 of the Draft RTS. We strongly disagree with the proposed substantial extension of the scope by referring to further group constellations such as undertakings with significant influence without participation or capital ties (Article 3 of the Draft RTS), single management other than pursuant to a contract, clauses in memoranda or articles of association (Article 4 of the Draft RTS) or participations or capital ties (Article 5 of the Draft RTS).**

We are aware that in its hearing on 30 June 2020, the EBA referred to its consultation on technical standards specifying the methods of prudential consolidation under Article 18 of Regulation (EU) No 575/2013 (Capital Requirements Regulation - CRR), 9 November 2017.[2] However, this ignores the rationale of the IFR and the fundamentally different regulated scope in the IFR on the one hand and in the CRR, especially its Article 18, on the other hand. In detail:

[2] Available under the following link: https://eba.europa.eu/sites/default/documents/files/documents/10180/2019694/3b8e5188-f7e3-4d11-b9ae-256e47d61e4b/Consultation%20Paper%20on%20RTS%20on%20methods%20of%20prudential%20consolidation%20%28EBA-CP-2017-20%29.pdf.

- **Legal definition of an 'investment firm group':** Article 4(1)(25) IFR defines the following group constellation of which at least one is an investment firm and which does not include a credit institution:

  "*a group of undertakings which consists of a parent undertaking and its subsidiaries or a group of undertakings which meet the conditions set out in Article 22 of Directive 2013/34/EU of the European Parliament and of the Council*" .

  According to this Level 1 definition of "investment firm group", there is no room for extending the scope on Level 2 to cases as proposed by the EBA in Articles 3 to 5 of the Draft RTS. This is a major difference compared to the existing rules on prudential consolidation under the CRR because the CRR does not even define an equivalent term to 'investment firm group' and the scope of Articles 3 to 5 of the Draft RTS is not covered by Article 22 of Directive 2013/34/EU. Any such extension would require respective Level 1 amendments of IFR and cannot be effected by means of RTS.

- **The IFR does not contain a provision resembling Article 18(5) and (6) CRR**: According to Article 18(5) and (6) CRR, competent authorities shall determine whether consolidation is required in case of other participations or capital ties or significant influence without a participation or other capital ties and single management other than pursuant a contract, memorandum or articles of association. There is neither a comparable regulation in the IFR nor a mandate to specify such cases in a Draft RTS under the IFR. The reference to a similar approach of the EBA public consultation on technical standards specifying the methods of prudential consolidation under Article 18 CRR is therefore in no way appropriate. In view of the rationale of the IFR to provide a regulatory framework for investment firms more suitably addressing specific risks and vulnerabilities inherent to investment firms in contrast to such risks addressed under the CRR (cf. Recitals (2) and (3) IFR), the need to ensure consistence between the scope and methods of prudential consolidation in banking and investment firm groups (cf. Recitals (3) of the Draft RTS) neither provides a justification or mandate for an alignment of the Drafts RTS to the scope and methods of consolidation specified in Article 18 CRR beyond the provisions of the IFR. Articles 3 to 5 of the Draft RTS are therefore also not appropriate as scope of consolidation under Article 7 IFR. This applies even more as the RTS on methods of prudential consolidation under Article 18 CRR is under development and has not even entered into force yet.[3]

- **Articles 3 to 5 of the Draft RTS are much more stringent as the approach of Article 18(6) CRR:** We understand the proposed Articles 3 to 5 in conjunction with Articles 6 to 7 of the Draft RTS in such a way that competent authorities should only have a right to choose the consolidation method (such as full or proportional consolidation, aggregation method), but no longer whether consolidation is required or not. Irrespective of the lack of a legal basis for such an approach, this would be much more stringent as it is currently required under the CRR: according to Article 18(6) CRR, competent authorities shall determine **whether** consolidation is required in additional cases such as of significant influence or single management.

[3] Cf. the reference made by the EBA itself on its website: https://eba.europa.eu/regulation-and-policy/accounting-and-auditing/rts-on-methods-of-prudential-consolidation.

## 3. Contractual arrangements: delegation or outsourcing in the asset management sector

Apart from the lack of legal basis the cases proposed by the EBA in Articles 2 and 3 of the Draft RTS would lead to inappropriate group constellations in the asset management sector, especially in the context of generic or market standard outsourcing.

The following example will demonstrate this:

- Asset management companies, qualifying as financial institutions in the meaning of the definition in Article 4(1)(14) IFR, could be related with an investment firm on a contractual basis. Under the Draft RTS it should be made clear that asset management companies do not fulfil the group approach proposed by the EBA, as there is no prudential necessity.

- According to the UCITS Directive and the AIFMD, management companies can delegate portfolio management services of the investment funds such as UCITS or AIF to third parties (such as investment firms with a licence to provide asset management) on a contractual basis. That case is fully covered by the prudential requirements of the AIFMD or UCITS Directive. However, Articles 2 and 3 of the Draft RTS on prudential consolidation of investment firm groups could be understood in such a way that such a contract would qualify as a significant influence without participation or capital ties (e.g. due to the rather broad notion of "existence of material transactions between the two undertakings" pursuant to point c) of Art. 3(2) of the Draft RTS). This would lead to the situation that the investment firm and the management company would be qualified as an investment firm group with the effect that the investment firm must carry out consolidation of the management company although this case is already comprehensively covered by the UCITS Directive or the AIFMD. Also, the Draft RTS does not consider the circumstance that a management company typically delegates portfolio management services of the investment funds not only to one, but various third parties. This could subject one and the same management company as part of various investment firm groups.

**In the further alternative, if EBA maintains its approach, we urge to clarify that, in the absence of other circumstances leading to the formation of a regulatory group case of generic or market standard outsourcing, such as a delegation of portfolio management services of the investment funds or the AIF or UCITS management companies, respectively, (which involves standard contractual termination rights for the undertaking delegating the right) in the above sense does not lead to the formation of a regulatory group.**

***Q7:*** *Do you currently use the method of proportional consolidation for the consolidation of subsidiaries in accordance with Article 18(4) of Regulation (EU) No 575/2013? If proportional consolidation is used, please explain if the conditions included in this Consultation Paper are met.*

***Q8****: Do you have any comments on the conditions established in this Consultation Paper to apply proportional consolidation to investment firms groups under Regulation (EU) No 2019/2033?*

In general, we welcome a clarification that participating undertakings subject to prudential supervision should benefit from the proportional consolidation because it considers that the probability of materialisation of a step-in risk of the parent undertaking is very low as a result of sector-specific prudential requirements that apply for these entities. Also, asset management companies (which qualify as financial institutions in the meaning of the definition in Article 4(1)(14) IFR and therefore also as financial sector entities) are subject to strict prudential requirements under the UCITS Directive and the AIFMD.

However, while we agree that accounting consolidation in financial statements provides no justified basis for prudential consolidation, it should be ensured under the Draft RTS that the methods of consolidation (Articles 6 and 7 of the Draft RTS), in accordance with provisions of the IFR, do not unnecessarily diverge, resulting in significant undue burden for investment firm groups. Such is currently the case as Article 6 of the Draft RTS in its choice of full consolidation as default method of consolidation disregard the aggregation method as equally – in many cases for prudential consolidation due to its conservative approach even more – suitable and appropriate default method. For example, the aggregation method allows for a more specific consolidation of group undertakings or reporting date specific currency conversion.

Furthermore, we would like to emphasize one important aspect related to the interplay between accounting consolidation and prudential consolidation which in our view should be considered in the specification of the methods for prudential consolidation (Articles 6 and 7 of the Draft RTS). In cases in which consolidated financial statements are prepared at the level of the Union parent undertaking (as defined in Article 1(1) of the Draft RTS), such consolidated financial statements generally represent the natural starting point for prudential consolidation (e.g. for the determination of consolidated own funds). It needs to be observed, however, that in several practically highly relevant cases no consolidated financial statements are prepared at the level of the Union parent undertaking. In one category of cases, the Union parent undertaking is itself the subsidiary of an 'ultimate' parent undertaking incorporated in the same Member State and the latter 'ultimate' parent undertaking (which prepares consolidated financial statements involving the subgroup of the Union parent undertaking) does not qualify as credit institution / investment firm / financial institution / ancillary services undertaking. In a second category of cases, the Union parent undertaking is itself the subsidiary of credit institution / investment firm / holding company incorporated in a third country and the latter parent undertaking prepares consolidated financial statements on the basis of equivalent accounting standards, which implies that an exemption from the obligation to prepare consolidated financial statements applies at the level of the Union parent undertaking (cf. e.g. Article 23(8) of Directive 2013/34/EU). EBA is kindly asked to consider whether for such and related constellations, use of an aggregation method could be admissible for the Union parent undertaking for purposes of prudential consolidation.

**We urge EBA therefore to amend Article 6 of the Draft RTS by establishing full consolidation and the aggregation method as equally eligible default consolidation method with an obligation for the Union parent undertaking to formally declare one as its individual choice of default method, the remaining method, together with the proportional consolidation becoming applicable upon permission by the supervisor. Where the supervisor objects to the individual choice in default method as not being appropriate for the respective investment firm group, the other method shall become the default method.**

***Q9**: The methods for calculating the K-factors in a consolidated situation may allow for further specifications. Is there any K-factor for which the calculation in the context of the consolidated basis would require further specifications? What aspects should be considered?*

**We disagree to involve 'the MiFID part of the AUM of asset management companies and of third country entities that would have been asset management companies had they been authorised in the Union' in the AUM of the group as proposed in Article 11(3)(c) of the Draft RTS. We urge the EBA to draft the consolidated K-factor requirement regarding the AUM in Article 11(3)(c) of the Draft RTS as follows:**

3. 'The coefficients set out in Table 1 of Article 15 of Regulation (EU) 2019/2033 shall be applied to the consolidated metrics in order to calculate the K-factor requirement for each metric on a consolidated basis.
   a. […]
   b. […]
   c. The AUM of the group shall be obtained by adding together~~:~~
      ~~*i.*~~ the AUM of the MiFID entities and of third-country entities that would have been MiFID entities had they been authorised in the Union~~***; and***~~
      ~~***ii. the MIFID part of the AUM of asset management companies and of third-country entities that would have been asset management companies had they been authorised in the Union***~~.
   d. […]
   e. […]
   f. […].'

**The MiFID part of the AUM of asset managers is already subject to prudential supervision:** The approach proposed by the EBA would imply that the MiFID part of the AUM of asset managers is not part of prudential supervision on solo-level of the asset manager and would pose risks to clients which are not covered. However, the opposite is the case: Asset management companies are already subject to their own regulatory prudential requirements for own funds under the AIFMD and the UCITS Directive irrespective of whether and to what extent they provide additional services (such as those within the meaning of Article 6(3)(a) and (b) of the UCITS Directive and Article 6(4)(a) and (b) of the AIFMD for which certain MiFID rules apply (cf. Article 6(4) of the UCITS Directive and Article 6(6) of the AIMFD)). Rigorous capital requirements which reflect all risks of these asset managers (also encompassing these services) are already in place under the UCITS Directive or the AIFMD. Moreover, they are obliged to cover operational risks (such as professional liability risks) through additional own funds[4].

**Such an approach would be much stricter as the current approach in Article 95 of the CRR**. The current approach under the CRR does not cover 'the MiFID part of AUM' of asset managers as a special item. We are aware that a K-factor approach does not exist under the CRR. However, Article 15(1)(a) of the CRR refers to Article 95(2) of the CRR with a calculation of the total risk exposure amount as the higher of the sum of the certain items covering different risk types (such as trading book risks, concentration risks) or a special factor multiplied by the amount based on the fixed overheads requirements. In fact, all our members affected currently apply the capital calculation method based on the fixed overheads required in Article 95(2) CRR. The new approach based on 'the MiFID part of AUM' would not be in line with the objective of the IFR to mirror the existing treatment of investment firm groups under the CRR and CRD Regulation (cf. Recital 12 of the IFR). In any case, a potential step-in risk of a parent undertaking regarding an asset manager being part of an investment firm group will be sufficiently covered by the fixed overheads requirements. Such an approach should be appropriate as the AIFMD and the UCITS Directive as well refer to a minimum capital limit based on the fixed overheads required. According to Article 9(5) of the AIFMD and Article 7(1)(a)(ii) of the UCITS Directive, the own funds of the management company shall never be less than the amount prescribed in Article 13 IFR (in the meaning of the amendment made in Articles 60 and 61 of the IFD).

**Such an approach would contradict the objective of the new framework to simplify the prudential requirements:** Asset management companies are themselves not covered by the scope of the IFD/IFR framework, even if they provide additional MiFID services. The approach proposed by the EBA would, however, result in an (indirect) obligation of asset managers being part of an investment firm group to calculate the MiFID part of AUM based on the K-factor approach established in the investment firm regime although this approach does not apply to them in particular. The objective of the new framework was that the rules on own funds introduced by the IFR will remain largely unchanged compared

[4] Cf. Article 14 of the Delegated Regulation (EU) No 231/2013 of 19 December 2012, BaFin Circular 5/2010 on the minimum requirements of risk management for investment management companies.

with the current CRR ones and that their implementation should therefore not represent a challenge for the industry.

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