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Submitted via the consultation portal

3 September 2024

Dear Sir/Madam,

AIMA response to the joint EBA-ESMA Discussion Paper on the European Commission call for advice on the Investment Firms Prudential Framework EBA/DP/2024/01

The Alternative Investment Management Association ("AIMA")[1] is pleased to respond to the joint EBA-ESMA Discussion Paper on the European Commission ("EC") call for advice on the Investment Firms Prudential Framework (the "DP").

We agree with the EBA's overall opinion that the rules achieve their objectives of providing a proportionate, risk-sensitive prudential framework for investment firms. Any changes should preserve the underlying recognition that investment firms operate very differently to credit institutions. There should be no presumption in favour of aligning the rules applying to investment firms and banks.

[1] The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with around 2,100 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than US$3 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides**.** AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 250 members that manage over US$1 trillion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, www.aima.org.

We also believe that it is helpful to look at similar prudential frameworks, such as the UK Financial Conduct Authority ("FCA") Investment Firms Prudential Regime ("IFPR"), to see how they have operated and what lessons can be learned from them. Where possible, greater alignment between regimes should be sought. This will reflect the international nature of the asset management industry, reduce opportunities for regulatory arbitrage and improve multi-national investment firms' operational efficiency.

We have identified some areas where we believe that changes can be made which will continue to meet the purpose of the investment firms prudential framework (the "Framework") in a way that is more proportionate and efficient for firms. We also explain where changes are not needed either because a risk is already captured by the Framework or data is already available to supervisors.

Our response looks at six areas:

- **Definitions and thresholds:** maintaining the current ability for firms to move between categories;
- **K-factors:** addressing complexity and recognising that issues such as crypto-assets are already captured;
- **Liquidity:** proportionate treatment for third country assets and better calibration of short-term fixed interest holdings;
- **Alignment with other sectoral legislation:** where there is a clear and evidenced need;
- **Remuneration:** maintaining the different treatment of investment firms compared with banks; and
- **Reporting:** limiting the provision of the same information to supervisors to no more than once.

We provide further details on in the annex. We would be happy to elaborate further on any of the points raised in this response. For further information, please contact James Hopegood, Director of Asset Management Regulation and Sound Practices (jhopegood@aima.org).

Yours faithfully,

Jiří Król
Deputy CEO, Global Head of Government Affairs

ANNEX

AIMA's response focuses on six areas, reflecting our view that the prudential framework for investment firms is functioning effectively and proportionately overall. Rather than answering each question in the DP we have only responded to questions 1, 3, 4, 5, 7, 9, 14, 17, 22, 24, 25 and 27 to 31. We have left these in the order presented and have left out the questions to which we have not responded for ease of reference.

Q1: What would be the operational constraints of potentially removing the threshold?

AIMA would not be supportive of removing the €5bn threshold and subjecting all investment firms that are part of a group to the expanded requirements. The DP notes that the purpose of the reporting is to monitor as firms approach the €15bn and €30bn thresholds. Given those policy goals, the significant delta between €5bn and €15bn and the significant additional burden created by this regulatory reporting, we do not think the costs outweigh the anticipated benefits. In addition, firms provide aspects of this data on an annual basis to their NCAs. Enhanced reporting from the NCAs to the EBA would be a more proportionate, properly tailored mechanism to enable the EBA to receive the additional data it may need.

Q3: Do you have any views on the possible ways forward discussed above regarding the transition of investment firms between Class 2 and Class 3 should be introduced?

AIMA appreciates the DP's aim of reducing burdens on investment firms moving between the "Class 3" and "Class 2" categories. However, we are concerned that the proposal to limit the number of times an investment firm must move between categories to once a year could have unintended consequences. An unrepeated transaction may push an investment firm from Class 3 to Class 2 before it then reverts to Class 3 in line with its normal business pattern. Under such circumstances an investment firm could find itself subject to inappropriate treatment for as much as eleven months. This would be disproportionate and burdensome for the firm and its national competent authority and may well be a result of factors outside the firm's control. We request EBA maintains the existing rules. Alternatively, EBA could consider allowing a 'grace' period two or three months after which if a firm still fulfils the criteria for Class 2 it must remain as such for the rest of that year.

Q4: Should the minimum level of the own funds requirements be different depending on the activities performed by investment firms or on firms' business model? If yes, which elements should be considered in setting such minimum?

Despite the length of the wind down period being the same for all business models, we believe the definition of fixed overheads is already sufficiently robust to ensure capital requirements are proportionate to the size and scope of individual firm activities. We do not, therefore, believe that extending the wind down timeframe for specific investment firms, beyond the existing three-month period, is necessary.

Q5: Is it necessary to differentiate the deductibles by activity or by business model for the purpose of calculating the FOR? If yes, which items should then be considered and for what reasons?

The Investment Firms Regulation ("IFR") Article 12, Small and non-interconnected firms, leads to a higher capital requirement than is necessary given the low level of risk small and non-interconnected firms present. We believe the factors in IFR Article 12 could be simplified in a way that would make the capital requirement more proportionate to their lower risk. We propose the following wording to do this:

> "The own funds requirement of a non-SNI investment firm is the highest of:

> 1. Its permanent minimum capital requirement;
>
> 2. Its fixed overheads requirement; or
>
> 3. Its K-factor requirement."

Q7: Should the FOR be calculated distinguishing the cost related to non-MIFID activities, which criteria should be considered? What kind of advantages or disadvantages would this have in practice?

Limiting the calculation of FOR to expenses related to MIFID activities would not be prudent as it could amplify the risk of a disorderly wind down. This is because all payment obligations are treated equally in a wind down scenario, irrespective of whether they arise in the context of MIFID activity.

Other elements

We would be supportive of the EBA providing further clarification around what is meant by "material change" in a manner that does not inhibit its proportionate application. This should detail specific considerations when adjusting capital requirements to reflect changes in investment firm activities, as there may be instances where exceeding quantitative thresholds could be driven by business activity unrelated to the provision of investment services. Finally, we believe the size of the firm should also be taken into consideration; the same nominal increase in projected FOR that might be considered a material change for smaller firms may be deemed immaterial by larger organisations.

Q9: Should the concept of 'ongoing advice' be further specified for the purpose of calculating the K-AUM? If yes, which elements should be taken into account in distinguishing a recurring provision of investment advice from a one-off or non-recurring one?

The calculation of the K-AUM is based on "investment advice" rather than the assets under management. This can make it difficult for firms to assess the element of non-discretionary investment advice. We request this is clarified, but in such a way that does not increase the complexity of the calculation. We propose the following guidance is added to clarify the issuer:

> "Where a financial entity ('A') provides investment advice of an on-going nature to an investment firm ('B') and B undertakes discretionary portfolio management, the arrangement does not fall within scope of the K-AUM calculation. This is because the arrangement is not a formal delegation of the management of assets by A to B, but involves 2 distinct activities: on-going investment advice provided by A and discretionary portfolio management undertaken by B. In this situation, if A is an investment firm, it must include any assets in relation to which it is providing the advice in its measurement of AUM. Where B undertakes discretionary portfolio management in relation to the same assets, B must also include those assets in its own measurement of AUM."

Concentration risk in the trading book (K-CON) (section 4.8)

Concentration risks related to positions in the non-trading book are already assessed under the risk management requirements of the IFD, and investment firms have a monitoring obligation that extends to non-trading book exposures. Given this context, we would not be in favour of recommending the scope of

K-CON application is extended to the non-trading book. Furthermore, when considering options, the precise nature of non-trading book exposures and/or financial instruments that are subject to the K-CON requirement should be detailed; the notion of client (as discussed in section 4.9) should therefore be clarified before any extension of K-CON is proposed. Finally, if K-CON is to be extended to the non-trading book, this should not apply to intra-group exposures or cash holdings with third-party banks. These exposure types do not carry the same risk as counterparty or client exposure arising from booking financial instruments in the non-trading book. Firms are best placed to conduct individual assessments of their own risk profiles.

Q14: Should crypto-assets be included into K-factor calculation, either as a new K-factor or as part of K-NPR?

No. Risks associated with crypto-assets should already be considered in the calculation of the K-AUM and K-ASA. Full account should be taken of other applicable EU rules such as the MiCA Regulation so there is no duplication of requirements.

Q.17: When addressing other activities an investment firm may perform, which elements, on top of the discussed ones, should be also taken in consideration?

For non-trading book exposures it is important to note that investment firms are already required to assess credit risk as part of the risk management requirements in the IFD, and that to some extent, introduction of a new K-factor requirement might result in transfer of risk capital from Pillar 2 to Pillar 1. As the EBA notes in paragraph 122, credit risk has been deliberately excluded from K-factor methodology to provide a more proportionate prudential regime specific to the nature of individual investment firms. It does not provide a convincing argument or evidence to support the introduction of a new K-factor requirement for credit risk. We are particularly concerned by the EBA's reference to the standardised credit risk approach in the CRR. Given it was designed for banks, the standardised credit risk approach is not an appropriate method to capture the nature of credit risk exposures in the non-trading book of investment firms.

Q22: Are there scenarios where the dependency on liquidity providers, especially in third countries, would lead to unexpected liquidity needs? Could you provide some examples?

Firms should have access to all appropriate sources of liquidity on the best terms available. This is explicitly recognised by the Treaty for the Functioning of the European Union, which in Article 63 prohibits all restrictions on the movement of capital between EU Member States and between Member States and non-EU countries, unless they are necessary for legitimate public interests.[2] We do not believe there is a demonstrable public interest justification for differentiating between capital and liquidity raised within or outside the European Union.

Further, placing extra burdens or restrictions on access to liquidity and capital will act against the EU's Capital Markets Union. This would be the case if barriers are put in place on accessing global liquidity pools. It would reduce access to capital and so reduce rather than increase the pool of capital available in the EU.

[2] *See* Consolidated version of the Treaty on the Functioning of the European Union - PART THREE: UNION POLICIES AND INTERNAL ACTIONS - TITLE IV: FREE MOVEMENT OF PERSONS, SERVICES AND CAPITAL - Chapter 4: Capital and payments - Article 63(1), available at https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX%3A12008E063.

Q24: Do you have any views on the possible ways forward discussed above concerning the provision of MiFID ancillary services by UCITS management companies and AIFMs?

We have yet to be presented with evidence that the difference in the requirements between MIFID and AIFMD and the UCITS Directive has led to any detriment or increase in risk to investors or counterparties. This was raised in our response to the Central Bank of Ireland 2023 consultation paper 152 on Own Fund Requirements for UCITS management companies and AIFMs authorised to perform discretionary portfolio management, which had no quantification of the number of firms that would be affected or the cost to them.[3]

Where the provision of the MIFID activity is ancillary to the collective portfolio management, proportionality should be further enhanced by not extending all the prudential requirements in IFR/IFD to those entities. For example, it would be unreasonable to enforce all the risk management requirements in the IFD, or the prudential consolidation requirements in the IFR, to AIFMs and UCITS management companies where MIFID activity only constitutes a small part of overall entity activity.

The European co-legislators also had the opportunity to revisit this issue as part of the AIFMD and UCITS Directive review but declined to do so. We are concerned that any attempt at aligning the requirements is in effect an indirect way of undermining the intention of the primary legislative text of AIFMD and the UCITS Directive and should be resisted.

Q25: Are differences in the regulatory regimes between MICAR & IFR/IFD a concern to market participants regarding a level playing field between CASPs & Investment firms providing crypto asset related services? In particular, are there concerns on the capital and liquidity requirement regimes?

We do not have any concerns about regulatory regime asymmetry. Crypto asset services governed under the MiCA Regulation and investment services governed by IFR/IFD are both highly regulated; since both services differ in nature, attempts to level the playing field by introducing overlapping categories for the purposes of K-factor application could lead to operational challenges such as double counting.

Q27: Is the different scope of application of remuneration requirements a concern for firms regarding the level playing field between different investment firms (class 1 minus and class 2), UCITS management companies and AIFMs, e.g., in terms of the application of the remuneration provisions, the ability to recruit and retain talent or with regard to the costs for the application of the requirements?

We note that remuneration restrictions are not an end in and of themselves and should be supported by clear evidence. We have not seen any evidence of systemic macroprudential risks arising at AIFMs and UCITS management companies that would justify enhanced remuneration requirements.

[3] See https://www.centralbank.ie/publication/consultation-papers/cp152-own-funds-requirements-for-ucits-mancos-and-aifms-authorised-for-discretionary-portfolio-management. AIMA responded on 23 February 2023.

Q28: Are the different provisions on remuneration policies, related to governance requirements and the different approach to identify the staff to whom they apply a concern for firms regarding the level playing field between different investment firms (class 1 minus under CRD or class 2 under IFD), UCITS management companies and AIFMs, e.g. in terms of the application of the remuneration provisions, the ability to recruit and retain talent or with regard to the costs for the application of the requirements?

We have no concerns regarding the different approach to classifying identified staff, however greater alignment on the identification criteria may increase consistency between investment firms.

Q29: Are the different provisions, criteria and thresholds regarding the application of derogations to the provisions on variable remuneration, and that they apply to all investment firms equally without consideration of their specific business model, a concern to firms regarding the level playing field between different investment firms (class 1 minus under CRD and class 2 under IFD), UCITS management companies and AIFMs, e.g., in terms of the application of the remuneration provisions, the ability to recruit and retain talent or with regard to the costs for applying the deferral and pay out in instruments requirements? Please provide a reasoning for your position and if possible, quantify the impact on costs and numbers of identified staff to whom remuneration provisions regarding deferral and pay out in instruments need to be applied.

We believe variation in derogation thresholds set by different regimes and national competent authorities will impact the objective of creating a level playing field. General provisions on remuneration should always be proportionate to the size of the organisation, and to the nature, scope, and complexity of activities they undertake. The organisational structure of an investment firm, AIFM or UCITS management company, along with staff responsibilities and, in turn, the staff's ability to impact a firm's risk profile or that of a fund under management will vary between organisations. Remuneration requirements should therefore consider these differences by affording firms sufficient flexibility when implementing requirements.

The guidelines would benefit from recognising that at a group wide policy level, investment firms (including AIFMs or UCITS management companies) that have already complied with a specific regime such as the IFD should also be deemed compliant under other regimes rather than having to implement multiple requirements.

Q30: Are the different provisions regarding the oversight on remuneration policies, disclosure and transparency a concern for firms regarding the level playing field between different investment firm, UCITS management companies and AIFMs, e.g., with regard to the costs for the application of the requirements or the need to align these underlying provisions? Please provide a reasoning for your position.

As the DP acknowledges, the Framework's intention to distinguish the characteristics of investment firms from those of credit institutions such as banks should remain a cornerstone for any changes to the Framework. Elements of the Framework address similar issues to those in both the AIFMD and the UCITS Directive, but the latter do so in a more proportionate way. Aligning some of the Framework's requirements with those applying under AIFMD and the UCITS Directive would reduce burdens on investment firms without diluting the intention or effect of the Framework. We note that investment firms that are asset managers are not systemic and so how they remunerate staff should not reflect the CRD as it does in some places.

The AIFMD and the UCITS Directive have just been reviewed by the co-legislators and found to be fit for purpose in these areas. We believe this supports the need to align the Framework better to them with respect to asset managers. It would also align them more with non-EU asset management hubs, so reducing the opportunity for regulatory arbitrage.

Quantitative thresholds

Currently there are quantitative thresholds to classify some employees as "identified staff". This threshold is currently €500,000 or paid more than the lowest paid material risk taker ("MRT"). Neither AIFMs nor UCITS and their management companies are subject to this threshold, and there is no evidence to show that it impedes the respective directives' aim of better aligning incentives. We request the quantitative threshold is put into alignment with AIFMD and the UCITS Directive.

Other remuneration issues

There are other elements of the Framework in relation to remuneration which we believe can be aligned with AIFMD and the UCITS Directive with respect to asset managers without any increased risk:

- The requirement for investment firms to get regulatory approval to exclude staff earning above €750,000 from the scope of identified staff should be removed;
- The minimum retention period should also be removed for vested deferred remuneration. This requirement has been taken from CRD and for public companies that compensate staff with equity;
- The prohibition on dividends should be aligned to AIFMD and the UCITS Directive which allow dividends to accrue, even though they cannot pay out. This would not create any extra risk and would be operationally simpler; and
- In line with AIFM and the UCITS Directive remove the ratio of fixed to variable and instead require that firms ensure an appropriate balance of fixed and variable pay.

Q31: What would be costs or benefits of extending existing reporting requirement to financial information? Which other elements should be considered before introducing such requirement?

Compliance with the Framework requires significant amounts of complex data reporting. Financial reporting such as firms' annual reports and accounts are already provided to supervisors. We do not see a case for reporting the same data twice to a single supervisor. It would be burdensome, costly and would provide no extra information to supervisors. We also note this goes against the intention of the European Commission's initiative to reduce administrative burdens on entities by rationalising reporting requirements.