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European Fund and Asset Management Association

CONSULTATION RESPONSE

Brussels, 3 September 2024

EFAMA's response to the EBA & ESMA discussion paper on the Commission's call for advice on the prudential framework for investment firms[1].

General remarks

Since the origins of the IFD/IFR regime, EFAMA has been supportive of the goal to create a separate prudential framework for investment firms that would recognise their specificities and distinguish them from credit institutions and their corresponding prudential treatment under the CRD/CRR regime.

As we also highlighted at the time, the new regime should not include modifications affecting UCITS management companies and AIFMs, as these entities and their capital requirements are already comprehensively regulated by the well-established AIFMD and UCITSD frameworks. We are concerned that with this Discussion Paper the ESAs are again opening the same debate and suggesting possible changes without a mandate and rationale to do so. Therefore, in our response, we concentrate mainly on issues covered in Section 9 and:

- Question the ESAs' mandate to propose changes in AIFMD and UCITSD, mindful that the review of both directives has been finalised only recently;

- Strongly oppose changes in the capital requirements for UCITS management companies and AIFMs which have been long established and tailored to the specificities of these entities' business activities; and

- Strongly reject the suggested limitation of the scope of MiFID services that management companies can provide, as this would be contrary to the primary purpose of such permissions, introduce inefficiencies on the market and limit competition.

In our response we also highlight following elements:

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[1] EBA, Discussion Paper. Call for advice on the investment firms prudential framework, 3 June 2024 (Discussion Paper).

- The implications that amendments in FOR would have for UCITS management companies and AIFMs and the lack of need for further differentiation of this requirement;

- The concerns over further alignment of the IFD/IFR framework with CRD/CRR which deviates from the initial goal of creating separate and proportionate rules for investment firms; and

- That there is no need for the further alignment of different frameworks on remuneration, as a general level-playing-field already exists and further complexity should be avoided.

Section 3: Fixed overheads requirement

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?

EFAMA would like to highlight that any changes in the fixed overheads requirement (FOR) will also have a direct impact on UCITS management companies and AIFMs. According to Art. 7(1)(a)(iii) of UCITSD[2] and Art. 9(5) of AIFMD[3] the own funds of these companies will never be less than the amount required under Art. 13 of IFR[4]. As we explain in more detail in our response to question no. 24, a comprehensive review of both AIFMD and UCITSD has just been finalised with no amendments to the provisions on capital requirements being proposed or discussed during its course. As the EU legislators didn't see the need to adjust capital requirements for UCITS management companies and AIFMs there, we do not believe it is justified for it to be done through the review of a different framework such as IFD/IFR.

Apart from this initial comment, we would also like to point out that FOR serves currently as a simple, minimum capital requirement that is common for all types of entities. Through the nature of its calculation method (one quarter of the fixed overheads of the preceding year according to applicable accounting framework) it is already tied to the size of the entity. Moreover, according to Art. 13(2) of IFR, national competent authorities (NCAs) may further adjust the amount should they consider that there has been a material change in the activities of an investment firm (UCITS management company/AIFM likewise). As both frameworks, AIFMD/UCITSD for management companies and IFD/IFR for investment firms, include also capital requirements other than FOR that are more aligned with these entities' business activities (as we also explain further under our response to question no. 24), we do not see a need for changes to be made in the provisions on FOR. Any further differentiation according to activities performed by entities and their business models would go against the general objectives of IFD[5]/IFR framework by adding more complexity, where simplicity was sought for.

Therefore, EFAMA is against differentiation of FOR depending on activities performed or firm's business model.

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[2] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITSD).

[3] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (AIFMD).

[4] Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulation (EU) No 1093/2010. (EU) No 600/2004 and (EU) No 806/2014 (IFR).

[5] Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EC, 2013/36/EU, 2014/59/EU and 2014/65/EU (IFD).

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?

For the same reasons as explained already in our response to question no. 4, we also do not see a need for the differentiation of the deductibles for the purpose of the calculation of FOR, by activity or business model. As the EBA raises itself, this would bring additional complexity, by multiplying calculation methods and the cases to be considered. With very limited added value of such differentiation, we are of the opinion that these drawbacks clearly speak against it.

Section 5: Risks not covered by existing K-factors

Q17: When addressing other activities an investment firm may perform, which elements, on top of the discussed ones, should be also taken in consideration?

Additional issues not covered by the ESAs' questionnaire:

EFAMA would like to use this question to highlight a few other topics which are analysed in the Discussion Paper (Sections 4-6 and 8), however they were not covered by the questionnaire. We are of the opinion that these issues could bring significant changes to the current provisions of the IFD/IFR framework and therefore stakeholders should be provided with an opportunity to comment on them:

a) Further alignment of the IFD/IFR framework with CRD/CRR

The initial purpose of the IFD/IFR framework was to establish an appropriate and proportionate prudential regime for investment firms, better adapted to their business models, as opposed to regulations established for credit institutions in CRD[6]/CRR[7]. Therefore, possible further alignments, as discussed in Section no. 6 of the Discussion Paper, with the recently agreed CRR 3[8] and CRD 6[9], as well as currently applicable banking package, seem to be contradictory to this initial objective. In particular, the fundamental review of the trading book and the new boundary analysis between banking and trading book is too complex for a prudential framework such as IFD/IFR, with Class 2 and Class 3 investment firms subject to it. In our opinion, the currently applicable definition of trading book in Art. 4(1)(54) of IFR, that focuses on trading intent, is sufficient and fit for purpose.

We would also question the proposal to consider certain K-factors being introduced on non-trading book exposures i.e. the investments of own funds of the investment firms. This would result in additional calculations of K-factors which currently apply to trading book activities, as well as the need to define in detail which own capital and liquidity investments belong to the trading book. This additional complexity of the framework is being proposed by the ESAs without any evidence to justify it. We also believe that the proposal, implied in Section 4.8., to set a hard limit for non-trading book exposures to manage the concentration risk is unjustified.

[6] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRD).
[7] Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRR).
[8] Regulation (EU) 2024/1623 of the European Parliament and of the Council of 31 May 2024 amending Regulation (No) 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor (CRR 3).
[9] Directive (EU) 2024/1619 of the European Parliament and of the Council of 31 May 2024 amending Directive 2013/36/EU as regards supervisory powers, sanctions, third-country branches, and environmental, social and governance risks (CRD 6).

b) Prudential consolidation

We would also like to object to the proposed alignment of the regulatory scope of consolidation regulated in Art. 7 IFR with the provisions of Art. 18 CRR (Section no. 8 of the Discussion Paper). We are of the opinion that current provisions of the IFR were a result of a proportionate approach being taken by the EU legislators and as no evidence is being provided by the ESAs to the contrary, we do not see reasons that would justify this additional complexity.

Overall, we are of the opinion that instead of additional requirements being added to the IFD/IFR provisions, what should be considered is whether the framework is fulfilling its initial objective of creating a proportionate prudential framework for investment firms that would also allow them to compete with non-EU entities. The further replication of elements from the CRD/CRR framework goes against the intent to recognise specificities of investment firms and distinguish these from credit institutions.

Section 9: Interactions of IFD and IFR with other regulations

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?

First and foremost, EFAMA would like to strongly oppose the approach taken by the EBA and ESMA to consider amendments to the AIFMD/UCITSD, while the European Supervisory Authorities (ESAs) have been given no mandate to do so under the review of the IFD/IFR framework. This refers both to the suggested changes in the capital requirements for UCITS management companies and AIFMs, as well as limitation to the amount of MiFID services that they can provide. Neither Art. 66 of the IFD, nor Art. 60 of the IFR, include these areas in the scope of the review clauses. As a result the Commission's Call for advice[10] does not refer to the capital requirements established for those entities, nor to any other provisions of AIFMD/UCITSD either. The Commission is seeking instead input on "*interactions between investment firms and other financial activities (and their specific regulatory frameworks, such as UCITS and AIFM), and determine whether changes would be required to IFR/IFD to better reflect risks resulting from those interactions*." Despite this clear direction given by the Commission, no changes to the IFD/IFR framework were proposed in the Discussion Paper in this regard. Differently, the ESAs appear to signal an intent to change other, sector-specific frameworks.

Moreover, we emphasise the fact that a comprehensive review of both the UCITSD and the AIFMD has just been finalised, with the amending Directive 2024/927[11] published in the Official Journal of the EU only on 26 March 2024. In the context of the ongoing discussions by policymakers on how to develop a Capital Markets Union (CMU) to compete with non-European jurisdictions, regulatory stability is key. Especially for frameworks such as UCITSD and AIFMD which have proven to be effective and efficient in achieving the purpose for which they were established. Moreover, the capital requirements for AIFMs were analysed during the Commission's consultation carried out in preparation for the recent review[12]. Among other topics, specific questions were asked about the capital requirements for AIFMs carrying out also MiFID services under Art. 6 of AIFMD and the need for them to correspond to the requirements for investment firms carrying out identical services. As a result of the input provided by stakeholders, the Commission did not put forward

[10] European Commission, Call for advice to the EBA and ESMA for the purposes of the reports on the prudential requirements applicable to investment firms, 1 February 2023 (Call for advice).
[11] Directive (EU) 2024/927 of the European Parliament and of the Council of 13 March 2024 amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, the provision of depositary and custody services and loan origination by alternative investment funds (Directive 2024/927).
[12] Financial services – review of EU rules on alternative investment fund managers (europa.eu).

any amendments in this area[13]. As such, we strongly believe that it would be disproportionate to re-open the UCITSD/AIFMD provisions on capital requirements, when a comprehensive review of the framework has just been finalised. It can have a daunting effect on the market participants' perception of the legal ecosystem that they operate in and its stability.

In response to the proposed way forward to impose additional capital requirements on UCITS management companies and AIFMs, we would like to highlight that the business model of these entities vary significantly in comparison to credit institutions and investment firms. UCITS management companies and AIFMs do not trade on their own books, they do not hold clients' assets, and instead act only on clients' behalf, which constitutes the very nature of their "agency" business model. Moreover, the depositary ensures that the funds' cash flows are properly monitored, that all payments made by or on behalf of investors have been received and that all the cash of the fund has been booked in cash accounts opened in the name of the fund, or of the manager (acting on behalf of the fund), or in the name of the depositary. These specificities, together with the high level of substitutability in the management companies sector, mean that a default of a UCITS management company or AIFM would not pose financial stability risks, unlike in the banking sector. As a result, capital requirements were introduced in AIFMD/UCITSD for business continuity reasons, to ensure the operation of a management company as a going concern, rather than to cover prudential risks such as credit, market or liquidity risk.

The possibility to authorise management companies to provide MiFID services, including management of portfolios of investments in accordance with mandates given by investors on a discretionary and client-by-client basis, was first introduced by UCITS III[14] in 2002. Through this change, capital requirements for management companies, as well as other provisions on governance etc., have already been calibrated to cover the operational and business continuity risks of such activities. Competent authorities, while granting authorisations, are also required to ensure that UCITS management company or AIFM has sufficient *initial* capital in accordance with Art. 9 of IFD, having regard to the nature of the MiFID service it provides (according to Art. 6(4) of UCITSD and Art. 6(6) of AIFMD which refer to Art. 12 of MiFID I[15] - currently Art. 15 of MiFID II[16]). We are not aware of any evidence over the past twenty years, since management companies were allowed to acquire authorisations for MiFID services, that would justify reopening the debate on capital requirements for UCITS management companies and AIFMs. Instead, both UCITSD and AIFMD have proven to be robust frameworks, with well calibrated capital requirements, as well as other safeguards.

EFAMA therefore deems that an effective and risk-based approach for asset management company prudential requirements is already in place under UCITSD and AIFMD and any changes thereof would only create additional and unnecessary complexity. Instead, and as requested by the Commission, it should be considered whether the capital requirements in IFD/IFR framework are well-tailored for investment firms and whether amendments should be proposed to align them with AIFMD/UCITSD.

[13] European Commission, Proposal for the Directive of the European Parliament and of the Council amending Directives 2011/61/EU and 2009/65/EC as regards delegation arrangements, liquidity risk management, supervisory reporting, provision of depositary and custody services and loan origination by alternative investment funds, Brussels 25 November 2021.

[14] Directive 2001/107/EC of the European Parliament and of the Council of 21 January 2002 amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with a view to regulating management companies and simplified prospectuses (UCITS III).

[15] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (MiFID I).

[16] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive2011/61/EU (MiFID II).

<u>EFAMA would also like to express its even stronger objection against the second way forward suggested by the ESAs, i.e. introduction of requirements limiting the amount of provided ancillary services by UCITS management companies and AIFMs</u>.

Firstly, we would question the assessment of the management companies' authorisation for individual portfolio management as an "ancillary service". Neither Art. 6(3)(a) of UCITSD nor Art. 6(4)(a) of AIFMD justify such conclusion, as they list the management of portfolio investments separately from ancillary services (i.e. investment advice or safekeeping and administration of units that are categorised by both directives as "non-core services" (Art. 6(3)(b) of UCITSD and Art. 6(4)(b) of AIFMD)).

<u>The ESAs' proposal in fact contradicts the primary purpose that was behind the introduction of these permissions for additional activities</u>. As mentioned in the recital 13 of the UCISTD (echoing recital 9 of UCITS III): "*With regard to the scope of activity of management companies and in order to take into account national law and <u>permit such companies to achieve significant economies of scale, it is desirable to permit them also to pursue the activity of management of portfolios of investments on a client-by-client basis (individual portfolio management)</u>, including the management of pension funds as well as some specific non-core activities linked to the main business without prejudicing the stability of such companies*.". Economies of scale are by definition related to the size of the business, which allows for the spreading of costs over a larger number of services. Moreover, as individual portfolio management is connected with the main activity of UCITS management companies and AIFMs, it allows its promotion and development.

<u>We are of the opinion that the introduction of any limits to the amount of individual portfolio management services could make these activities unviable, and as such impede the further development of CMU.</u> It would most likely force the reestablishment of separate UCITS management companies/AIFMs and investment firms authorised under MiFID, and hence introduce inefficiencies and additional costs, without any added value. These would affect not only financial services' groups, but also competent authorities by increasing the number of individual regulated entities and adding complexity to the supervisory oversight of asset managers. As a logical consequence to these inefficiencies, what might be expected is the increase of outsourcing arrangements. In circumstances when financial services' groups would not be able to justify separate entities performing the same investment activity, they would outsource individual portfolio management services from UCITS management companies/AIFMs to the MiFID investment firms. It would also create a barrier to entry for management companies that could still consider providing MiFID services and hence limit the level of competition on the EU market.

<u>As a result, we see the proposed limitation as overly restrictive and disproportionate, with no benefits for any participant of the investment market, from investors, to the European industry, and finally to competent authorities and their supervisory processes.</u>

Section 10: Remuneration and its governance

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?

EFAMA appreciates the effort taken by the ESAs to look into the differences between frameworks on remuneration applicable to UCITS management companies/AIFMs and different types of investment firms, as expressed in Art. 66(a) of the IFD and questions 27 to 30 of the Discussion Paper. <u>However, we would also question the necessity of achieving uniform provisions in this area</u>. <u>While all frameworks on</u>

remuneration introduced in the financial sector (in CRD, IFD, MiFID and AIFMD/UCITSD) stem from common principles on sound remuneration, they also need to take into account the specificities of each business activity and therefore differences are inevitable.

We would like to highlight the lack of comparability between business models and risks of UCITS management companies/AIFMs and vast majority of investment firms or credit institutions operating based on the provisions of CRD/CRR. As was already outlined, UCITS management companies/AIFMs operate in a very different way compared to credit institutions. They do not directly hold assets, but rather than that they are under the keep of depositaries. Assets do not "run through" the balance sheet of management companies, as is the case for credit institutions. As management companies operate under an "agency" business model and fiduciary duty, they act for and based on the investment objectives of their investors. Therefore, governance on remuneration, however relevant, plays out against a distinctly different background. This is reflected in the remuneration regime introduced under the UCTSD and AIFMD, which, as a result, may depart in some areas from the bank-specific remuneration principles under CRD. To recall, EBA in its own December 2015 Report on Investment Firms[17], recognised the different pay structures being natural to business models other than those of banks.

It is also important to bear in mind that differences in activities carried out by these entities, mean that they also require different professional qualities and recruit different types of employees. In case of UCITS management companies / AIFMs the bulk of their teams is dedicated to the management of funds and as such they seek qualities on certain typology of financial instruments. For investment firms, which among others have the ability to distribute different types of financial instruments, skills in the area of distribution and target markets can play a bigger role.

As such, we are not aware of any practical implications of existing differences for the ability to recruit and retain talent. In general, the level-playing-field in this area has been achieved from the very beginning as all remuneration frameworks were based on the FSB Principles for Sound Compensation Practices and G20/OECD Principles of Corporate Governance. Provisions in this area have already reached a high level of complexity and their implementation was a significant effort, therefore we would be very cautious in introduction of any further changes and would consider only those that could bring simplification.

As such, what could be suggested and what would allow for a better alignment of the remuneration policies with the activities of a particular entity, would be the possibility for subsidiaries being a part of capital group to apply their sector specific provisions on remuneration. This is already the case for investment firms covered by CRD, where Art. 109(4)(a) allows subsidiaries to apply different remuneration policies if they are subject to sector-specific EU legislation (e.g. AIFMD/UCITSD). This is however not the case for the provisions of IFD and therefore we would suggest alignment of Art. 25 IFD and Art. 109(4)(a) of CRD in this regard.

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 would like to refer to issues raised already in our response to question no. 27. In our opinion the guiding principle underpinning remuneration practices and regulations is to ensure an alignment of the identified staff's managerial incentives with the types of activities carried out by particular type of entity and risk-

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[17] EBA, Report on investment firms. Response to the Commission's call for advice of December 2014, EBA/Op/2015/20, p. 78.

adjusted returns for investors. As such we see the AIFMD/UCITSD requirements on governance and identification of relevant staff as sufficient and would oppose introduction of any thresholds in this regard in the AIFMD/UCITSD remuneration framework.

We would however like to highlight a different area, where we see a strong need for better adjustment of remuneration provisions to the entities and categories of staff that they cover. The Delegated Regulation 2021/2154[18], which supplements IFD rules on "identified staff", does not sufficiently recognise in our opinion the principle of proportionality. As it mirrors rules imposed on relevant staff by CRD framework, it fails to address the specificities of investment firms that are subject to the IFD framework and not CRD rules. It is in our opinion unjustified to apply to them the same rules as CRD when in fact the implementation of the IFD framework was initiated by the need to create a set of simplified rules, better tailored to the specificities of these types of 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 would like to refer to issues raised already in our response to question no. 27, as we see no need to amend the remuneration frameworks under AIFMD/UCITSD.

What could however be suggested in case of the IFD framework is the introduction of more flexibility in terms of the catalogue of instruments that could be used for the pay-out of variable remuneration within groups where different entities are subject to different regimes. IFD in Art. 32(1)(k) provides that "*by way of derogation from point (j), where an investment firm does not issue any of the instruments referred to in that point, competent authorities may approve the use of alternative arrangements fulfilling the same objectives*". In our opinion, such approval should not be necessary if these alternative arrangements consist of the same instruments as are being already used by other entities from the same group. For example, an investment firm being a part of a capital group that includes a UCITS management company or AIFM could use also fund-linked instruments as alternative arrangements, without the need of approval by the competent authority.

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.

We would like to refer to issues raised already in our response to question no. 27. We would be against increasing requirements on oversight, disclosure and transparency, included in the AIFMD/UCITSD

[18] Commission Delegated Regulation (EU) 2021/2154 of 13 August 2021 supplementing Directive (EU) 2019/2034 of the European Parliament and of the Council with regard to regulatory technical standards specifying appropriate criteria to identify categories of staff whose professional activities have a material impact on the risk profile of an investment firm or of the assets that it manages (Text with EEA relevance).

remuneration framework as it has no implications on the possibility to recruit or retain appropriate staff. Any additional, more stringent rules in this regard would mainly lead to additional costs, implementation efforts and overall burden in fulfilling obligations, which is not in line with the objective of the European Commission to reduce the reporting obligations. To the contrary, we believe that IFD/IFR requirements on disclosure and transparency (i.e. reporting to the NCA) could be streamlined, and made less granular.

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EFAMA

ABOUT EFAMA

EFAMA is the voice of the European investment management industry, which manages about 28.5 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors.

Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities. EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the EFAMA Fact Book.

More information is available at www.efama.org

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