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Arguments on the Revised Framework for Investment Firms

The European Commission's proposals for a new supervisory regime for non-bank and non-systemic investment firms (IFR/IFD) relate in particular to investment firms with a MiFID license, which limit their activities to offering portfolio management, investment advice, receiving and transmitting orders and executing orders. The new regulations fundamentally redefine their own funds requirements and impose additional new organisational/governance requirements, reporting obligations towards competent supervisory authorities and make changes to their supervision as such (powers of intervention and sanctions).

General concerns

The new proposal would not lead to a simpler and more risk-based prudential regime for firms which are currently excluded from the CRR definition of "investment firm". These firms are not required to comply with the CRD/CRR framework completely because they are not authorised for holding client money or securities belonging to clients or to deal on own account (hereafter: limited licensed investment firms). Especially the following countries would be affected by the proposal[1]: UK (1172), Germany (596), Netherlands (160), Liechtenstein (120), Luxemburg (52), Austria (48), Ireland (40), Denmark (32), France (20). The high number of new articles in the area of internal governance, transparency and reporting (more than 100 new articles with additional delegated acts in contrast with the current CRD/CRR regime of only four articles[2]) to be applied to limited licensed investment firms, in addition to the revised MiFID and EMIR framework, **creates a major regulatory and administrative burden for smaller firms.**

1. Categorisation of limited licensed investment firms: As long as sized-based thresholds determine the "Class" categorisation of these firms (size per se is not necessarily a risk factor), some of the limited licensed firms will inevitably be Class 2 firms with additional/stricter requirements compared to Class 3 firms. Due to volatile size-based factors in the portfolio management sector, the categorisation of limited license firms could change several times a year and would create legal uncertainty.

BVI's suggestion: *There is a need for a much simpler approach for limited licensed firms. This could be implemented in such a way that limited licensed firms are placed on an equal footing with small and interconnected investment firms ("Class 3" investment firms) without sized-based thresholds. As an alternative, it should be at the national discretion of regulators or national authorities to decide if some rules of the new system should apply to limited licensed investment firms or not, taking into account the specific business models in each Member State.*

2. Unlevel playing field for investment firms compared to UCITS or AIF management companies: There is an unlevel playing field in prudential requirements for investment firms, in particular for portfolio managers or advisors, as compared to management companies licensed under the UCITS Directive or the AIFMD. This is a result of the 'cut and paste' requirements of the CRD developed for (systemic) credit institutions and which do not reflect the special business models of non-systemic investment firms, in particular not of those investment firms with a limited licence for which these kinds of CRD requirements currently not apply. This applies, in particular, to the new extensive disclosure requirements (Part Six of IFR draft) and to the following issues:

- **Country-by-country reporting**: The intention of this kind of reporting was an outcome of the financial crises for banks to inform the public about their activities and earnings including tax savings of their branches within other countries. This situation is completely different and in no way comparable with the

[1] Source: https://ec.europa.eu/info/sites/info/files/171220-investment-firms-review-staff-working-document_en.pdf.
[2] Articles 4(1)2)c), 95(2) in conjunction with Article 92 or Article 97 CRR.

business of non-systemic investment firms and their branches. There is no obvious reason for such requirement for non-systemic investment firms.

- **Remuneration:** The proposed requirements for variable remuneration (Article 39 IFD Draft) apply, in principle, for any variable remuneration (also very small ones) granted and paid by an investment firm to its staff (including the pay-out rules for instruments, deferral, malus/clawback). This is much stricter than the requirements for credit institutions or UCITS or AIF managers, where it is limited to relevant categories of staff identified by the undertaking. Moreover, as a result of the cut and paste of CRD requirements, the requirements for the pay-out in instruments do not fit for the earnings and structures of asset managers. The proposed disclosure requirements do not take into account that the remuneration requirements currently applicable to institutions under the CRD are amended for investment firms in an appropriate and proportional manner. Therefore a need for the same level of disclosure as required for credit institutions is inconsistent. In this context, it is also questionable why there is a need for detailed Delegated Acts to define instruments and identify the categories of individuals whose professional activities have a material impact on the investment firm`s risk profile. This applies all the more as ESMA has already established special remuneration guidelines for the services provided by MiFID investment firms.

BVI`s suggestion: *In order to avoid an unlevel playing field compared to UCITS or AIF management companies, there is a need to review and, where required, to amend the internal governance, disclosure and reporting requirements for investment firms providing portfolio management, investment advice, receiving and transmitting of orders and executing orders in an appropriate and proportionate manner.*

3. Inconsistencies with regard to the portfolio management of collective investment undertakings: The management of collective investment undertakings (CIU) such as UCITS or AIF is strictly regulated under the UCITS Directive and AIFMD. These requirements also encompass cases of delegation of portfolio management. In practice, UCITS or AIF managers often delegate the portfolio management of the CIUs to third parties such as other UCITS or AIF managers with a licence under the UCITS Directive or the AIFMD, or to investment firms with a MiFID license. In these cases, the investment firms also act as fund managers when they provide management services to CIUs by means of outsourcing agreements. However, the proposals of the IFD and IFR do not fully take into account the sector-specific requirements for UCITS or AIF which reflect the risks of management of CIUs.

- **Capital requirements (Article 20(2) IFR Draft)**: Because of the existent rigorous and exhaustive capital requirements for management companies under the UCITS Directive or the AIFMD, the K-factor of assets under management (AuM) excludes all delegated assets under management. In this context, it is inconsistent that the new K-factor of client orders handled (COH) should include transactions executed by investment firms providing portfolio management services on behalf of investment funds. Such an approach would penalise the portfolio manager in fulfilling its portfolio management activities by way of delegation because such higher capital requirements do not apply for other managers, to which the portfolio management of investment funds could also be delegated. This would lead to a competitive disadvantage for portfolio managers with a MiFID license.
- **Reporting of concentration risk (Article 34 IFR Draft):** AIF or UCITS managers with a licence under the UCITS Directive or AIFMD are already required to report all relevant risks (including concentration risks of its managed CIUs) to competent authorities, including the delegation of portfolio management. Therefore, it would lead to a kind of double reporting if an investment firm which provides portfolio

management by means of delegation to the CIU also would be required to report concentration risks of the CIU.

- **Disclosure (Article 46 IFR Draft):** The proposed new disclosure requirements are too far reaching as long as these requirements also affect the risks of CIUs, in particular with regard to the risk management objectives and policies for each separate category of risk including the strategies and processes to manage those risks (an ITS will specify templates for disclosure).

BVI suggestions: *Any rule with impact on the management of CIUs must be reviewed and, where required, amended. In particular, the rule that transactions executed on behalf of investment funds should be included in the K-factor COH should be deleted. There should be a clear exemption for the exposures of CIUs.*

4. New category of "significant investment firms": The new IFD and IFR shall only apply to non-systemic investment firms. Hence, there is no need for implementation of rules which under the CRD/CRR are required for systemic credit institutions only (such as the obligation to establishing a remuneration committee or a risk management committee). This applies for the proposed rule that Member States shall determine which investment firms are considered "*significant*" in terms of their size, internal organisation and the nature, scope and complexity of their activities. This could lead to a new classification of investment firms outside European legislation with different approaches within Europe and would undermine the general assessment that the IFD and IFR should only apply to non-systemic investment firms. Moreover, it would also result in an unlevel playing field for non-systemic investment firms compared to non-systemic credit institutions, for which a similar categorisation of "*significant*" credit institutions does not exist under the CRD. It is of utmost importance that any new requirements for investment firms are not significantly stricter than those that currently apply under the CRD/CRR.

BVI suggestions*: Any references to "significant" investment firms should be deleted.*

5. Group context: The exemptions proposed for individual investments firms being part of a group (Article 6 IFD) are limited to banking groups; thus there is an unlevel playing field for other sector specific groups with special prudential requirements such as under Solvency II. Moreover, there is double regulation for investment firms being part of a banking group (Article 109 CRD) , which would be obliged in addition to conform to divergent provisions to fulfil the IFD/IFR on an individual basis: The group approach under Article 109 CRD also involves subsidiaries which are part of a banking group and to which the CRD does not apply (such as investment firms under the IFD/IFR in future). Furthermore, the intended scope of group regulation (Article 23(4) paragraph 1 IFD-Draft) is not clear. An additional regulation of investment firm-only (sub-) groups within banking or insurance groups would cause disproportionate administrative burdens and could even lead to conflicting requirements and supervision. Finally, the new group approach (Article 23(4) paragraph 2 IFD-Draft) also involves subsidiaries that are financial institutions, in particular UCITS or AIF management companies for which sector-specific rules already apply. This would also lead to further double regulation for UCITS/AIF managers as subsidiaries of investment firms.

BVI suggestions: *There is a need also to include specific references to insurance groups required under the Solvency II Directive within the exemptions proposed for investment firms being part of a group. In considering existing sector specific requirements, any kind of double regulation must be avoided.*

6. Competent authority: A completely new regime for investment firms outside the banking requirements should be clearly supervised by securities regulators and authorities, especially ESMA. It is not appropriate that ESMA should have a purely consultative role.