Frankfurt,
18 February 2022

BVI[1] Position on draft guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) under IFD

In general, we propose to reduce the overall scope of the draft guidelines. Many of the requirements contained therein are already covered by other EBA guidelines (e.g. on internal governance). We have the impression that due to the large number of regulations and the complexity of the requirements, the draft is increasingly moving away from the original objective of the IFD to reduce the overall supervisory requirements for investment firms in comparison to banks and to make them more risk- and principle-based. This in particular applies to investment firms which neither hold clients' assets nor deal on own account, such as portfolio managers or investment advisors.

Furthermore, we understand the approach of the EBA to address ESG risks in the draft guidelines as a high-level approach and to develop further guidelines for the inclusion of ESG risks in the SREP in the future, primarily focusing on the assessment of the potential impact of ESG risks on the business model, internal governance and risk management. We support such a two-step approach. However, we definitely see the need to further discuss the final outcome of the EBA report to cover ESG risks in the internal processes of investment firms which was not part of the consultation process. In particular, we were very surprised by the results, especially as we had made further proposals for this. As the topic is very complex, we propose to hold further discussions in which we are happy to provide support and technical input (please see our answer to question 11). However, with view to the proposals made in these drafted guidelines, we strongly disagree with singling out mere ESG risks as a key vulnerability to which the investment firm's business model and strategy expose it or may expose it (please see our answer to question 2).

Question 1: *Do you agree with the proposed categorisation and the proportionate approach to the application of the SREP to different categories of investment firms?*

We agree with the categorisation approach, however, further clarification is needed to help market participants prepare for the upcoming SREPs.

- **Group approach:** Under Title 1 and Title 2 it is currently not defined whether additional SREPs would be carried out for investment firms, which are part of a union parent investment company, or if it is sufficient to conduct the SREP only once on the parent level. We propose to clarify either in Section 1.3 of Title 1 or in Title 11 that it is sufficient to conduct the SREP only on a parent level basis while taking into account the specificities of each regulated legal entity within the group.

- **Decision-making process:** Clarification is needed on the decision-making process of categorising investment firms. According to Title 2, paragraph 9.iii and paragraph 11, competent authorities may have the right to overwrite quantitative categorisation based on qualitative criteria such as the amount of client money held and the risk profile of the investment firm. Currently it is detailed

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

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neither how much qualitative insights are weighted when determining the final categories, nor what is considered (except for a high-level description of complexity and size). An approach that provides transparency in the decision-making process vis-à-vis the supervised investment firm could be helpful to allow market participants to assess and challenge the results as necessary.

Question 2: Do you agree with our proposal regarding business model analysis? Are there any other drivers of business model/strategy that you believe competent authorities should consider when conducting the investment firms' business model analysis?

- **Assessing the sustainability of the investment firm's strategy**: Title 4, section 4.8, letter c) of paragraph 86 of the draft guidelines states that the sustainability of the firm's investment strategy is, among others, based on the risk level of the strategy (i.e. the complexity and ambition of the strategy compared to the current business model) and the consequent likelihood of success based on the investment firm's likely execution capabilities (measured by the investment firm's success in executing previous strategies of a similar scale or the performance against the strategic plan so far). We understand that an investment firm's ability to execute its strategy is assessed via performing a plan-to-actual analysis by the competent authorities. However, it would benefit market participants to further understand how overly ambitious plans are identified and how they are distinguished from unforeseeable economic circumstances. Clarifying the regulators' intentions would be most effective through the provision of an example. Furthermore, we propose to add a clarifying sentence to Title 4, section 4.8, which states competent authorities might take into account 'force majeure' events when evaluating the successful implementation of an investment firm's strategy.

- **Identification of key vulnerabilities (ESG risks)**: We strongly disagree with singling out mere ESG risks as a key vulnerability. The EBA itself has stated in its report on ESG risks that they are not a separate risk category, but rather a part of the known material financial risks. As far as the EBA would like to consider ESG risks, these must always be considered in the overall context of all material financial risks. Picking out an individual risk, moreover without a materiality feature, does not add any value to the risk assessment of a supervisory authority. We therefore propose to amend Title 4, section 4.9, letter g) of paragraph 88 of the drafted guidelines as follows:

> 'g. ~~***ESG***~~ ***material financial*** risks ***(including ESG risks)*** and their impact on the viability and sustainability of the business model and long-term resilience of the investment firm.'

Question 5: *Do you agree with the proposed criteria for the assessment of risks-to-capital? Does the breakdown of risk categories and subcategories provide appropriate coverage and scope for the supervisory review, having in mind various business models of investment firms?*

We do not have objections against the proposed criteria and breakdown of risk categories. However, we request further clarification on scoring.

- **Findings and scoring**: Tables 5-8 under paragraphs 190, 216, 245 and 269 of the draft guidelines summarise findings and scoring. Each table shows a risk score from 1-4. Scores 1 and 2 are assigned to low to medium inherent risk combined with adequate management and controls. Scores 3 and 4 are assigned to medium to high inherent risk combined with control deficiencies. It is not clear from the tables how the final score would be determined in case of high inherent risk combined with good controls.

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Question 6: *Do you agree with the proposed guidance for the setting and communication of additional own funds requirements?*

The impact assessment (opinion 7b on page 142) explains the rationale behind the communication of an absolute amount of additional own funds requirements and a relative amount of additional own funds requirements as a percentage of Pillar 1 requirement. The rationale is that the absolute amount may become less adequate over time, especially in case of significant changes in business activities and the risk profile of an investment firm. The proposal to complementarily introduce a relative amount of additional own funds requirements well addresses the proportional growth of the risk profile, but not a significant change in business activities leading to an uneven change of the risk profile following e.g. transformational events such as mergers or acquisitions. In case of transformational events, we consider an ad-hoc revision of the additional own funds requirements by competent authorities to be more appropriate than maintaining the relative amount of additional own funds requirements despite the increased administrative burden. The SREP guidelines should at least foresee alternatives to the mechanic approach, e.g. to allow investment firms to estimate themselves their Pillar 2 requirements until the next SREP.

Question 8*: Do you agree with the proposed guidance for the setting and communication of P2G? Would you consider it appropriate to express P2G not only as an absolute amount of own funds but also as a percentage of Pillar 1 own funds requirements? Please provide rationale for your views.*

We agree with the proposal and do not recommend introducing a relative Pillar 2 requirement because increased Pillar 1 own funds requirements do not necessarily lead to increased vulnerability to cyclical economic fluctuations. The opposite might be true under certain circumstances, e.g. in case of an increasing K-AuM requirement, which would strengthen the firm’s profitability due to higher fee revenues.

Question 11: *Do you have any views or suggestions with regard to appropriate incorporation of ESG risks within SREP, including any proposed methods or criteria for the assessment of ESG risks within SREP?*

As highlighted in our introductory remarks, we definitely see the need to further discuss the final outcome of the EBA report to cover ESG risks in the internal processes of investment firms which was not part of the consultation process. In particular, we were very surprised by the results, especially as we had made further proposals for this. According to the EBA report, investment firms (such as portfolio managers) should consider how ESG factors harm the financial position of their clients and have an impact on their own capital and liquidity position. However, according to initial practical analyses, ESG factors do not currently have an impact on portfolio performance and could therefore not be considered. Portfolio performance and could therefore not lead to damage to the financial position of clients. The EBA's approach is also contrary to the fiduciary approach, according to which, in principle, no performance is promised to the client. The analysis proposed by the EBA to assess how ESG factors may have an impact on the fees and commissions and other monetary gains that the investment firm may generate from the provision of portfolio management is also too complex and costly for investment firms acting as portfolio managers. A portfolio manager will not lose a client because he has not adequately assessed the ESG risks. This will always be a conglomerate of different reasons. Measuring such effects is almost impossible in practice. This applies even more as the ESG risks are not a separate risk category but are inherent to other material financial risks.

However, as long as the requirements for investment firms themselves are not appropriately defined and discussed, we cannot provide proposals for the SREP requirements. We therefore refer to our proposals already made last year. As the topic is very complex, we propose to hold further round table discussions in which we are happy to provide support and technical input, especially regarding the methods or criteria for the assessment of ESG risks within the SREP.

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