BVI[1] comments on the EBA Final Draft Regulatory Technical Standards on own funds requirements for investment firms based on fixed overheads under Article 97(4) of CRR (EBA/RTS/ 2014/01)

While we are overall supportive of the proposed 'subtraction approach' as currently outlined under Article 34a of the Final Draft RTS, we believe that this approach requires a minimum level of clarification on the definition of fixed overheads. Otherwise, the overall capital requirements could increase by a factor 5 or more for the German investment fund industry and become most volatile over time. This, however, is obviously not in line with the original intention to harmonise the calculation of capital requirements and to provide a clear definition of fixed overheads.

1. Profit transfers which are based on contractual profit transfer agreements

We do not agree with EBA's assessment that contract-based profit transfers would not be avoidable on a legal basis because they are based on a contract between a parent company and a subsidiary entity and therefore the subsidiary entity will have to fulfil the terms of the contract (cf. page 20).

With regard to the objectives of any own funds requirements based on fixed overheads of the previous year, there is no difference between distributions of profits (e.g. dividends) and profit transfers based on contractual profit distribution agreements. 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 expense. Only in cases of yearly profitability, the subsidiary entity is required to transfer all (or parts) of its profit to the parent company. 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 pay additional contributions. 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.

This fact distinguishes profit transfers from operative costs such as personnel or IT costs. These costs incur even in disadvantageous profit situations. Assigning contract-based profit transfers to the fixed overhead would lead to the paradoxical situation that under given operative costs, sound and highly profitable companies would be subject to much higher capital requirements than loss-making undertakings.

Moreover, a contractual duty to pay an (undefined) amount of profits is comparable to transaction-related costs (see Art. 34a(1)(d) and (e) Final Draft RTS) which depend on the business development that cannot be planned with certainty. These costs may be subtracted as variable costs even though they must be deemed "non-avoidable". Therefore, it is not comprehensible why a profit transfer that depends all the more on the business development has to be taken into account in the calculation of own funds. In particular, Art. 97 CRR does not differentiate between transaction-linked and profit-linked costs.

[1] BVI represents the interests of the German investment fund and asset management industry. Its 79 members currently handle assets of EUR 2.0 trillion in both investment funds and mandates. BVI enforces improvements for fund-investors and promotes equal treatment for all investors in the financial markets. BVI`s investor education programmes support students and citizens to improve their financial knowledge. BVI`s members directly and indirectly manage the capital of 50 million private clients in 21 million households. BVI's ID number in the EU register of interest representatives is 96816064173-47. For more information, please visit www.bvi.de.

BVI
Bundesverband Investment und Asset Management e.V.

Kontakt
Fon +49 69 15 40 90 0
www.bvi.de

BVI Berlin
Unter den Linden 42
10117 Berlin

BVI Brüssel
Rue du Commerce 20–22
1000 Bruxelles

BVI Frankfurt
Bockenheimer Anlage 15
60322 Frankfurt am Main

Geschäftsführung
Thomas Richter Hauptgeschäftsführer
Rudolf Siebel Geschäftsführer

Inclusion of profit transfers would trigger additional (one-time) regulatory capital demand in case of one-time revenues for example from the gain of selling assets or subsidiaries which in our view clearly creates no additional risk for the company.

Finally, the proposed treatment of contractual profit transfers would inevitably result in a double-counting of the same p/l component if there are multiple profit transfer agreements within a complex group structure. Such an approach would therefore be clearly inconsistent with common practice in prudential supervision and would put an unreasonable burden on the investment industry.

It should be noted that transforming profit transfer arrangements into dividend payments would not be a solution. In Germany, the reason for such agreements is the disadvantageous tax treatment of dividend payments. **Hence, we suggest clarification (e.g. via a recital in the final RTS) that contractual profit transfer agreements are to be regarded as part of "distribution of profits" within the meaning of Article 34a(1) of the Final RTS and should therefore be deducted before calculation of fixed overheads.**

2. Income taxes

For the same reasons as above, we request to **clarify that taxes on income which depend on the yearly profitability should not be treated as fixed** either. Income taxes only occur if the company is profitable and thus create no additional risk for the company.

3. Commissions and fees

It is a common approach that investment management companies receive a management fee from the funds for the management and servicing of the fund. In addition, a percentage of this management fee is subsequently paid to third parties (such as the distribution partners of the fund). In terms of accounting this is shown under commission expense (gross approach). The obligation to pay parts of this management fee to the distribution partners does not create any credit, market or operational risk which would need to be covered by additional regulatory capital.

Article 34a(1)(d) of the Final Draft RTS could be read in a way that such payments would not be deducted from the total expense because legally, they are not "contingent upon the actual receipt of the commission". Still, the investment firm is always able to finance the commission expense out of the commission income. In particular, it is inherent in the system of sales commissions that there always must be a positive commission income. Therefore, in the asset management area it is not appropriate to consider the commission expense under the own funds requirements.

Given that the regulatory needed capital (e.g. for commission expenses) is mainly driven by Assets under Management (and thus partly market driven) such an approach would lead to a volatile regulatory capital demand which in our view should be avoided.

Hence, we suggest clarification that commissions which are paid out of a funds' management fee should not be treated as fixed under Article 34a(1)(d) of the Final RTS.

Frankfurt am Main, 25.03.2014