Frankfurt am Main,
8 March 2018

Summary of BVI's position paper on a new prudential framework for MiFID investment firms

BVI[1] would like to thank the Commission for the opportunity to present the initial views of the German asset management industry. The following statements summarise the impact on the German market and our main concerns. Please note that we have some more detailed proposals for amendments which are not included in this paper but will be presented at a later stage.

I. General remarks

We welcome the initiative to develop a new prudential framework applicable to investment firms. The extraordinary number of regulatory reforms in the banking sector in the aftermath of the 2008 financial crisis has resulted in a complex legal system that is largely focused on credit institutions and that therefore requires a range of specific exemptions for non-bank entities like investment firms. **We therefore support the Commission's proposal to introduce a separate new framework in the form of a European Directive (IFD) and a directly applicable Regulation (IFR) on the prudential requirements of non-systemic investment firms outside the banking sector.** This could lead to better regulation which simplifies the application and implementation of the prudential requirements for investment firms. Separate prudential requirements, moreover, would allow a targeted supervisory process focused on the risks arising from the activities of investment firms.

The new IFD and IFR shall only apply to non-systemic investment firms. Hence, it is very questionable if there is a need for implementation of rules which under the CRD/CRR are required for systemic credit institutions only. **In this context, we strongly disagree 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 shall 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 such a 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 much stricter than those that currently apply under the CRD/CRR. This also applies for the country by country reporting.

In any case there is a need for achieving **a level playing field in prudential requirements for asset managers.** In particular, many of the proposed new rules would lead to much stricter requirements and disproportionate burden for portfolio managers or advisors authorised as investment firms under the MiFID as compared to asset managers licenced as management companies under the Directive 2009/65/EC ("UCITS Directive") or the Directive 2011/61/EC ("AIFMD"). This applies all the more for the new proposed requirements on capital (K-factor approach), reporting, disclosure, internal governance and remuneration for asset managers which do not qualify as small and non-interconnected investment firms. In this regard, it must be noted that most portfolio managers provide services on behalf of in-

[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. Fund companies 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 over 100 members manage assets of some 3 trillion euros for private investors, insurance companies, pension and retirement schemes, banks, churches and foundations. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

vestment funds such as UCITS or AIFs by way of delegation for which strict requirements already exist. Double regulation in the field of reporting and disclosure of risks of investment funds should be avoided.

In this context, it is a common understanding that the new prudential regime for investment firms shall not apply to UCITS management companies or AIF managers authorised under the UCITS Directive and the AIFMD. The prudential requirements of UCITS or AIF management companies are conclusively regulated by these European Directives that reflect the specific risks of their special business models irrespective of whether or not they also provide MiFID services. In the same manner, it is our understanding that these management companies could never qualify as credit institutions in the meaning of the proposed new definition because they are not authorised to take deposits or other repayable funds from the public and to grant credits for their own account as well as to carry out MiFID services such as dealing on own account and underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis[2].

This is also supported by the fact that any persons to whom the MiFID does not apply (irrespective of whether there are of reasons of legal exemptions in the meaning of Article 2 of the MiFID or optional exemptions in the meaning of Article 3 of the MiFID) are also out of scope of new prudential requirements for investment firms.

II. Impact on the German market

Germany represents about 700 MiFID investment firms, accounting for nearly one quarter of all firms affected by the new initiative. The vast majority of these firms (about 600) is currently exempt from the CRR definition of “investment firm” because they are only authorised to provide MiFID services such as portfolio management, investment advice, reception and transmission of orders in relation to one or more financial instruments or execution of orders on behalf of clients without a licence to hold client money or securities belonging to clients or to deal on own account. They are not “institutions” as presently defined in the CRD IV framework and therefore not required to comply with the CRD IV framework completely. They are only required to fulfil the current capital requirements of Article 95(2) of the CRR. All other requirements of the CRD/CRR framework, as those pertaining in particular internal governance such as disclosure and reporting do not apply to these firms. According to the EBA’s analyses of the population of all concerned firms by category there are a total of about 870 investment firms in the EU with such a limited licence.

Germany, therefore, is the biggest market in this field. It is of utmost importance to carefully analyse whether the new framework applicable to firms with such a limited licence is workable, effective and proportionate. In particular, the new framework proposes more than new 100 Articles and a number of additional Delegated Acts that must be reviewed and implemented by these firms. By contrast with the current CRD/CRR regime with **only four Articles**[3] which apply to these firms, the new framework would require huge administrative intervention, measures and controls, and it would be very costly for the mostly small limited licence firms. This applies all the more as such firms are already subject to specific obligations relating to conduct, organisation and reporting requirements under the revised MiFID and EMIR frameworks There would be no rationale for the new regime to be superimposed on top of existing requirements.

[2] Activities referred to in points (3) and (6) of Section A of Annex I of Directive 2014/65/EU.
[3] Articles 4(1)2)c), 95(2) in conjunction with Article 92 or Article 97 CRR.

The new proposal with two categories of investment firms required by the IFD and IFR could lead indeed to a simpler prudential regime. On the other hand, such an across-the-board approach is not appropriate to consider the special business models and risks arising from the activities provided by limited licenced investment firms. In particular, as long as sized-based thresholds determine these firms' "Class" categorisation some of the limited licence firms will inevitably be qualified as "Class 2" firms, to which additional and stricter requirements would apply compared to the requirements proposed for "Class 3" firms (small and non-interconnected in the meaning of the drafted Article 12 IFR). Size-based-factors could be very volatile in the asset management sector. This could lead to the situation that the categorisation of the limited licenced investment firm can change over time and does not ensure legal certainty. Huge administrative burdens to change the internal systems and requirements would be the consequence. Moreover, these size-based factors could harm limited licence firms which provide activities slightly below the thresholds to create new business because they want to avoid the burden to comply with the requirements for Class 2 firms. Therefore, the proposed new regime is designed to create anti-competitive effects especially for limited licence firms.

In our view, there is no need for introducing stricter prudential requirements as proposed for Class 3 firms under a new framework in order to reflect the business models of such firms and to capture the risks faced and posed by them. Bearing in mind that the vast majority of these limited licence firms are relatively small sized firms and effective supervisory practices are already in place, it is questionable whether a modified regime should be enforced without practical need at this stage. Moreover, the EBA has not yet shown that the current requirements or the proposed requirements for Class 3 firms are not appropriate to cover the risks of these firms.

We are therefore calling for a very simple approach for limited licence firms. This could involve the need for significant changes to the proposed text of the IFD and IFR. In any case there is a need to require that limited licence firms are placed on an equal footing with small and interconnected investment firms ("Class 3" investment firms). As an alternative, this could also call for an approach that the national regulators or national authorities should have the power to decide if some rules of the new system should apply to limited licence investment firms or not, taking into account the specific business models in each Member State.

III. Group context

The CRD/CRR and the Solvency II Directive already state comprehensive prudential requirements on group level including a respective consolidated supervision by the lead group regulator. Such prudential consolidation sufficiently addresses the potential group risks stemming from the operations and/or wind-down of individual investment firm subsidiaries. **Therefore, it is incomprehensible why the exemptions proposed for investments firms being part of a group are limited to banking groups. There is a need to clarify accordingly by including also specific references to insurance groups required under the Solvency II Directive.**

In this context, under the new framework investment firms will no longer qualify as institutions in the meaning of the CRD. According to the group approach under Article 109 CRD, this would lead to the situation that subsidiaries which are part of a banking group and to which the CRD does not apply in the future would be required to implement the banking processes on internal governance requirements set out in Section II of Chapter 2 CRD. On the other hand they would be also obliged to fulfil the IFD on solo-level with deviating provisions. This includes, among others, processes regarding remuneration, internal capital adequacy assessment processes, internal governance and recovery and resolution plans, technical criteria concerning the organisation and treatment of risks. **Double regulation through the IFD on the one hand and CRD on the other should be avoided. Moreover, since the new requirements in the IFD are consistent with the requirements under the CRD, there is no need to extend the scope of the CRD to the non-bank entities such as investment firms subject to the IFD.**

Moreover, the new framework should be clearer and more consistent regarding the intended scope of group regulation being limited to investment firm-only groups. **It should be explicitly clarified that companies being part of a banking or an insurance group prudentially regulated under CRD/CRR or Solvency II are not considered part of an investment firm-only group and not regulated on group level under the IFD/IFR.** An additional regulation of investment firm-only (sub-) groups within banking or insurance groups would cause disproportionate administrative burden and could even lead to conflicting requirements and supervision.

According to the new group approach under the IFD, the internal governance, transparency, treatment of risks and remuneration requirements shall also apply to subsidiaries that are financial institutions as defined in Article 4(13) of IFR. This includes asset management companies (there is no definition within the IFR, but asset management companies are defined under the CRR as investment management companies authorised under the UCITS Directive or AIFMD). **It must be clarified that the group context of the IFD does not apply to subsidiaries already subject to special prudential requirements (such as described under the AIFMD or UCITS Directive).**

IV. Competent Authority

The relationship of EBA and ESMA and their tasks are not clear to us. A completely new regime for investment firms outside the banking requirements should be clearly required under guidance of securities regulators and authorities, especially ESMA.