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2 February 2017

Dear Sir / Madam,

Response to the European Banking Authority Discussion Paper – Designing a new prudential regime for investment firms[1]

About Baillie Gifford
By way of background, Baillie Gifford & Co, ('BG&Co') is an independent investment management firm based in Edinburgh. We manage about €170bn, almost wholly on behalf of institutional clients (many of which are pension schemes), and employ over 950 staff. The firm is a general partnership established over 100 years ago under the laws of Scotland and includes a group of companies which are authorised and regulated by the UK Financial Conduct Authority. The Baillie Gifford group provides one essential product to its clients, namely fund management.

Executive Summary
We welcome the efforts taken by the European Banking Authority (EBA) to engage with investment firms, and for the opportunity to comment on the proposal for a new prudential regime specifically designed for them. In preparing our response, we recognise the complexity of the task of devising a common framework for a diverse group of firms across Europe, as well as the constructive tone adopted in the Discussion Paper.

In summary, we strongly support the introduction of a regime that focuses on the specific activities performed by investment firms rather than a regime designed primarily to prudentially regulate banking activity which is then applied to investment firms as a secondary consideration. We are therefore supportive of a distinct regime rather than any regime which seeks to use the Capital Requirements Regulations and Directive ('CRR' and 'CRD') as the building blocks for the prudential regulation of investments firms. The proposal which is based on a principle of relevant, simple, and observable activity-based metrics driving a capital requirement is therefore a positive development, as is the proposal

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[1] EBA/DP/2016/02

A list of the partners' names is available at the above address.
Authorised and regulated by the Financial Conduct Authority.

INVESTORS IN PEOPLE

for the simplification of the regulations governing Own Funds and the recognition of the need for a specific reporting framework for investment firms.

In relation to the proposals set out in the Discussion Paper, the key areas we would highlight are summarised below. In the supporting appendices we have also provided more detailed responses to certain specific questions raised in the Discussion Paper.

Basis of Approach

We agree with the proposal to focus on the potential risks created by investment firms to their customers and to the markets in which they operate and, that the resulting capital requirements reflect the activities that they perform. In relation to the Risks to Firm (RtF), non-systemic firms should be allowed to fail in certain circumstances and the UK wind down requirements ensure that sufficient resources are available in this case. There is the potential to include other simple observable metrics which reflect the impact of specifics of a firm's business model, however there is clearly a balance to be struck between "simplicity" in the regime by defining a small number of simple activity based measures and having a regime which is more "risk focussed", but as a consequence more complex. The emphasis of the EBA appears to be on the former rather than the latter, and opportunities to enhance the regime with some scalar inputs which are already used by investment firms should not be ruled out as a consequence. The calibration will also be particularly important, in addition to ensuring that there are no unintended consequences by over simplifying activities and risks.

Use of K-Factors

We understand the desire to move away from measures which can be arbitraged through the application of accounting principles, and focus on capturing "activity levels" rather than "risks". We are supportive of this as one factor for the base calculation, with some observations around the specific definitions of K-Factors to be used and the need to apply an element of smoothing to avoid excessive volatility in capital requirements. An understanding of the EBA's expectations around external audit or certifications of the K-Factors is also necessary.

Liquidity Risk

We welcome the proposal for simple liquidity requirements for investment managers which are driven by their working capital requirements plus the ability to deal with stress events relevant to their specific activities.

Other Observations

The proposed regime is still at a formative stage and we have some observations on the current drafting that it would be helpful to clarify as the proposals develop. These include:

- Clarification of the proposed transitional arrangements, including timeframes and the relationship between the introduction of the new base calculation and the expected developments to the existing Pillar 2 and SREP regimes (referred to in the Discussion Paper as Additional requirements on an individual firm basis).
- Confirmation of the role of the wind down assessment beyond current requirements under the new regime, and the scope of work expected of investment firms. We see

this as essential if investment firms are to be regulated on a gone rather than going concern basis.

We would welcome the opportunity to discuss our comments with you, and engage with you further as the proposals are developed.

Yours faithfully

Graham Laybourn
Partner, Director of Compliance & Legal

Appendix 1 – Baillie Gifford responses to specific questions highlighted in the Discussion Paper

Topic	*Associated questions*	*Baillie Gifford response*
Principles for the proposed regime	Qu2	- Our overall views on the principles are outlined in the main letter. - We strongly support the introduction of a regime that focuses on the specific activities performed by investment firms rather than a regime designed to regulate banking activity which is then applied to investment firms as a secondary consideration. We are therefore supportive of a distinct regime rather than any regime which seeks to use the Capital Requirements Regulations and Directive ('CRR' and 'CRD') as the building blocks for the prudential regulation of investments firms. - The proposal based on relevant, simple, and observable metrics driving a capital requirement is therefore a positive development, as is the proposal for the simplification of the regulations governing Own Funds and the recognition of the need for a specific reporting and remuneration framework for investment firms.
Overall approach focussing on RtC, RtM and RtF	Qu5	- We agree with the proposals to look at the specific risks faced by investment firms and that these risks come primarily from the activities that they perform and not from balance sheet exposures. Basing the regime on the specific "activities" of investment firms should ensure that it is more appropriate to their business model and risks. - Risks to Clients (RtC) and Risks to Market (RtM) are reasonable overall categories on which to assess the activities of a firm and base the regime, however they are not clearly defined in the Discussion Paper. We also suggest that a single risk is not expected to lead to the failure of a firm, rather a combination of factors are likely to contribute to failure or significant pressure on the viability of the business. This is borne out by ICAAPs and reverse stress tests which consider a much more detailed range of risks in order for a firm to undertake their own assessment. For example, the main risk area is operational risk (those coming from activities and resulting in significant loss due to failure of processes, people or systems) which is usually broken down into a number of individual categories such as a dealing error, mandate breach or misselling and then separately assessed. Details of the specific nature of operational risks for investment firms were also recognised and set out in the EBA Report on Investment Firms (EBA/Op/2015/20). - We understand however that the intention of the proposed regime is not to replace this more detailed own risk assessment, with the priority being to establish simple measures which are comparable across the diverse range of investment firms rather than more detailed risk based measures which would necessarily be more complicated. - We think that the Risks to Firm (RtF) are less appropriate for agency asset managers. Credit risks are generally immaterial or

Topic	*Associated questions*	*Baillie Gifford response*
		too remote to require capital, however we understand that some measures are needed in order to provide a consistent regime across all European jurisdictions. - In addition there will clearly be other specific areas such as pension obligation risk and securitisation risk which may be faced by a subset of firms and we agree that this is better dealt with as part of a firms own Pillar 2 risk assessment (or equivalent under any new regime).
Comments on the K-Factors identified	Qu6	- We recognise the challenge to find good, simple, reliable and comparable measures of activity across a diverse range of firms. The discussion paper is a good basis for this, however as recognised in the paper each K-Factor will need more thought as they are developed over the coming months. The main themes relate to having a clear definition, ensuring volatility is smoothed, and determining the frequency of measurement and reporting to the regulator. - Clearly the K-Factors could be made more 'risk based' however this would reduce simplicity and comparability across investment firms, with the intention to get a more appropriate base calculation rather than replace Pillar 2. - The comments set out below on K-Factors are made in the context that the calibration is not yet available, so it is not possible for us to see the impact on regulatory capital or how different K-Factors might be weighted and combined with each other (for example to remove duplication). That said, our comments on specific K-Factors as set out in the Discussion Paper are as follows: Assets Under Management (AUM) - AUM is a simplistic, but a well recognised measure, however it would need a clear definition and also smoothing over time to be a viable measure. Although a useful indicator of size of a firm, it does not necessarily reflect activity or risks to customers given the potentially diverse nature of portfolios which could be managed. Risk to the customer does not necessarily increase as a firm becomes larger in a linear fashion, as arguably it reduces as improved processes and controls are adopted. To make this measure more proportionate, the nature or investments or client portfolio types could be reflected within this measure potentially through the inclusion of a revenue metric, however this would necessarily reduce simplicity. - In relation to the definition of AUM, a number currently exist within FCA regulations. If the sourcebook is solely for CRD entities then a definition that captures assets managed on a discretionary basis should lead to all delegated assets (i.e. those managed on behalf of UCITS/AIFMD regulated entities) being captured.

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		- Volatility is inherent in certain measures including AUM and a number of potential smoothing mechanisms exists e.g. use of 3yr historical average, use of y/end AUM which is only amended if changes by +/- a given % (potentially 10%). This is in line with the application of the CRD III FOR rules. By using averages or an annual reset mechanism, potential exists to embed some external verification of the metrics (akin to FOR using audited financials as the starting point). Customer Orders Handled (COH) - As with AUM, this K-Factor would need a clear definition and also smoothing over time to be viable. It is a simplistic although reasonable indicator of activity levels within the business (if number of trades is used), but not necessarily an accurate indicator of risk e.g. compare a listed equity order (large/non-complex) with a derivative order (smaller/more complex). - Different investment strategies could give rise to significantly different results from a COH perspective. Quantitative investment strategies may make significant number of small trades on a daily basis while fundamental strategies may make fewer, less frequent larger trades. We would be interested to understand the regulator's perspective as to which model exposes the customer to more risk. - Customer orders might also be defined differently across different firms and any definition will need to ensure that it does not influence behaviours and also to avoid the potential for 'gaming' the result. - A combination of AUM and revenue metrics could more appropriately model the "operational" risk faced by firms with different business models. For example, firms which engage primarily in the management of assets on a passive basis will have comparably lower revenue for same AUM. Again we would welcome the regulators thoughts on whether they therefore face a lower level of operational risk. - The proposal for all entities in the process chain to hold capital for "customer orders handled" could lead to a double count of capital in the system, depending on how the metric is defined. Client Assets - We understand the potential risk to customers from firms holding Client Assets (either protected or on balance sheet), but would wish to ensure that the real risk to customers is appropriately defined and reflected, as the common belief in the UK is that assets held in Client Money Bank Accounts are protected in the event of a firm becoming insolvent. However we recognise the desire to capture the activity of holding client assets rather than the specific risks associated with it, given different

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		accounting practises are followed across Europe. One way of taking this into account and encouraging firms to optimise their client money arrangements would be to permit a down scalar where client money is protected and ring fenced in a separate account. Proprietary Trading Activity (PTA) - Given the agency nature of our business model with no on account trading, we assume that this K-Factor would not be relevant or applicable. Calibration of K-Factors - We believe that calibrating the K-Factors based on data from the EBA data collection exercise and other regulatory returns is appropriate. - There remains a risk of double counting so clarity is needed on any interaction between measures and how the firm can reflect this in the assessment. One aspect of this is whether the focus of the K-Factors should be on values or volumes to reflect activity and whether this focus should be consistent across all K-Factors. Suggestions for other K-Factors and scalars - We welcome the opportunity to discuss alternative options as the K-Factors and scalars are developed over the coming months. Some alternative suggestions for consideration would be: o Size and complexity - rather than use a pure AUM measure should the K-Factor be a mix of a % of AUM + % of Revenue. This would bring together measures from Basel Pillar 1 for banks and UCITS/AIFMD requirements. o Scalars to reflect: ▪ Liquidity risk - this measure could take the average of ratio of cash to i) FOR, ii) % of any operational risk calculated iii) current liabilities, and iv) all liabilities and/or a combination of the above. The scalar would factor in a firm's ability to fund its known liabilities and potential liabilities in the event that revenue ceased immediately. A firm with less liquid resources would be required to hold more capital than a similar firm with more liquid resources. ▪ Business risk - a metric which considers current AUM v level of AUM required to cover fixed expenses ('breakeven AUM'). This would factor in the amount of AUM that a firm could bear to lose before being unable to cover its fixed

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		costs through revenue from that AUM. A firm with a smaller headroom would be required to hold more capital than a similar firm with a larger headroom. - Most of the data noted should be already be reviewed as part of a firm's regular management information or could easily be calculated from it.
Comments on the RtF uplift factor approach and assessment	Qu7	- We agree that the main focus of the regime should be on the RtC and RtM measures rather than the RtF. Investment firms operate an agency business, making decisions on behalf of a third party, and therefore can fail (and should be able to fail) without putting the assets of investors at risk. They do not typically take market exposures on their own balance sheet. The rules should focus on their key risks as a going concern (operational risk and business/financial risk) and aim to minimise disruption in the event of failure. - Rather than seeking to apply a capital uplift in the form of the RtF, we believe that for a non-systemic asset manager, the wind down requirements in the UK provide sufficient and appropriate assurance in this area. For UK regulated firms, the wind down requirements of a firm are considered on a gone concern basis with minimal additional measures being required to address the failure of the asset manager. Of primary concerns is the transfer of assets to a new manager or their return to the owners, as expeditiously as possible, whilst not causing undue market disruption. UK firms produce wind down analysis to support this, focussing on the costs of their plans to transfer assets in a controlled manner. - The financial weakness of a firm is also typically assessed via a scenario stress test of a fall in assets under management (and therefore revenue), including careful consideration of management actions which might reasonably be taken to mitigate the impact on profits. This provides a more meaningful assessment rather than focussing only on leverage as a proxy for risk arising in relation to the firm itself.
Use of the Fixed Overhead Requirement (FOR)	Qu9	- While there are shortcomings in the existing FOR rules we accept that this forms a basic calculation for the minimum capital requirement. The FOR calculation aligns, in the main, with the stated desire to have a regime that is based on simple observable metrics. FOR is an established calculation and one which can be reviewed by external parties for accuracy. - We accept that there is potential for the application of different accounting concepts to result in different FOR calculations, and consideration should be given to the likely prevalence of such treatments in the smaller firms that are most likely to have FOR as the driver of their capital requirement as opposed to the "K-Factor" calculation of capital. Overall though we support the continued inclusion of the FOR as a factor within the new regime, with the potential for improvements in certain areas.

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		- If FOR is retained then the rules could be made simpler. There are currently two sets of rules (CRDIII and IV). Both have been subject to differing application and interpretation across jurisdictions in the EU. Our proposal would be to have a clear starting point as we are aware that there have been different opinions as to which expenses should be included before deductions. The current FOR rules allow expenses to be deducted if they fall under a number of expense types, some of which may not be entirely variable and also require the inclusion of items of expenditure which are not entirely fixed. We therefore also support reducing the number of deductions available in the calculation of the FOR. By reducing the potential deductions the new regime would seek to try and avoid different FOR results for different business models with the same total cost base. For example, differences between a firm that retains activities within the firm (and therefore headcount and infrastructure costs which will be mainly fixed in nature) and a firm that outsources activities and is charged for the services on a basis that currently allows them to deduct them from the calculation of fixed expenditure.
Definition and types of capital, specifically any points relevant to partnership capital	Qu12 Qu13 Qu14	- We believe that the three key characteristics that any instrument should exhibit to allow classification as capital are i) Permanence ii) Ability to absorb losses iii) Gains/profits which are both realised and distributable. - From our individual perspective as an unlimited liability partnership we note that the EBA list of CET 1 instruments issued under CRR Art 26.3 (latest list October 2016) includes Partnership Capital (under Partnership Act 1890) as an eligible form of capital. There are many and varied forms of non joint-stock companies across the EU and we would recommend that a similar mechanism be included to that in the CRR which allows competent authorities to approve capital as CET1 (or its equivalent under an investment firm focused regime). - Permanence is obtained through existing CRR Art 28(f) which does not allow instruments to be reduced or repaid except in liquidation or with prior permission of the competent authority. This Article also ensures that no individual partner can withdraw capital unless the overall level is maintained by new subscriptions from existing or new Partners. Such a restriction should be included in any future regime to ensure permanence of capital is maintained. Such a restriction also addresses concerns around access to capital within the year, which would only be possible if the overall level was maintained. - Simplification – In our own circumstances (Partnership capital, Share Capital, occasional subordinated loans within group for start ups) the simplification would be welcome. However any simplification should not exclude existing or new entrants to the market. The key consideration for most investment firms' business model is to hold enough capital with the ability to absorb losses such that the business can continue in business long enough to discharge its obligations to its customers (in an orderly

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		wind down/completion of a sale process).
Initial capital definition and level	Qu17 Qu 18	- The existing initial capital regime is already relatively simple and the matching of these to regulatory capital would simplify this further. Any decision to remove or increase the lower EUR50,000 limit should include a transition period to allow smaller firms to build towards the new requirement. - We do not have a strong view of the minimum initial capital other than ensuring that the level should not unduly inhibit new entrants to the market.
Liquidity management rules and approach for an asset manager	Qu20, Qu21, Qu22, Qu23, Qu24	- We agree with the purpose of liquidity as stated in Para 115 – in effect, liquidity in investment firms is nothing more than working capital management. Like any business investment firms cannot function without sufficient cash to meet liabilities as they fall due but do not necessarily need fully liquid assets at all times. Working capital is also be managed across term deposits, receivables and payables. - We agree that the LCR is not an appropriate standard for investment firms and has no relevance for their business model. In an agency business, lending, investment or default risk are not relevant and do not sit on the balance sheet so should play not part in liquidity requirements. Banks are to investment firms what they are to all other non financial services commercial organisations – a place to provide a service to collect cash from their customers and make payments to their staff and suppliers. We don't lend to our customers or borrow from them. - Due to the agency nature of our business there is not the direct link to RtC/RtM in terms of requiring sufficient liquidity within our own balance sheet to cover withdrawal of assets. Within funds this is covered by the relevant fund regulations. - With regard to an additional liquidity buffer in excess of the "counter balancing capacity approach" the situations which cause liquidity stress in an agency fund management business are limited – any failed trades on behalf of segregated funds and within pooled vehicles are isolated from the liquidity of the manager. Intra-day liquidity risk does not arise for the investment firm in this scenario. - In terms of managing flows in and out of our pooled vehicles where these pass through the balance sheet of the investment firm, any short term bank facilities which the investment firm has arranged to cover any failure to receive cash for purchases until such time as cash is received, or the units cancelled, should be taken into account in considering liquidity needs. - Where liquidity stress might arise is in connection with an error made by the manager and that error has to be recompensed prior to recovery of amounts under their insurance policy. In our response to question 6 we suggest the potential to include a

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		metric which compares the estimated requirement for such an error with the level of cash resources held by the firm as part of an overall liquidity scalar. - With regard to the nature of liquid assets, any definitions need to recognise the simple nature of the balance sheet of investment firms with liquid assets generally held as deposits at banks and other financial institutions, gilts or cash funds. Consideration should also be given to the nature of receivables in the form of outstanding fees which are generally converted to cash on a regular and reliable basis. The consultation paper recognises the different nature of liquidity at investment firms yet the definitions at Appendix 4 from the Bank Account Directive are built around items typically found on the balance sheets of banks and use banking terminology throughout. For example, few if any fund managers have access to hold balances at central banks and cash in hand will be nothing beyond small amounts of petty cash. With regard to considerations of "short term" the EBA should have due regard to the tension resulting from the need for financial institutions to hold additional capital where they are in turn holding deposits for other institutions including investment firms. As a result, investment firms are finding it increasingly difficult to source deposits with maturity of less than 32 days. - In addition gilts/government securities should be considered liquid assets (with a haircut for low credit rated countries and for foreign currency exposure) along with accounts receivable (with a haircut for potential bad debts and to completely exclude any long outstanding amounts – say 30 days beyond terms).
Large exposures	Qu25	- We understand and accept that including a large exposure reporting regime could bring benefits to any proposed prudential framework. Any reporting required should focus on financial positions resulting from an investment firm's relationship with its clients and should not require the reporting of balances held on deposit with banks. - This proposal would raise awareness of potential counterparty concentration risk, both from an asset recovery perspective as well as a business model perspective, to the extent that an investment firm is overly reliant on a small number of clients, without imposing a requirement to hold capital that could potentially impact a firm's ability to continue to do business. Limits should be considered on trading firms which also act as a fiduciary to ensure low risk of contagion from issues in the trading book. For investment firms a more appropriate metric for concentration could consider the % of revenue from the top x clients. This measure would factor in the reliance that a firm has on a small number of clients. A firm with a more concentrated client base would be required to hold more capital than a similar firm with a more diversified client base. - We do not believe that any reporting regime should include the large exposure reporting on balances in client money accounts.

Topic	***Associated questions***	***Baillie Gifford response***
		Any balances that have been protected are not included on the balance sheet of the firm as the firm does not hold legal title.
Group risk, implications for investment firm only groups	Qu26	- We support the proposal to attempt to regulate, on a consolidated basis, groups which include a number of investment firms. - The risks associated with a regulated firm being part of a group are two fold. Firstly where the firm and the entirety of the group are regulated by the FCA/EBA, the financial position or financial results of the regulated firm could be adversely impacted by the activities of unregulated entities in the group. In this case, the model proposed in the discussion paper is relevant. A second fact pattern exists when the regulated firm or group is part of a wider group which carries on activities beyond the scope of the FCA/EBA and the risk to the financial position or financial results of the regulated entities comes from the activities of those foreign entities or from the demands placed on the regulated entities by foreign holding companies. - To clarify the above, we do not believe that a dual regulated entity, for example FCA and SEC regulated, should be subject to a higher requirement as a result of the dual registration as the entire operations of the firm as subject to FCA supervision and prudential requirements. - While the first risk is potentially easier to quantify and certainly easier to legislate, the risks from overseas entities need to be factored in. We accept that this may not be easy, but it is relevant as EU regulations may be more stringent than other regulatory regimes. Consider the number of regulated entity failures in UK/EU compared to SEC corporate failures in the US. This risk to the regulated firm could be included in the proposed K-Factor model through comparing the AUM of the entities regulated in the EU to the global group AUM and applying some factor of this to the RtC factors proposed. - In relation to the first risk, the proposal, where a group waiver exists, to ensure that the holding company holds more capital than the value of any loans and investments in subsidiary entities is, on the face of it, a sensible proposal. This would ensure that the stability of the group would not be compromised in the event that one or more the subsidiary companies became loss making. Any contingent liabilities included in the assessment would introduce an element of subjectivity, something we understand the EBA is keen to avoid. - The proposal may however have unintended consequences, especially where a groups has been restructured. Certain tax regimes require the transfer of companies and/or businesses to be done at market value. This value may well be significantly in excess of the book value of any investment. In this case the holding company may have investment values that have been artificially inflated with the corresponding increase in reserves uplifting a reserve that may not be treated as capital as it would not be realised or distributable. This is a specific consideration that should not detract the EBA from the proposal to

Topic	*Associated questions*	*Baillie Gifford response*
		appropriately reduce the burden on groups of companies that include a number of investment firms.
Burden of regulatory reporting	Qu29	- We fully support the requirement for firms to report relevant, accurate information to the regulators on a timely basis. This information should allow the regulators to assess an investment firm's financial position and financial performance on an historical basis, as well as providing sufficient information to allow the regulator to make an assessment as to the future viability of each firm. This forward looking assessment could be used to allow the regulator to supervise firms on a more targeted basis, focusing on those firms that may pose most risk to customers as a result of their likelihood and impact failure. Furthermore any well designed reporting regime should allow regulators to benchmark firms within countries and across Europe. <u>CRD III</u> - We accept that the volume of reporting is not overly burdensome under CRD III. The current reporting is not however specifically designed for investment firms. We would support any future regime that ensured the data points reported were specific to investment firms and not adopted from legislation designed for banks. This would allow the collection of more meaningful data upon which the regulator may adopt a focused supervision regime based more than just upon size. <u>CRD IV</u> - The current CRD IV reporting regime places a disproportionate burden on investment firms. The regime was designed to enhance the prudential reporting for banks and was imposed on investment firms as a secondary consideration. - As a result, the volume data that firms are require to collate and report is significant and not always relevant to the business model of an investment firm (e.g. asset encumbrance reporting) or the risks that investment firms are exposed to (e.g. credit risk reporting). There is an increased the risk that users and reviewers of the information in the submissions are unable to see key trends due to the sheer volume of information requested in the numerous submissions. - The framing of capital adequacy in the current regime not easily understandable. Expressing capital adequacy in relation to 8% of Total Risk Exposure Amounts, which in turn are calculated by applying percentages to balance sheet values or by scaling up an FOR by 12.5, is not intuitive. As a result of this complexity, those responsible for the approval and oversight of the

Topic	*Associated questions*	*Baillie Gifford response*
		prudential reporting for investment firms will find any critical review and assessment of the returns very challenging. This is exacerbated by the fact that CRD IV did not carry forward the requirement in CRD III to notify the FCA in the event that a firm's capital adequacy fell below 110%. This notification limit served as a useful benchmark to allow those charged with governance to assess the appropriateness of the firm's current adequacy. Use test - We believe that any proposed reporting regime should collate prudential information from investment firms that does more than confirm historical financial position and performance. The disclosure of historical information is essential to allow regulators to assess compliance with prudential requirements as they relate to capital adequacy. Additionally, it can confirm the strength or otherwise of the firm's balance sheet which may provide insight into the ability to withstand a significant event, but the focus on historical results alone will not assist in considering future prospects for that firm. - Potential exists for the regulator to request information from firms that is already collated and reported to senior management on a regular basis. This information is likely to include: o Assets under Management (AUM) ▪ Historical point to point data ▪ Breakdown of the movements in AUM that arise from client inflows, client outflows, market movements and foreign exchange movements. o Projected financial information – revenue and profit for the next 12 months/rest of the financial year - We believe that using the same information for the supervision of investment firms that is widely used by management of the same firms has a number of benefits. Over and above the efficiency from a reporting perspective it will help the regulator to assess the firm from a similar perspective as management.
Other prudential tools and disclosures	Qu30	Other prudential tools - We do not believe that it is appropriate that the focus of the prudential regime is on recovery and resolution plans for firms which conduct business on an agency basis. However, ensuring a smooth transition and orderly wind down of a firm where it is no longer viable should be a consideration.

Topic	*Associated questions*	*Baillie Gifford response*
		Disclosure - We do not believe that the public disclosure of regulatory returns in their entirety would provided any additional value to external stakeholders. The current volume of data included and the level of complexity in aspects of the reporting coupled with the likelihood that users will have insufficient detailed knowledge of the requirements could lead to incorrect conclusions being made. - Any public disclosure requirements should focus on ensuring that any disclosures contain simple, relevant and understandable information for users that is focused on what should be held and what is held in terms of capital and liquid resources. - Any set of simple measures, consistently disclosed should allow stakeholders to benchmark firms. Ideally these measures will be a subset of information to be disclosed to the regulator. This will aid both efficiency of preparation, but more importantly will ensure consistency between what the regulator and public are provided.
Prudential remuneration framework for investment firms	Q33	- We believe that remuneration structures for investment firms should be designed for alignment with the risk adjusted returns over the medium to long term for their clients, reflecting the fiduciary nature of the relationship. This should be differentiated from the regulatory principles underpinning remuneration regimes for credit institutions which look to mitigate excessive risk taking from dealing on their own account by using the firm's balance sheet. - The agency based nature of investment firms typically leads to revenues based upon fees earned on discernible performance over a defined period and typically this will be based on assets under management. A remuneration framework should therefore reflect a fully flexible remuneration policy where variable remuneration can rise or fall in line with revenues and performance of client portfolios. The inclusion of limits on the amount of remuneration or the ratio of fixed to variable is not appropriate for an agency manager as to require a greater amount of fixed remuneration would increase fixed costs and could result in the need for cost cutting in severe market downturns. - A remuneration regime should include the elements of performance being assessed in a multi-year framework geared towards the long term, and with appropriate governance and oversight to avoid conflicts of interest or behaviours which are not in line with sound risk management. The nature of these arrangements should be capable of being designed proportionately, in line with the nature, scale and complexity of the organisation. - A pay-out process which includes an element of deferral for a portion of variable remuneration, and which can be subject to malus provisions during the deferral period is also not inconsistent with the aims of the asset manager in delivering longer term

Topic	*Associated questions*	*Baillie Gifford response*
		returns to its clients.
Separate prudential regime for investment firms	Q34	- We support the proposal for a separate prudential regime for investment firms. The current regime was designed for banks and is not relevant to investment firms for a number of reasons, not least the significant burden it places on firms under CRD IV to collate and report data to meet requirements more suitable to banks. - We understand that there is potential to amend the current regime, but we have a number of concerns as to the effectiveness of this approach in meeting the overall aim of having a proportionate regime based on simple observable metrics. - We are uncertain how easy it would be to amend the current requirements to make them more proportionate. One concern would be if this involves carving out large elements of the requirements, would this make the application of the rules no less complex or subjective? We would be concerned that any attempts to amend the current prudential regime would result in a negotiation between lawmakers as to which requirements should be included and which excluded. To the extent that any trade off resulted there is potential that the effectiveness of the new regime would be compromised. - For the reasons noted above, we believe that the most efficient and effective way to develop a fit-for-purpose prudential regime is to start from a blank page and assess the activities performed by firms, how they have the potential to impact stakeholders and how a firm can calculate a capital requirement against observable measures that are, in the main, already calculated and monitored by senior management within the investment firm.
Main problems from an investment firm perspective with the current regime	Q35	- The current framework is not appropriate for investment firms as it was designed primarily to regulate banking activity. As a result it creates a large number of problems for investment firms, some examples of which are set out below: - There is more than one sourcebook (CRDIII and CRDIV) that groups of firms need to be able to apply. Both are lengthy and the need to apply one sourcebook or the other is not intuitive and is based on specific MiFID permissions rather than being aligned to prudential categorisation (e.g. €50k or €125k). - As the CRD requirements are written with the activities of banks in mind, investments firms find the interpretation and application of the current CRD IV sourcebook overly complex and subjective. As a result there is too much scope for interpretation leading to different but justifiably different positions being adopted by firms. - The standardised approach to credit risk required under CRDIV is not appropriate for investment firms. Significant work is required to stratify the balance sheet receivables into numerous categories which were designed for banks. Further detailed work is required to assess if clients have a credit rating, which is rare for the companies contracting with investment firms, to

Topic	*Associated questions*	*Baillie Gifford response*
		apply a risk weighting based on that credit rating to assess the credit risk capital required to be held against that exposure. All this work is required to calculate a risk that is not relevant to investment firms. - The current sourcebook does not adequately deal with non-joint stock company firms, more prevalent in the investment firm population than in banking. - On a comparable basis the application of CRDIV can lead to higher capital surpluses, than under CRD III, due to the treatment of material holdings (element risk weighted under CRDIV or not required to be deducted under Article 49(2).). This seems counter intuitive if the aim of CRDIV was to strengthen the quality of capital held by firms. - The focus of the current Pillar 1 requirements is not appropriate for investment firms as they do not use their balance sheet to derive revenue. The result of this focus is that the level of capital calculated under Pillar 1 is significantly lower than calculated by firms as part of the internal assessment required under Pillar 2 which focus on the specific risk to the firm based on the business it conducts and the risk management framework that the firm has implemented. KPMG, in their annual review of the ICAAPs of investment firms in the UK, highlight the quantum of the Individual Capital Guidance ('ICG') provided to firms by the Financial Conduct Authority ('FCA'). These ICGs suggest the existing Pillar 1 regime is not effective in ensuring firms hold adequate levels of capital to mitigate the specific risks they face. - The volume and complexity of reporting is not proportionate to the risk faced by investment firms. There are a significant number of data points requested that relate to the activities of banks and as such investment firms are not required to report. Significant work is required by firms to be able to reach the conclusion that a nil submission is appropriate, however, as the terms used do not naturally align to the operations of an investment firm. - The framing of capital adequacy in the current regime not easily understandable. Expressing capital adequacy in relation to 8% of Total Risk Exposure Amounts, which in turn are calculated by applying percentages to balance sheet values or by scaling up a FOR by 12.5 times, is not intuitive. As a result of this complexity, those responsible for the approval and oversight of the prudential reporting for investment firms will find any critical review and assessment of the returns very challenging. This is exacerbated by the fact that CRD IV did not carry forward the requirement in CRD III to notify the FCA in the event that a firm's capital adequacy fell below 110%. This notification limit served as a useful benchmark to allow those charged with governance to assess the appropriateness of the firm's current adequacy.