Frankfurt,
10 March 2022

BVI[1] Position paper on the EBA's consultation paper on Draft Regulatory Technical Standards on the specific liquidity measurement for investment firms under Article 42(6) of Directive (EU) 2019/2034

The new framework shall enhance the ability of the investment firm to achieve a more 'orderly wind-down' in the event of failure. In principle, our members which are covered by the Draft Regulatory Technical Standards (Draft RTS) on the specific liquidity measurement for investment firms under Article 42(6) of Directive (EU) 2019/2034 have sufficient liquid own funds to function in an orderly manner over time without the need to set aside liquidity specifically for times of stress. There can therefore only be exceptional cases in practice where they are exposed to liquidity risks or liquidity risk components that are not or not sufficiently covered by the prudential liquidity requirements. We are not aware of any such cases so far. This applies even more as our members providing portfolio management or investment advice of an ongoing nature hold in principle their own funds in liquid assets (such as unencumbered short-term deposits at a credit institution or highly liquid investment funds) as a whole (and not limited to an amount of at least one third of the fixed overhead requirements). Therefore, in purely practical terms, there are no conceivable cases in which the competent authority would still have to increase the minimum liquidity requirement because our members already provide higher liquidity than it is required. This would have to be distinguished from higher capital requirements, which, however, are not affected by this consultation paper.

Question 1: *Where respondents are of the view that the draft RTS should define other elements of liquidity risk, comments are most helpful when they clearly describe the alternative elements of liquidity risk that competent authorities may use to assess whether liquidity risk is adequately covered by Part Five of IFR.*

We would like to highlight that we disagree with the general assumption that losses of income from portfolio management or investment advice of an ongoing nature should be qualified as a special liquidity risk which is not covered or not sufficiently covered by the liquidity requirements set out in Part Five of IFR and which can impose stronger liquidity requirements. We therefore ask that this approach be critically reconsidered. We refer to our answers to question 2 for further explanations.

However, we would like to suggest clarifying the Draft RTS regarding liquidity risk stemming from loss in income from portfolio management. In our view, only the losses of income that affect the company (and not the portfolio managed in trust for clients) and are related to portfolio management (e.g., loss of fees or loss of the client due to poor service provision) may be relevant here. As an alternative, the wording in **Recital 3** and **Article 1(3)** of the Draft RTS could therefore be amended as follows:

Recital
(3) To further ensure proportionality, this Regulation requires the assessment of elements that are deemed to be material for investment firms. These firms that meet the conditions for qualifying as small and non-interconnected investment firms set out in Article 12(1) of Regulation (EU) 2019/2033 have a limited

[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.

material liquidity risk relative to other investment firms. Against this background, this Regulation provides that, for these firms, competent authorities should at a minimum assess the liquidity risk stemming from the loss in income ~~*from*~~ ***at investment firms providing*** portfolio management, the funding risk and the group structure relevant to liquidity.

Article 1
'3. Competent authorities shall assess the following:
(a) liquidity risk stemming from trading activities or from loss in income ~~*from*~~ ***at investment firms providing*** portfolio management in accordance with Article 2;
[…]
For investment firms that meet the conditions for qualifying as small and non-interconnected investment firms set out in Article 12(1) of Regulation (EU) 2019/2033, competent authorities shall, at a minimum, assess points (a), (b) and (g), while the assessment under point (a) may cover solely liquidity risk stemming from loss in income ~~*from*~~ ***at investment firms providing*** portfolio management.'

Moreover, it seems that **Article 1(3)(g) of the Draft RTS** contains an erroneous reference to Article 4(1), point (13), of Directive (EU) 2019/2034. The correct wording should be Article ***3***(1), point 13), of Directive (EU) 2019/2034.

We do not see the need to define other elements of liquidity risk that competent authorities may use to assess whether liquidity risk is adequately covered by Part Five of IFR.

Question 2: *Are the requirements for liquidity from trading activities or from loss in income from portfolio management or investment advice of an ongoing nature sufficient? Should market risk on liquidity be relevant only for investment firms providing or performing investment services and activities referred to in paragraph 1 of this Article?*

As mentioned in our answer to question 1, we do not see the need to highlight losses of income from portfolio management or investment advice of an ongoing nature as a special liquidity risk which can justify stronger liquidity requirements. We therefore ask that this approach be critically reconsidered.

In general, an investment firm should be expected to have sufficient cash or other liquid assets as own funds to pay for its obligations while winding down. Article 43 of the Regulation (EU) 2019/2033 (IFR) requires a minimum amount of liquid assets equivalent to at least one third of the fixed overhead requirements. In this context it is of utmost importance to distinguish between the liquidity risks of own funds based on Article 43 IFR and the liquidity risks of portfolio management's assets or portfolios/assets under advice of an ongoing nature. In our view, the Draft RTS does not yet elaborate on this difference in a meaningful manner. Rather, the impression is that the liquidity risk of the portfolio management's assets or losses of income of the portfolio managed are what should be important here. In our view, only the losses of income that affect the company (and not the portfolio) and are related to certain investment services (e.g., loss of fees or loss of the client due to poor service provision) may be relevant here to assess potential need to impose stronger liquidity requirements for own funds.

As an example: A portfolio manager holds its own funds only in cash deposits. The liquidity risks from changes in the value of the portfolio's asset prices and subsequent losses on portfolio level do not have an impact on the liquidity of the cash deposits. Only a fee earned by the investment firm from portfolio management could be reduced by certain events (e.g. poor execution of the service or reduction of assets under management as a benchmark of the fee). Thus, in a very theoretical case of an accumulation of such events, the statutory own funds may no longer be sufficient to pay any liabilities with liquid own funds. It would therefore have to be examined whether such events have an influence on the minimum amount of liquidity to be held. Furthermore, this question is to be distinguished from the question of whether the investment firm has enough capital to cover its risks in avoiding insolvency.

In our view, these risks mentioned above are already covered by the own capital requirements based on the K-factor AUM (assets under management) or the fixed overhead requirements. Moreover, losses of income at the portfolio level must be borne by the portfolio management client as a general investment risk.

The same applies to investment firms which provide **investment advice of an ongoing nature.** The risk of losses of fees earned by an investment advisor are already covered by the prudential capital and liquidity requirements of the IFD and IFR. This is all the more true because the K-factor AUM now explicitly takes into account ongoing investment advice and can thus in practice lead to higher own funds than was the case before the introduction of the IFD and IFR. In this context, it is of utmost importance to clarify that an advisor only gives a recommendation to its clients. The final decision whether or to which extent to invest in a financial instrument will be taken by the client. A client of an advisor may only suffer losses where an investment firm provides inadequate investment advice on which basis the client has made an investment decision. From a prudential perspective, the advisor has to ensure that the firm is well organised to avoid such inadequate recommendations and that the firm has sufficient own liquid capital to cover legitimate claims resulting from this liability only. Therefore, any risk to which an investment adviser is exposed must be linked to the question of whether this is based on a lack of internal standards. In our view, this question is not linked to a specific liquidity risk which is not already covered by the IFD/IFR framework.

These assumptions must be considered in the Draft RTS. As an alternative, the wording of the headline of Article 2 of the Draft RTS could therefore be amended at least as follows:

'Article 2
Liquidity risk stemming from trading activities or from loss in income *at investment firms* ~~from portfolio management~~'

Question 3: *This article identifies the items in Table 3 of Article 324 of Regulation (EU) No 575/2013 that are more relevant for liquidity risk of an investment firm. Are there any other operational risk events materially relevant to the liquidity risk of an investment firm?*

No. We do not see any other operational risk events materially relevant to the liquidity risk of an investment firm.

Question 4: *Are there any other elements of reputational risk that would significantly affect an investment firm's liquidity risk?*

No. We do not see any other elements of reputational risk that would significantly affect an investment firm's liquidity risk.

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