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European Banking Authority
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Submitted via online portal

03 September 2020

Dear Sir/Madam,

AIMA's response to EBA/CP/2020/06 – Draft Regulatory Technical Standards related to implementation of a new prudential regime for investment firms.

The Alternative Investment Management Association Limited (AIMA)[1] appreciates the opportunity to submit its comments to the European Banking Authority (EBA) in relation to its consultation on its Draft Regulatory Technical Standards ('RTS') to specify the methods for measuring the K-factors (Article 15(5), point a) and on prudential consolidation of investment firms groups (Article 7(5)) of the Investment Firm Regulation ('IFR') (the 'draft RTS').

We appreciate that the EBA has developed the draft RTS in accordance with its mandates under Article 7(5) and Article 15(5) of the IFR. Although we support the draft RTS in principle, we believe that, in their current form, important aspects of the measurement of the Risk-to-Client ('RtC') K-factors as proposed in the draft RTS require express clarification to assist our members in preparing for the significant changes which IFR will introduce. We have set out our members' comments in the Annex to this letter.

In particular, we think it is crucial that the EBA clarify that the term "financial entity", which is used in the K-AUM calculation in the context of delegation arrangements, includes non-EU entities. Limiting the term "financial entity" to EU firms may result in material additional regulatory capital

[1] AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 1,900 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 170 members that manage $400 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, www.aima.org.

being required for firms that are delegates of non-EU investment firms. We note that relevant third-country firms are already required to meet their own local regulatory capital obligations in respect of their management activities, even if these may not be based on an assets under management (AUM) calculation in all jurisdictions. It would, therefore, be disproportionate to require the asset management group to capture the potential risk to client that the K-AUM factor is concerned with, twice. As the EBA states in paragraph 50 of EBA/CP/2020/06, the text of Article 17(2) IFR "does not actually state explicitly about one of the entities having included the relevant amount of AUM within an AUM-based capital requirement".

We also have concerns around the application of the unified management test and the significant influence test which could cut across concepts already established in other areas of law and regulation and create material uncertainty for AIMA members. In particular, we would welcome clarification from the EBA that these tests are matters for national competent authority determination and may be rebutted depending on the facts and circumstances of any given arrangement.

In addition, although not specifically dealt with in the EBA's questions for consultation, we also want to raise two further issues.

First, AIMA notes the absence of a transitional regime for investment firms that are not subject to an existing capital adequacy directive framework (i.e., CRD IV/CRR and CRD III) and whose capital requirement is driven by the fixed overheads or K-factor requirement. Given the potential for these type of firms to face material uplifts in their current capital requirement, and while we note this may not be an issue that can be addressed in revisions to the draft RTS, we urge that additional transitional relief be considered. Not doing so could see such firms face immediate and material increases to their regulatory capital requirements in June 2021. Given the additional challenges firms are meeting in response to Covid-19, we think that introducing such a transitional regime is very important.

Secondly, for AIMA members who could potentially be considered as "small and non-interconnected investment firms" ('SNI'), there is uncertainty around the term "investment firm". It is important that this is clarified as it feeds into investment firms' ability to qualify as an SNI and may also impact how certain of the calculations (i.e., those required to be undertaken at a group level) are carried out. The uncertainty here relates to whether this term is only meant to cover EU authorised MiFID investment firms. We think that it must, given it is the most natural interpretation of this provision having regard to the wording of the IFR and the anti-avoidance purpose of the group aggregation provision.

We would be happy to elaborate further on any of the points raised in this letter. For further information please contact Jennifer Wood, Managing Director, Global Head of Asset Management Regulation & Sound Practices, at +44 (0) 20 7822 8380 or jwood@aima.org.

Yours faithfully,

ANNEX

In addition to the points raised in the letter, we have responded below to some of the individual questions asked in the consultation paper. Questions on which we had no comments have been omitted, but the order and numbering of the remaining questions has been retained for clarity.

Question 1. Is the proposed articulation of the K-factor calculation methods, in particular, between AUM and CMH and ASH, exhaustive or should any other element be considered?

We generally support the approach that the EBA has taken to avoid certain data being double counted in the K-factors. However, we have some observations on the methodologies which are discussed below. In addition, we also support the EBA's view that AUM is calculated using fair value.

In relation to K-AUM, while AUM does not need to be counted twice when it is the subject of a delegation by a "financial entity", we note that this term is not defined in IFR. We consider that paragraph 50 of EBA/CP/2020/06 could be read to imply that (in the EBA's view) the term "financial entity" only encompasses, very broadly, EU AIFMs, other EU MiFID investment firms and UCITS management companies. We believe that the EBA should clarify that the term may capture any type of financial firm, so as to properly reflect the often cross-border and international nature of investment firms' businesses. We note the EBA's comment in paragraph 50 of EBA/CP/2020/06 that the text of Article 17(2) IFR "does not actually state explicitly about one of the entities having included the relevant amount of AUM within an AUM-based capital requirement", and we do not think there is any good reason to exclude firms from the concept of a "financial entity" just because they are not European, or because they are subject to a different (but equally well respected) scheme of prudential regulation (including one which may not use AUM as the basis for calculating the delegating third-country firm's capital requirements). Otherwise the asset management group would have to capture the potential risk to client that the K-AUM factor is concerned with, twice – which we do not think would be proportionate or within the spirit of the rules.

From the draft RTS, it appears that where an investment firm undertaking discretionary management appoints another investment firm to provide it with investment advice of an ongoing nature then this is not to be regarded as a delegation. The effect of this is that the firm providing investment advice is required to include the assets subject to this advisory mandate within its K-AUM. We believe this creates double counting, which is what the delegation provision is designed to avoid. In our view, the EBA's language restricts the position unnecessarily.

In addition, with regards to the calculation of K-AUM for non-discretionary advisory arrangements, we believe these should be limited to firms that have committed to provide non-discretionary advisory services to their clients (e.g., private wealth managers providing discretionary management services to clients), rather than entities providing advice to their EU or non-EU affiliate firms which by their nature will be of an ongoing nature. The latter case should be excluded from the K-AUM calculation to avoid double counting and also to ensure a more proportionate application of the regime to such entities (noting that the affiliates they provide advisory services to will also have local capital requirements which should help cover the potential risk to the underlying end clients).

Question 6. Do you have any comments on the elements included in this Consultation Paper for the application of the aggregation method?

Although we do not have any specific comments on the aggregation method, we do have concerns around the application of the unified management test (which leads to prudential consolidation using the "aggregation method" under the draft RTS) and also the significant influence test (which leads to prudential consolidation using the "full consolidation" approach as set out in the draft RTS).

As general background, it appears that elements of the draft RTS impose additional glosses to the "soft" tests for prudential consolidation, which materially expand their scope. By way of example, the draft RTS envisages that:

- one firm may have significant influence over another if there are material transactions between the two entities, interchange of management personnel and provision of critical services; and

- two firms may be "managed on a unified basis" if their governing bodies are composed of individuals who are appointed by the same person (without majority board overlap).

The concepts of managed on a unified basis and significant influence are already used in other contexts and their meaning is well understood. We think the EBA's proposed approach may create tensions between different sets of rules or result in anomalous results, under which a firm needs to take one approach for the purposes of IFR and a different approach under other regimes.

In relation to the concept of "significant influence without participation or capital ties" in particular, the hallmarks of significant influence provided for in Article 3(2) of the draft RTS on prudential consolidation of investment firms groups are, we think, too broad and (i) could be difficult to apply; (ii) could create uncertainty; and (iii) may not reflect the correct relationship between an investment firm and other firms (within the scope of consolidation) with whom it may share personnel, services or a commercial relationship. Such firms, whether in a group context or otherwise, would not typically consider the provider of such personnel or services to be exercising significant influence over it, for example. It is possible that protections could exist in relevant governance or contractual documentation that would preclude, or be inconsistent with, such a conclusion. We strongly encourage the EBA to clarify that the hallmarks set out in Article 3(2) are not determinative and may be rebutted depending on the facts and circumstances of any given arrangement.

We welcome the express clarification in Article 4(2)(c) of the draft RTS providing that it is for national competent authorities to assess, on a case-by-case basis, whether two or more firms are placed under single management having verified whether in practice there is sufficient coordination of the firms' financial and operating policies. We consider that the same approach should be taken in relation to determining whether one firm exercises significant influence over another. We urge the EBA to give certainty to firms by issuing express clarification to this effect.