

MEMO# 30571

February 9, 2017

ICI Global Submits Response to EBA Discussion Paper on a New Prudential Regime for Investment Firms

[30571] February 9, 2017 TO: ICI Members

Investment Company Directors

ICI Global Members SUBJECTS: International/Global RE: ICI Global Submits Response to EBA Discussion Paper on a New Prudential Regime for Investment Firms

In November, the European Banking Authority (“EBA”) published a discussion paper on the design of new prudential requirements for European Union investment firms (“Discussion Paper”).^[1] The Discussion Paper responds to a European Commission (“Commission”) Call for Advice requiring the EBA to specify “the appropriate design and calibration of all aspects of a new prudential regime specifically tailored to the needs of different business models of firms and the risks that their operations present.” Consistent with the Commission’s articulation of the mission, the Discussion Paper envisions (1) an approach that better captures the risks of investment firms and (2) harmonized requirements that are reasonably simple, proportionate, and more relevant to the nature of an investment business.

ICI Global’s comment letter focuses on the implications of the Discussion Paper for investment firms that are asset managers, and in particular those that manage regulated funds such as UCITS (“asset managers”). It observes that the proposal has the potential to bring positive change to the existing prudential framework for investment firms which, as the EBA has observed, has a number of significant flaws. The letter notes, however, that the Discussion Paper lacks essential details without which we and other stakeholders cannot assess with any precision the impact of the proposal. It also expresses ICI Global’s concern that certain aspects of the proposal appear too rooted in banking and do not appropriately reflect the business and operations of asset managers. A more detailed summary of ICI Global’s comments on the Discussion Paper is provided below.

Summary of Comments

- ICI Global supports the development of a prudential regime for investment firms that is not based on the bank-oriented Capital Requirements Directive/Capital Requirements Regulation.
- The experience and expertise of capital markets regulators is essential to sound financial policymaking outside the banking sector. We therefore urge the EBA (and later, the European Commission) to include the European Securities and Markets

Authority and its constituent capital markets regulators—and those entities to engage—as full partners as this initiative moves forward.

- Under the EBA’s proposed classification scheme, asset managers (including managers of regulated funds) most likely would fall into Class 2—the class described as “not systemic and bank-like.” We take strong exception to a suggestion in the Discussion Paper, however, that size could equate to “systemic” status in the case of an asset manager. The EBA instead should focus on the activities in which an asset manager engages, as the Financial Stability Board recently has done.
- Consistent with the EBA’s recommendation, any prudential requirements should be calibrated to address the specific risks posed by a firm. For an asset manager (such as a manager of regulated funds), this means risks to the firm’s balance sheet and not market or other risks associated with regulated fund or other client assets. Those risks belong to clients, who knowingly bear them.
- Any prudential regime that would apply to asset managers should take into account the risk-mitigating effects of existing regulation and professional indemnity insurance. In the case of managers of regulated funds, existing laws such as the UCITS Directive already apply prudential requirements calibrated to address the specific risks posed by the activities in which these entities engage. We believe the EBA should conclude that those requirements are sufficient. Should the EBA decline to follow this recommendation, however, we offer additional comments on prudential requirements in the asset manager context.
 - *Capital requirements.* ICI Global cautions against reflexive use of capital requirements for addressing all types of risks in the financial sector. Given the fundamental differences between banks/credit institutions and asset managers, the purpose to be served by any capital requirements that would apply to asset managers must be well explained and appropriately reflect risk differences. Although the EBA seems to intend to incorporate such differentiation, the Discussion Paper does not provide enough detail to assess the precise impact of the proposed approach—*i.e.*, a capital floor (for wind-down) with “add-ons” based on “k factors” designed to serve as “observable proxies” for a firm’s particular risks.
 - Two of the proposed k factors—assets under management and assets under advice—raise specific concerns because they incorrectly suggest that an asset manager’s size is a reliable indicator of the risks it poses to customers or markets. Such an approach departs from the idea of a regime calibrated based on an investment firm’s activities—which, in our view, is the appropriate place to focus.
 - *Liquidity requirements.* For asset managers, any liquidity requirements should *not* be intended to address liquidity management of managed assets/customer accounts, and minimum requirements therefore should be sufficient.
 - *Macro-prudential supervision.* We urge the EBA to hold off on any further consideration of the use of macro-prudential tools for investment firms until the Commission completes its pending, comprehensive review of the EU macroprudential framework.
 - *Remuneration.* ICI Global strongly believes that remuneration requirements need to take into account the nature of a firm’s business and activities and should not follow a one-size-fits-all approach. A comprehensive and strict framework for remuneration for fund managers—with requirements specifically adjusted to the distinct nature of the regulated fund sector—is already in place under UCITS V. Departing from this existing framework and applying CRD-style remuneration requirements, including any bonus cap, to regulated fund

managers would be inappropriate.

- Developing an appropriate prudential regime for investment firms is an enormously complex task that will take time. Our view is that the quality of the end product is more important than speed. We strongly recommend an additional consultation once the EBA, working with ESMA, provides the specific details stakeholders need to evaluate fully the calibration of the proposal.

Rachel H. Graham
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[Attachment](#)

endnotes

[1] EBA, Discussion Paper, *Designing a new prudential regime for investment firms*, EBA/DP/2016/02 (4 November 2016), available at <https://www.eba.europa.eu/documents/10180/1647446/Discussion+Paper+on+a+new+prudential+regime+for+Investment+Firms+%28EBA-DP-2016-02%29.pdf>.

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