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DUFAS response on the IFR&IFD review

To	EBA and ESMA
From	DUFAS (the Dutch Fund and Asset Management Association)
Date	2 September 2024
Subject	**EBA-ESMA Discussion Paper Call for advice on the investment firms prudential framework (EBA/DP/2024/01)**
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Introduction

The Dutch Fund and Asset Management Association (**DUFAS**) welcomes the opportunity to respond to EBA-ESMA Discussion Paper on the Commission Call for Advice (**CfA**) on the Investment Firms Prudential Framework, as published 3 June 2024.

General comments

- *General appreciation*

DUFAS and its members are of the opinion that the introduction of the Investment Firm Regulation (**IFR**) and Investment Firm Directive (**IFD**) provided for an adequate start in the development of a prudential framework for investment firms, for whom the previous Capital Requirement Directive (**CRD**) and Capital Requirement Regulation (**CRR**) was less befitting. DUFAS also welcomes the EBA/ESMA Discussion Paper (**DP**) as established to follow up the CfA as an opportunity to further develop and improve this relatively new framework.

In general, DUFAS strongly supports the notion, as stated throughout the DP, that requirements for capital and liquidity should be fitting and proportional to the specific risk and business profile of firms in order to achieve a truly risk sensitive regime. This proportionality in our view could take form in better linking specific requirements under IFD/IFR to specific Markets in Financial Instruments Directive (**MiFID**) services, as different MiFID services also have different risks for capital. As far as is being considered in the DP to extend the scope of applicability of IFR/IFD to firms authorised as fund managers under both the Alternative Investment Fund Managers Directive (**AIFMD**) and the Undertakings for Collective Investments in Transferable Securities Directive (**UCITSD**) (together "**Fund Managers**") who are also authorised to provide certain MiFID services, in DUFAS' view, the observance of this principle of proportionality should lead to only application of IFD/IFR to these MiFID services, to the extent that the prevailing sectoral (AIFMD/UCITSD) provisions of the license do not provide adequate coverage for these MiFID services.

If the revisions to the IFD/IFR will not address these potential conflicts and overlap, DUFAS believes that the new framework will result in unnecessary complexity and requirements unnecessary to address prudential concerns.

DUFAS will in its comments on this consultation reflect on the experience and the perceived bottlenecks, but also on the solutions established by the Dutch authorities in the implementation of the IFR/IFD in 2021, when a legal framework was introduced applying the IFR/IFD to Fund Managers that are authorised

to provide certain MiFID services. This means that for the questions in the DP related to Fund Managers, DUFAS can already draw on experience, and DUFAS respectfully would like to take the chance to provide some feedback in this respect, addressing some issues (and also present certain solutions) concerning the Fund Managers authorised to provide certain MiFID services.

- *IFR&IFD increased capital requirements*

In general, DUFAS and its members experience that the introduction of IFR&IFD increased the capital requirements for both MiFID firms and Fund Managers authorised to provide MiFID services. Since 2021 Fund Managers authorised to provide MiFID services are subject to a Dutch prudential regime, in which the capital requirement is defined as the "higher of" the requirements pursuant to the UCITSD/AIMFD or the IFR. In the event IFR capital requirements are considered to be higher, then the IFR regime applies to such firms with the exclusion of the requirements of AIFMD/UCITSD. In any case the Dutch competent authority applies the provisions of the Supervisory Review and Evaluation Process (SREP) to the fullest extent, and may and does apply the provisions of Article 39(2) IFD (capital add-ons) to these Fund Managers as well. In most instances this results in the imposition of higher capital requirements (and liquidity requirements) based on a Pillar 2 capital and liquidity add-on.

Although the IFR&IFD prudential framework is in line with or based on the specific risks faced by asset managers, the capital requirements do not always seem to be in line with the risk profile of investment firms and Fund Managers which provide MiFID services, especially when the various EBA guidelines need to be applied. This risk profile is not comparable to that of banks.

- *Proportionality*

The IFR&IFD framework when being applied to Fund Managers with an authorisation to provide MiFID services should observe the principle of proportionality and should focus on the typical business organisation and products and services offered by these firms. As far as these AIFMD-licensees also perform MiFID services, IFD/IFR should be applicable *only* to those MIFID services as a complimentary set and only to the extent this is not already covered by AIFMD requirements.
Secondly, only relevant provisions of IFR (and IFD) in relation to the specific MiFID services should be included in the scope of applicability of the requirements for Fund Managers with an authorisation to provide MiFID services. Other than MiFID licensed investment firms, such firms are prohibited to carry out the services listed in Annex I (C) points (3) and (6) of MiFID, and therefore are not dealing on own account nor are involved in the business of underwriting. For these reasons DUFAS believes that it would be beneficial to explicitly determine in the to be revised IFR and IFD text, that the scope of applicability is restricted to certain provisions of the Risk to Client (**RtC**) sections, and that the provisions Risk to Market (**RtM**) or Risk to Firm (**RtF**) (including, but not limited to the rules on concentration risk) are only applicable to Fund Managers with an authorisation to provide MiFID services as far as these risks are still relevant, which is most likely very limited due to the type of MiFID services allowed.

With such a narrow scope provision, it would be clarified to the fullest extent that a significant part of the IFR regime is not relevant and not applicable to this sector. Based on the experience members of DUFAS have gained in the regime that applies from 2021, discussions are often about the boundaries of the RtC, RtM and RtF sections, and within the RtC section further lack of clarity arises in respect of the application of certain RtC K-Factors, in view of the factual and legal organisational circumstances that are prevailing in the Netherlands. This for instance applies to the K-Factors K-ASA and K-CMH where, based on mandatory provisions of Dutch law in respect of the safeguarding of client money and assets, a full legally perfect bankruptcy remote segregation is being applied, thereby effectively mitigating the prudential concerns to the fullest extent, and therefore avoiding the need to maintain capital to address this risk

- *K-factors*

In general, we have no substantial comments on the application of the K-factors. However, it is unclear how material risks or elements of risks not covered or not fully covered by the K-Factor requirement, should be taken into account. In this matter it is DUFAS' view that the provisions of Delegated Regulation (EU) 2023/1668 (**RTS Capital Add On**) should be clarified to the extent that in case a firm is subject to the Fixed Overhead Requirement (**FOR**) as its capital requirement based on application of Art. 11 IFR, only Art. 1 RTS Capital Add On must be applied with the exclusion of the other provisions. This avoids double counting of capital add on provisions, as the provisions of Art. 2 and further RTS Capital Add On address the additional risks for firms that must calculate capital on the basis of the K-Factors. This issue especially arises in case the highest capital requirements calculation is the FOR. In the Netherlands many Fund Managers that are authorised to provide MiFID services have the FOR as 'highest' calculation, and therefore the FOR encompasses both the AIFMD activities and MiFID services. However, if a Fund Manager conducts a Pillar 2 assessment, this needs to address the capital requirements based on the K-factors. It is unclear how to consider a material risk which requires extra capital in relation to K-factors. There are diverging views if such material risk (and associated capital) should be considered by adding this to the K-factor capital calculations, or by increasing the FOR with such an amount. We are of the strong opinion that it should be the latter and would welcome any clarification on this matter. To cater for this situation, we suggest to clarify in the above mentioned regulation that if a firm is subject to the FOR as its capital requirement, only the provision of Article 1 of RTS Capital Add On needs to be applied. If there is no appetite for this change, then at least we strongly suggest to clarify that material risks not covered by the K-factor requirement should be added to the K-factor calculation, and not the highest of the FOR and the K-factor calculation.

- *Prudential consolidation*

DUFAS believes that the prudential consolidation regime under IFR/IFD can be unnecessarily complex, burdensome and disproportional compared to the prudential stakes, particularly for groups where only one firm falls under the investment firm category. We call upon the European legislator to review and re-assess and redefine this regime in order to address this. In addition, as indicated above, we advocate to clarify that the IFD/IFR prudential consolidation requirement should not be applicable to those Fund Managers whose principal business is mainly fund management activities rather than MiFID business. To quantify the exclusion of applicability of the rules on prudential consolidation, it could be addressed that in the event fund management business covers e.g. more than 50% of the activities, the provisions of Art. 7 nor 8 IFR must be applied. It should be noted that in the Netherlands, after the regime for Fund Managers which are authorised to offer MiFID services had been introduced the Dutch legislator in conjunction with the competent authorities, have fully excluded the applicability of the provisions on prudential consolation, as it was assessed that there was no need to address prudential concerns in this event.

- *Fund Managers providing MiFID services into scope IFR&IFD*

Given the experience in The Netherlands, and as the specific risks to investment services are more or less the same whether provided by a MiFID investment firm or Fund Manager authorised to provide MiFID services, DUFAS supports any initiative to bring the relevant investment activities of Fund Manager authorised to provide MiFID services into the scope of IFR&IFD, provided that such regime is proportional, tailored to the actual risk profile of such firms and respects the applicability of other sectoral provisions set forth in AIFMD and UCITSD. This will ensure also a European level playing field and a consistent approach on capital requirements for firms providing investment services. However, bringing Fund

Managers authorised to provide MiFID services into scope of IFR&IFD should be proportionate and subject to the following conditions:

- A clarification and split in that 1) all Fund Management activities fall under AIFMD /UCITSD capital requirements, and 2) all MiFID services under IFD/IFR – but not under both, and double counting is avoided.
- When AIFMD or UCITSD licensed, the firms' organisational requirements - also for the management of capital risks – should all be under AIFMD/ UCITS regime as part of the main license. Thus: the amount of capital for MiFID services can be decided under IFD/IFR - but how it is held and managed in the organisation should be under the main license. It should be avoided that certain rules of both MiFID and AIFMD or UCITSD, such as remuneration and governance, are applicable at the same time. Collision of rules should be avoided, and it should be clear that e.g. only the AIFMD or UCITS governance and remuneration requirements should be applicable.
- Only relevant provisions of IFR (and IFD) should be applicable, which are those in relation to the MiFID services which Fund Managers with an authorisation to provide MiFID are allowed to perform (also see Chapter Proportionality).

Our responses in detail

1. Categorisation of investment firms

Q1: What would be the operational constraints of potentially removing the threshold?

We have no specific comments on the thresholds and classification. However, related to the classification and the IFR&IFD regime, we do have concerns about the prudential consolidation. We believe that the prudential consolidation regime set forth under IFR&IFD may trigger a supervisory regime of undertakings which is unnecessarily complex and burdensome compared to the prudential stakes. Where only one investment firm is part of a group, prudential consolidation may be unnecessary, unduly burdensome and disproportional. We call upon the European legislator to review and re-assess and redefine this regime in order to address this. We advocate to clarify that the IFD/IFR prudential consolidation requirement should not be applicable to those Fund Managers whose principal business is primarily fund management activities, rather than MiFID business. Primary fund management business should e.g. cover over 50% of the activities.

2.Conditions for investment firms to qualify as small and non-interconnected

Q2: Would you suggest any further element to be considered regarding the thresholds used for the categorisation of Class 3 investment firms?

No comments

Q3: Do you have any views on the possible ways forward discussed above regarding the transition of investment firms between Class 2 and Class 3 should be introduced?

No comments

3.Fixed overheads requirements (FOR)

Q4: Should the minimum level of the own funds requirements be different depending on the activities performed by investment firms or on firms' business model? If yes, which elements should be considered in setting such minimum?

The FOR requirement already depends on a calculation of the fixed overhead and a default wind-down scenario analysis, for which DUFAS concurs with the point that is made in the DP, that evidence is not being produced that the default wind-down analysis generally does not produce sufficient prudent results. As such DUFAS believes that the own funds requirement is already dependent on sufficiently precise variables, taking into account the firm's specificities and business model. As such, DUFAS does not see a need to further extend the FOR requirements or make them more dependent on the firms' business model at the level of Pillar 1 requirements. It should be noted that in the event the FOR requirement applies, there is ample opportunity at the occasion of the SREP to tailor possible increases of the FOR, in the event the idiosyncratic risk profile and the specific requirements of the business organisation of the firm so requires. Introducing as a default rule a higher Pillar 1 FOR requirement risks that a rough and disproportionate measure is being applied to all the firms, and such development would stand in the way of tailored made solutions in this respect.

Q5: Is it necessary to differentiate the deductibles by activity or by business model for the purpose of calculating the FOR? If yes, which items should then be considered and for what reasons?

No comments

Q6: Are expenses related to tied agents material for the calculation of the FOR to the extent to require a dedicated treatment for their calculation? If yes, are the considerations provided above sufficient to cover all the relevant aspects?

No comments

Q7: Should the FOR be calculated distinguishing the costs related to non-MiFID activities, which criteria should be considered? What kind of advantages or disadvantages would this have in practice?

We believe that the starting point should be that double counting for FOR calculation should be avoided. As such, any activities which are already capitalised under another (financial) regulation, including the management of collective investment units, should not be captured under the IFR/IFD regime. In addition

to that, if there is a preference to capitalise such non-MiFID services/ activities, we recommend to provide sufficient flexibility to the investment firm, which could then be challenged in the SREP.

Q8: Should expenses related to fluctuation of exchange rates be included in the list of deductions for the calculation of the FOR? If yes, which criteria should be considered in addition to the ones suggested above?

No comments

4. Review of existing K-factors

Q9: Should the concept of 'ongoing advice' be further specified for the purpose of calculating the K-AUM? If yes, which elements should be taken into account in distinguishing a recurring provision of investment advice from a one-off or non-recurring one?

In practice, the concept of 'ongoing advice' does not create any problems. Interpretation of 'ongoing advice' under IFR&IFD should be aligned with MiFID guidance on ongoing advice set forth by ESMA.

Q10: Does the K-DTF provide a proper level of capital requirements for the provision of the services Trading on own account and execution of order on behalf of clients on account of the investment firm? If not, what elements of the calculation of the K-DTF present most challenges?

No comments

Q11: Would you have any examples where the calculation of the K-DTF based on comparable activities or portfolios results in very different or counterintuitive outcomes? If yes, how could the calculation of the K-DTF be improved?

No comments

Q12: What are the elements of the current methodology for the calculation of the K-ASA that raise most concerns? Taking into account the need to avoid complexifying excessively the methodology, how could the calculation of the K-ASA be improved to assess those elements?

No comments

Q13: Clients' asset protection may be implemented differently in different Member States. Should this aspect be considered in the calculation of the K-ASA? If so, how should that be taken into account in the calculation?

DUFAS believes that the relevant provisions of K-ASA and the definitions contained in the current text of the IFR, adequately address the different legal regimes applicable in the member states, avoiding additional surcharges for the risk concerning assets safeguarded and administered. It should not be forgotten that within the current regime in the EU, already strict rules apply with respect to the operational effectiveness of asset segregation and avoidance that monies and assets belonging to clients co-mingle with those of the firm. Most of the transactions in financial instruments administered and managed in the asset management industry relate to exchange traded business, with the full protection of the custodian being instrumental in the clearing and settlement and custodian processes. For non-exchange-traded assets, strict rules apply, for instance in the form of collateralisation or establishment of proper security interest to the benefit of clients, that properly mitigate the risks concerning assets safeguarded and administered on behalf of clients. This is certainly the case for member states (such as the Netherlands), with strict mandatory rules in this area.

Q14: Should crypto-assets be included into K-factor calculation, either as a new K-factor or as part of K-NPR?

No comments

Q15: In the context of addressing operational risk for investment firm trading on own account, is there any further element to be considered to ensure that the requirements are proportionate to their trading activities?

No comments

Q16: The discussion paper envisages the possibility to rely on alternative methodologies with respect to the K-DTF. If the respondents suggest an alternative approach, how would this refer to the two activities addressed under the K-DTF (trading on own account and execution on own account on behalf of the clients)?

No comments

Q17: When addressing other activities an investment firm may perform, which elements, on top of the discussed ones, should be also taken in consideration?

DUFAS is of the view that the provisions of Delegated Regulation (EU) 2023/1668 (**RTS Capital Add On**) should be clarified to the extent that in case a firm is subject to the Fixed Overhead Requirement (**FOR**)

as its capital requirement based on application of Art. 11 IFR, only Art. 1 RTS Capital Add On must be applied with the exclusion of the other provisions. This avoids double counting of capital add on provisions, as the provisions of Art. 2 and further RTS Capital Add On address the additional risks for firms that must calculate capital on the basis of the K-Factors. This issue especially arises in case the highest capital requirements calculation is the FOR. In the Netherlands many Fund Managers that are authorised to offer MiFID services have the FOR as 'highest' calculation, and therefore the FOR encompasses both the AIFMD activities and MiFID services. However, if a Fund Manager conducts a Pillar 2 assessment, this needs to address the capital requirements based on the K-factors. It is unclear how to consider a material risk which requires extra capital in relation to K-factors. There are diverging views if such material risk (and associated capital) should be considered by adding this to the K-factor capital calculations, or by increasing the FOR with such an amount. We are of the strong opinion that it should be the latter and would welcome any clarification on this matter. To cater for this situation, we suggest to clarify in the above mentioned regulation that if a firm is subject to the FOR as its capital requirement, only the provision of Article 1 of RTS Capital Add On needs to be applied. If there is no appetite for this change, then at least we strongly suggest to clarify that material risks not covered by the K-factor requirement should be added to the K-factor calculation, and not the highest of the FOR and the K-factor calculation.

Q18: Investment firms performing MiFID activities 3 and 6 (trading on own account and underwriting on a firm commitment basis) are more exposed to unexpected liquidity needs because of market volatility. What would be the best way to measure and include liquidity needs arising from these activities as a liquidity requirement?

No comments

Q19: Investment firms performing the activities of providing loans and credit to clients as an ancillary service in a non-negligeable scale would be more exposed to liquidity risks. What would be the best way to measure such risk in order to take them into account for the purposes of the liquidity requirements?

We consider this activity the provision of loans / credits to acquire financial instruments. We believe when introducing a measure to mitigate such risks, investing in loans and credit should be beyond the scope of this measure, as this is already addressed in the K-AUM factor.

Q20: Investment firms, providing any of the MiFID services, but exposed to substantial exchange foreign exchange risk may be exposed to liquidity risks. What would be the best way to measure such risk in order to take them into account for the purposes of the liquidity requirements?

No comments

Q21: Are there scenarios where the dependency on service providers, especially in third countries, if disrupted, may lead to unexpected liquidity needs? What type of services such providers perform?

No comments

Q22: Are there scenarios where the dependency on liquidity providers, especially in third countries, would lead to unexpected liquidity needs? Could you provide some examples?

No comments

Q23: What other elements should be considered in removing the possibility of the exemption in Article 43 of the IFR?

No comments

Q24: Do you have any views on the possible ways forward discussed above concerning the provision of MiFID ancillary services by UCITS management companies and AIFMs?

Given the experience in The Netherlands, and as the specific risks to investment services are more or less the same whether provided by a MiFID investment firm or Fund Manager authorised to provide MiFID services, DUFAS supports any initiative to bring the relevant investment activities of Fund Manager authorised to provide MiFID services into the scope of IFR&IFD, provided that such regime is proportional, tailored to the actual risk profile of such firms and respects the applicability of other sectoral provisions set forth in AIFMD and UCITSD . This will ensure also a European level playing field and a consistent approach on capital requirements for firms providing investment services. However, bringing Fund Manager authorised to provide MiFID services into scope of IFR&IFD should be proportionate and subject to the following conditions:

- A clarification and split in that 1) all Fund Management activities fall under AIFMD /UCITSD capital requirements, and 2) all MiFID services under IFD/IFR – but not under both, and double counting is avoided.
- When AIFMD or UCITSD licensed, the firms' organisational requirements - also for the management of capital risks – should all be under AIFMD/ UCITS regime as part of the main license. Thus: the amount of capital for MiFID services can be decided under IFD/IFR - but how it is held and managed in the organisation should be under the main license. It should be avoided that certain rules of both MiFID and AIFMD or UCITSD, such as remuneration and governance, are applicable at the same time. Collision of rules should be avoided, and it should be clear that e.g. only the AIFMD or UCITS governance and remuneration requirements should be applicable.
- Only relevant provisions of IFR (and IFD) should be applicable, which are those in relation to the MiFID services which Fund Managers with an authorisation to provide MiFID are allowed to perform (also see Chapter Proportionality).

In the light of the above, DUFAS supports the first option mentioned in paragraph 212, i.e. introduce specific capital requirements for Fund Managers providing ancillary MiFID services. This approach would create a more level playing field between MiFID investment firms and Fund Managers providing MiFID services while still respecting the existing capital requirements set out in the AIFMD and UCITSD.

The option to limit the provision of MiFID services could have a significant impact on business models, and should in the opinion of DUFAS not be considered.

Q25: Are differences in the regulatory regimes between MICAR and IFR/IFD a concern to market participants regarding a level playing field between CASPs and Investment firms providing crypto-asset related services? In particular, are there concerns on the capital and liquidity requirement regimes?

No comments

Q26: Sections 5.2, 5.4 as well as this Section 9.1 all touch upon how crypto-assets (exposures and services) may influence the IFD and the IFR. Is there any other related element that should be considered in the review of the investment firms' prudential framework?

No comments

Q27: Is the different scope of application of remuneration requirements a concern for firms regarding the level playing field between different investment firms (class 1 minus and class 2), UCITS management companies and AIFMs, e.g., in terms of the application of the remuneration provisions, the ability to recruit and retain talent or with regard to the costs for the application of the requirements?

In The Netherlands, there are stricter remuneration requirements in place for the majority of financial undertakings. As such, there is another national layer on top of the European requirements. We believe that the current AIFMD/UCITS requirements are sufficiently similar to the IFD/IFR requirements. If one were to change these requirements, one should clarify that this applies across Europe without a member state option, and it should warrant a level playing field between pure play fund managers and fund managers with a MiFID top up. That way we will continue to be able to recruit and retain talent from across Europe.

Q28: Are the different provisions on remuneration policies, related to governance requirements and the different approach to identify the staff to whom they apply a concern for firms regarding the level playing field between different investment firms (class 1 minus under CRD or class 2 under IFD), UCITS management companies and AIFMs, e.g. in terms of the application of the remuneration provisions, the ability to recruit and retain talent or with regard to the costs for the application of the requirements?

No comments

Q29: Are the different provisions, criteria and thresholds regarding the application of derogations to the provisions on variable remuneration, and that they apply to all investment firms equally without consideration of their specific business model, a concern to firms regarding the level playing field between different investment firms (class 1 minus under CRD and class 2 under IFD), UCITS management companies and AIFMs, e.g., in terms of the application of the remuneration provisions, the ability to recruit and retain talent or with regard to the costs for applying the deferral and pay out in instruments requirements? Please provide a reasoning for your position and if possible, quantify the impact on costs and numbers of identified staff to whom remuneration provisions regarding deferral and pay out in instruments need to be applied.

No comments

Q30: Are the different provisions regarding the oversight on remuneration policies, disclosure and transparency a concern for firms regarding the level playing field between different investment firm, UCITS management companies and AIFMs, e.g., with regard to the costs for the application of the requirements or the need to align these underlying provisions? Please provide a reasoning for your position.

No comments

Q31: What would be costs or benefits of extending existing reporting requirement to financial information? Which other elements should be considered before introducing such requirement?

In the Netherlands, Investment firms are already required to report on financial information through the FINREP.

Q32: Should there be the need to introduce prudential requirement for firms active in commodity markets and that are not currently subject to prudential requirements? How could the existing framework for investment firms be adapted for those cases? If a different prudential framework needs to be developed, what are the main elements that should be considered?

No comments

DUFAS

DUFAS: Dutch Fund and Asset Management Association

Since 2003, DUFAS has been committed to a healthy asset management sector in the Netherlands. DUFAS has more than 50 members: from large asset managers who invest Dutch pension and insurance assets to smaller, specialist asset managers. DUFAS increases awareness of the social relevance of investing, helps to develop sector standards and represents the sector in the implementation of new laws and regulations. In addition, DUFAS is committed to a single European market with equal regulations.

More information

Would you like to respond, or should you have any questions? We would be pleased to hear from you. Please feel welcome to contact Gerwin van de Steeg, manager regulatory affairs a.i., gvds@dufas.nl