EFAMA Position Paper on the Proposal for a Regulation on *Structural measures improving the resilience of EU credit institutions* [2014/0020 (COD)]

EFAMA is the representative association for the European investment management industry. EFAMA represents through its 27 member associations and 62 corporate members almost EUR 17 trillion in assets under management of which EUR 10.2 trillion managed by 55,000 investment funds at end March 2014. Just over 35,600 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds. For more information about EFAMA, please visit www.efama.org

1 GENERAL REMARKS

European fund managers invest extensively in European banks on behalf of their clients. Therefore, we would be supportive of a structure for banks that protects retail activities from systemic shocks. However, losses in the European banking system during the recent financial crisis were incurred primarily due to a lack of liquidity, capital and funding diversification, as well as poor risk management and impacted different bank business models – retail and investment banking – both large and small. The separation of trading activities into separately capitalised entities is unlikely to address such weaknesses. The depth and breadth of the banking structural reform coupled with other elements of the broader regulatory reform agenda (i.e. capital requirements, market structure reform through MiFID II and MiFIR) may also have unintended consequences, which could eventually be felt at a systemic level.

When taking a closer look at the proposed draft Regulation EFAMA members would like to stress that, first and foremost, while being directly addressed at EU banks this Regulation will severely impact asset management companies that are EU bank subsidiaries as well as many alternative investment funds (as defined in the AIFM Directive[1]) – including those managed by alternative investment fund managers (AIFMs) not belonging to banking groups – as banking groups might be severely restricted in investing in those funds in the future which can lead to negative impacts on long-term funding of the economy through AIFs.

The proposed regulation seems to echo the Volcker Rule developed under the Dodd Frank Act in the United States. We need to stress here the crucial need for consistency between these two legislations, as internationally acting asset managers might be subject to both legislations. This international alignment is of paramount importance, as the proposed draft EU Regulation goes much further than

[1] Directive 2011/61/EU of the European Parliament and of the Council: link

the US Volcker Rule. Firstly, the Volcker rule regulates but does not fully prohibit some activities[2]. Secondly, it provides for some exceptions that allow the seeding of funds, while the current Commission's proposal seems to be far more restrictive. We therefore see the need for the Commission's Proposal to be amended in such a way as to allow the seeding of funds.

All these inconsistencies are likely to create an unlevel playing field opening up the possibility of regulatory arbitrages between the EU and the US. In a wider context it is also important to highlight that the proposed third country regime is simply not substantial enough and creates the risk of EU credit institutions being put at a serious disadvantage when compared to credit institutions outside the EU.

2 DETAILED COMMENTS

2.1 *<u>Article 6 – Prohibition of certain trading activities</u>*

In general, we believe that a clarification is needed on whether the prohibitions of certain trading activities and rules on remuneration apply beyond systemic entities. We kindly request derogations from Chapter II based on the Volcker rule as to narrow the range of Alternative Investment Funds Managers (AIFMs) concerned.

2.2 *<u>Article 6 Paragraph 1</u>*

One of the main objectives of the Commission's Proposal is to prevent banks from circumventing the prohibition of certain activities e.g. owning or investing in hedge funds (see explanatory memorandum, p. 7). In order to pick up this approach in the necessary precise manner, we think that it is of utmost importance to draw a line between different types of funds which qualify as Alternative Investment Funds (AIFs), namely hedge funds and other funds with a very conservative risk-return-profile more akin to UCITS. Unfortunately the Proposal equates all AIFs with hedge funds by making them subject of a ban of trading activities. The most worrying result of such a large generalisation is that banking groups will have major difficulties to continue to provide seed money for investment funds. Indeed, we believe that it is necessary for banking groups to be allowed seeding investment funds: otherwise this would purely and simply forbid any launch of AIFs within banking groups through their asset management company subsidiaries. In addition, such seeding rules should be aligned on those already

[2] The draft Regulation not only prohibits proprietary trading by banks but it also requires the separation of other trading activities, including market making, where certain, as yet undefined, conditions are met. Although the proprietary trading definition in the EC's draft Regulation is narrower than in the Volcker Rule, we believe that there is a potential for the separation of a much broader range of activities in the EU compared to the US. Additionally, Volcker's trigger is USD 50 billion in assets. Banks with assets under GBP 15 billion are exempt from the need to ring fence their retail and payments arms. We therefore are of the opinion that the Commission should revisit the threshold to see if there can be alignment or these other triggers are more appropriate.

existing in the US legislation, in particular in the Volcker Rule – in order not to be too restrictive and to keep a level playing field vis-à-vis third country main competitors.

2.3 Article 6 paragraph 3

Hence – in line with our above comments – we are strongly suggesting an extension of the derogation laid down in Article 6 paragraph 3 of the Proposal.

To be more precise we think that it is of upmost importance to point out that the restrictions laid down in point (b) of para. 1 shall also not apply to AIFs that are not substantially leveraged AIFs (as defined in the AIFMD)[3]. Such an approach would preserve the possibility for credit institutions to acquire or retain units or shares of the aforementioned category of AIFs and would allow the holding of units or shares in an entity that acquires units or shares in AIFs. If the provision remains unchanged, the distribution of AIFs, which for e.g. are deemed for the purpose of the credit institution's capital preservation and hence making credit institutions more resilient, would be massively hampered[4].

Furthermore, we see no specific justification for the exemption for certain closed-ended and unleveraged AIFs, European Venture Capital Funds (EuVECAs), European Social and Entrepreneurial funds (EuSEFs) and European Long Term Investment Funds (ELTIFs) laid out in Article 6(3). It could lead to regulatory arbitrage among products. In any case, if such an exemption were to be allowed, we believe that such an exemption should be limited in terms of amount and time horizon.

2.4 Article 13 – Rules on separate group entities

According to the Commission's Proposal, competent authorities may allow core credit institution under certain requirements to hold capital instruments or voting rights in a trading entity where the competent authority considers that holding such capital instruments or voting rights is indispensable for the functioning of the group and that the core credit institution has taken sufficient measures in order to appropriately mitigate the relevant risks.

In this context it is crucial to add that this permission also encompasses that core credit institutions are allowed to engage in an entity that acquires or sponsors units or shares in AIFs in order to bring the ratio of Article 13 paragraph 5 subparagraph 2 to effect.

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[3] Article 24 (4) of Directive 2011/61/EU and Article 111 of Commission delegated regulation 231/2013 of 19 December 2012

[4] Equity holdings in investment funds, including seed capital, are no longer required to be deducted as Capital Requirements Regulation Article 36 refers to holdings in common equity tier 1, i.e. financial institutions, not funds. The Basel Committee has updated this approach to (bank equity investments in) funds. The new rules come into force in 2017. Capital charges or a limit in proportion to capital base, 3% as per Volcker, may be the way to address this risk.

2.5 Articles 14 & 15 – Large exposure provisions

Regarding the provisions towards large exposures we believe that it is crucial to clarify that the basis for calculating the large exposure limits shall take place within the meaning of Art. 390 para. 7 of Regulation (EU) No 575/2013 (CRR I). Such a reference is of great importance in order to ensure that the underlying assets of Collective Investment Undertakings (CIUs) constitute an exposure but not necessarily the structure of a transaction. Furthermore EBA's Regulatory Technical Standards (EBA/RTS/2013/07) already make clear that under certain conditions (fulfilled by UCITS and AIFs) the structure of a transaction does not constitute an additional exposure.

2.6 Article 21 – Derogations from requirements of Chapter III

This article provides for a derogation from the requirements of Chapter III on the separation of certain trading activities. It applies to specific entities of a Member State which should request the relevant derogations to the Commission. This seems to grant extremely large powers to the Commission and could lead to a lack of level playing field among players.

In doing so, only the underlying assets of CIUs and AIFs shall qualify for the treatment of the large exposure provision according to Art. 90 para 7 of CRR I (also to be specified within Art. 14 and 15 of the COM proposal).

2.7 Chapter VI - Relationships with third countries

We believe that the Regulation should apply to relevant entities located in non EU countries in order to ensure a level playing field and as in other parts of the world the local legislative texts are applied on an extra-territorial basis on players which are located anywhere in the world.

Brussels, 09 July 2014

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