EFAMA
European Fund and Asset Management Association

Brussels, 20 May 2022

EFAMA STATEMENT ON THE OECD'S PUBLIC CONSULTATION ON PILLAR ONE – AMOUNT A - REGULATED FINANCIAL SERVICES EXCLUSION

The **purpose** of this response to the Public Consultation document is to **reiterate EFAMA's position on the topic aiming to change the views of those members of the OCDE/G20 Inclusive Framework (IF) that still maintain that asset managers should not be excluded from Amount A.**[1]

The confirmation on the exclusion of Regulated Financial Services (RFS) from the scope of Pillar One is to be welcomed. EFAMA continues supporting all the good work of the OECD/IF in particular the way our industry's needs were acknowledged and catered for in the previously released blueprints – please refer to paragraphs 135 to 140 of the report on Pillar One – and that should be reflected in the Model Rules.

Why asset management should not be in scope?

Our industry is highly regulated and there should be no doubt that **Asset Managers work under significant and specific legal, regulatory, transfer pricing and tax frameworks**. The defining characteristic of asset management and the wider financial services industry is that it is subject to a unique form of national and/or regional financial services regulation.

The asset management industry operates within regulatory requirements that focus on investor protection, product suitability and transparency. An effect of this regulation is that asset management businesses are maintained and taxed in the markets in which its customers are located.

For these reasons, we strongly support the view that RFS carve out must include Asset Management.

How do EU regulations have an impact on investment management business models?

Investment funds and asset management activities are heavily regulated in almost all their aspects and in particular, marketing towards retail investors in the EU (but also outside the EU) is subject to stringent regulatory authorisation processes and supervision requirements that may also vary from country to country; these requirements are consistent within the EU and foreseen under the UCITS and the AIFMD regulatory framework.

[1] It is not the first time EFAMA is engaging with the OECD in this respect. Please refer to EFAMA's responses to the Public Consultations launched in March 2019, in November 2019 and more recently in December 2020.

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Concerning the EU regime, **irrespectively their business model**[2], **asset managers have own resources requirements in the jurisdictions in which they operate** (**with appropriate regulatory capital being maintained**, specific risk management requirements and appropriate levels of people employed, resulting in appropriate taxation of such operations).

We can read in the public consultation document that *"the scope of the exclusion derives from that requirement, meaning that **Entities that are subject to risk-based capital measures** (and only those) are excluded from Amount A"* ***[our emphasis]***.

This is materialized in the definition of "Asset Manager" included in point 24 paragraph b) (page 13 of the public consultation document) and that will be complemented by the Commentary to the Model Rules. **As noted in footnote 19 to the Public Consultation, capital requirements will be considered to be 'risk-based' where the determination of the amount of capital to be held takes into account an entity's risks, including assets under management, size, liabilities, execution volumes, credit risk, market risk, or operational risk.**

These measures are already part of the existing EU legal framework, which is also transposed in the law of national jurisdictions.[3]

In this respect, we should add **risk-based capital measures are already applicable to our industry i.e., capital requirements applicable to management companies and self-managed funds that, as mentioned above, need to comply with regulatory/supervision requirements in the several jurisdictions where they operate.**

Specifically, **the level of own funds which must be held by the manager of a UCITS or AIF is regulated** based on the value of the portfolio under management and, subject to member state decision, based on the presence of a guarantee from a bank or insurer, if there is a close link between the asset manager and the other financial entity.[4]

The amount of own funds held must be no less than the manager's fixed overhead requirements as calculated under the Investment Firms Regulation or a minimum amount of €125,000 for UCITS funds and €300,000 for AIFs, whichever sum is greater.

Managers are also subject to the requirement to hold professional indemnity insurance or sufficient own funds to cover liability risks arising from professional negligence.

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[2] We see two different business models being followed:

a) Indirect model: Intermediaries that are the main consumer facing segment of the asset management industry, such as retail banks, insurance companies, and brokers are heavily regulated and thus are also subject to the proposed exclusion from Amount A. Therefore, the distribution of investment products to retail investors is universally a highly regulated activity, regardless of who is undertaking that activity (be it bank, insurer, etc.). That regulation results in the same outcome within market jurisdictions as we see for banking and insurance services.

b) Direct distribution model: From a contractual and commercial perspective, the investor acquires such shares or units from the investment vehicle (e.g., a fund), and that investment vehicle engages the asset manager to provide investment management services. The asset manager does not control the investment vehicle. The unit holders own it. In this sense, the asset manager's business is not consumer facing. Additionally, within the asset management industry, the retail sales process is highly regulated. These types of requirements necessarily result in a local presence to ensure sufficient information can be provided to prospective and current investors in a way that complies with the local regulatory requirements.

[3] Article 15 of the MiFiD deals with capital adequacy and "*Member States shall ensure that the competent authorities do not grant authorisation unless the investment firm has sufficient initial capital in accordance with the requirements of Regulation (EU) No 575/2013 having regard to the nature of the investment service or activity in question."*

[4] Article 9 of the AIFMD and Article 7 of the UCITSD set out the initial capital and own funds requirements which a manager must meet in order to obtain authorisation.

In addition, **asset managers are captured by explicit and detailed risk management provisions both under the AIFMD and the UCITS Directive** (Level 1 and 2).

As can be seen from the preceding paragraphs, the own funds' requirements of each AIF or UCITS manager will vary depending on the assets under management. As such, **it is clear that managers of AIFs and UCITs are subject to risk-based capital requirements.**

We stand ready to engage with the relevant stakeholders and explain how these rules would work for the determination of the amount of capital to be held considering the risk of the entities to be excluded (considering assets under management, size, liabilities, execution volumes, credit risk, market risk, or operational risk).

Level playing field and distortion of competition

Banking and insurance companies offer a wide range of investment products that are similar to investment funds and in many cases, sell investment poducts for investment managers**. An exclusion that does not cover asset management business is therefore likely to distort the financial services market.** Furthermore, many financial services groups are highly integrated containing banks, insurance companies and asset management businesses. A broad exclusion is less likely to generate competitive distortions and will minimise complexity and uncertainty. Given asset managers are generally located in market jursidictions for the reasons set out above, there are unlikely to be any benefits to market jurisdictions in any case.

With the banking and insurance industries carved out, in case the OECD/IF fails to agree that asset managers should be excluded, there is a risk of a large part of FS businesses having to extract the investment management element of their business and apply Amount A principles for little overall profits allocated to market jurisdictions for reasons set out above. The additional cost of compliance will certainly outweigh any benefits to market jurisdictions much against the overall principle behind Pillar One.

Other issues to be addressed with caution

- **Definitions of excluded entities (investment funds):** for sake of consistency, the Pillar One / Pillar Two definitions of investment funds should be aligned i.e. the 85% test that is part of the Pillar Two Model Rule 1.5.2. b) should also be included in the definition of excluded entities of the Pillar One Model Rules.
- **Treatment of Third Party Revenues:** If the test for regulation will apply at an entity level, it would be advisable to see confirmed in the Model Rules (or in the Commentary) that third party revenue received by Regulated Financial Institutions (RFIs) – revenue that is included in the financial statements by the RFI that will be filed with the regulator – should be subtracted in step 2.[5] [6]
- it is important that **Step 3 of the RFS exclusion** contains a straightforward methodology for identifying in-scope profits, with a view to not imposing onerous compliance costs on in-scope businesses and minimising the potential for disputes with tax authorities.

EFAMA stands ready to assist the OECD/IF technical teams working on this initiative and discuss the issues raised by our industry in this consultation when drafting and finalising the Pillar One Model Rules.

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[5] At footnote 5 to the Public Consultation we can read the exclusion rules for RFSs focusses on prudential requirements based on capital adequacy and the several elements of the definitions are intentionally high-level and principles-based. The rules will require that the entity (as a whole) is subject to regulation by the home state regulator.

[6] If the Model Rules (and the Commentary) will incorporate definitions that are intentionally high-level and principles-based, the requirements to make the exclusion rules work should always be framed within the broader financial regulation i.e. we should not be limiting the scope of the exclusion rules to businesses with capital adequacy requirements incorporating a risk-based measure. Entities subjected to substance based measures associated with financial regulation in the form or risk management capability/governance should have the same treatment and should be excluded. Otherwise, there is a risk significant complexity for large Financial Services groups that may need to bear additional compliance costs to determine which income should be allocated to in-scope or out of scope entities.

ABOUT EFAMA

EFAMA, the voice of the European investment management industry, represents 28 member associations, 58 corporate members and 24 associate members. At end Q1 2021, total net assets of European investment funds reached EUR 19.6 trillion. These assets were managed by more than 34,600 UCITS (Undertakings for Collective Investments in Transferable Securities) and almost 29,600 AIFs (Alternative Investment Funds). At the end of 2020, assets managed by European asset managers as investment funds and discretionary mandates amounted to an estimated EUR 27 trillion.

More information is available at www.efama.org

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