Prot. N. 43/24

<u>Risposta AMF Italia al Discussion Paper EBA/ESMA sulla revisione del regime prudenziale delle SIM</u>

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?

Before commenting on the length of the wind-down period to be considered when calculating the FOR, our members would ask the European legislator to further specify the FOR calculation methodology. In particular, our members would like to know whether, in order to calculate the FOR, they should consider

(i) Total costs as resulting from the financial statements; OR

(ii) Part of the total costs (fixed costs). In such case, it would be useful to be provided with a list of costs to be included.

Once the above is defined, then it would be possible to comment on the proposal to extend the period for an assumed wind-down or restructuring process.

Furthermore, our members believe that costs closely linked to revenues should be excluded from the FOR in a wind-down scenario. Indeed, where there is a cause-and-effect relationship between the costs incurred and the revenues generated, it would be appropriate to offset them. As an example, this methodology could be applied to commissions paid by investment firms to execute orders on trading venues.

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?

On the assumption that there is no clarity relating to the costs to be included in the FOR, it would be too burdensome to distinguish between costs related to MiFID activities and non-MiFID activities. Furthermore, such a distinction would be inconsistent with a wind-down rationale, given that in such a scenario the investment firm would be considered as a sole economic entity.

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?

With general reference to deductions, our members would like to underline an issue relating to dividends. In particular, they would like to understand whether or not dividends can be deducted from costs. In this regard, our members would like clarification on the wording "after distribution of profit" set out in paragraph 71 of the Discussion Paper. According to the further correction mentioned in paragraph 72, dividends should not be deducted if they have not been included in the total costs (which is generally the case).

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?

Our members believe that the concept of "ongoing advice" is clear in the MiFID implementation. In addition, they agree with the possibility to apply the prudential treatment foreseen for the delegation of asset management to ongoing advice. This would avoid double-counting of assets with respect to K-AUM by both parties to the delegation agreement.

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?

Our members believe that such a requirement is properly set. Furthermore, they already take into account both legs of buy/sell side transactions. However, our members think that any amendment to the K-DTF could only be made following an impact assessment (to be shared with the industry) which clearly shows any failure of the current regime (if any).

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?

On this point, our members believe that clarification is needed as to whether or not 'technical asset deposits' associated with settlement phases should be included in the ASA calculations. Indeed, in this particular case, investment firms do not have custody and administration contracts with institutional clients (as in the case of investment firms dealing with retail clients) but hold assets temporarily for the sole purpose of completing post-trading phases.

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

Investment firms consider credit risk for Pillar 2 purposes, as is well known. Therefore, in line with the principles that led to the introduction of an ad-hoc prudential regulation for investment firms, our members are strongly opposed to the reintroduction of credit risk into Pillar 1. The European Commission itself has repeatedly stated during the preparatory work on the IFR that credit risk is not relevant to the specific business carried out by investment firms.

Coming to the question, the IFR provides all the necessary safeguards to deal with exposures in the trading book (Pillar 1) and other exposures (Pillar 2). This means that, should crypto-assets be included in the trading book, investment firms would be able to manage them by applying the K-Factors.

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. In line with the principles that led to the introduction of an ad-hoc prudential regulation for investment firms, our members disagree with the introduction of further elements in the context of addressing operational risks.

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?

Our members think that further elements are needed in order to comment on such an issue. As mentioned in the answer to Question 10 above, given the possibility of a review of the IFR regulation, only changes based on clear facts and circumstances highlighting

critical issues should be considered. Otherwise, an overly volatile regime would create a lack of legal certainty for intermediaries, with implications for costs and investment.
In addition, our members would like to take this opportunity to seek clarification on the treatment of encumbered assets for the purposes of calculating the liquidity requirement.

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?

Our members believe that further elements are needed to express a view on such issue. However, they would welcome any proposal from the European legislator, in the context of a public consultation, that identifies facts and circumstances where liquidity risk has given rise to concerns.

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?

As indicated in the answer to Question 14 above, our members believe that the current regulatory framework for investment firms provides all the necessary safeguards for the treatment of trading book exposures for Pillar 1 purposes. They would like to reiterate that there is absolutely no need to reintroduce the Pillar 1 requirement for credit risk because, as the European Commission has stated in the past, credit risk is not relevant to the specific business of investment firms.

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?

With reference to other related elements that should be considered in the review our members would like to outline the following with respect to Section 6 **-** *Implications of the adoption of the Banking Package (CRR3/CRD6)* of the Discussion Paper.

1. Regarding the three options outlined in paragraph 145), our members prefer option (b): "*introduce the FRTB alternative standardized approach as an optionality for investment firms, regardless of the size of their trading book, subject to the approval of the NCA.*"

2. Regarding the three options outlined in paragraph 154), our members prefer option (b): "*Introduce the CRR3 CVA methodologies on a voluntary basis, subject to the approval of the NCA.*"

3. Regarding the three options outlined in paragraph 158), in the CRR3 the definition of the trading book has been changed in order to implement the FRTB. Our members believe that the adoption of such definition should be on a voluntary basis.

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?

Our members are of the opinion that, to create a level playing field and maintain the ability to recruit and retain talents, in the process of identification of risk takers the criterion relating to the remuneration brackets should be eliminated also in the IFD.

They also believe that the requirement contained in art. 4(1, (a) of EU Delegated Regulation 2021/2154 (remuneration equal to or greater than EUR 500 000 in or for the preceding financial year), has an impact on costs for investment firms and should be aligned with the quantitative criterion laid down in Article 6(1)(a) of the EU Delegated Regulation 2021/923 for institutions.

With reference to the other topics covered by this section of the Discussion Paper, we do not see relevant impacts on costs for the application of the requirements.

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.

On paragraph 241, the Discussion Paper recalls that the thresholds for derogations from the application of the deferral and pay out in instruments requirements for individual staff members differ between IFD and CRD. While both stipulate EUR 50k of variable remuneration as a baseline criterion for the derogation, IFD specifies that the derogation is only applicable if it does not represent more than one fourth of that individual's total annual remuneration. Differently, CRD specifies that the derogation is only applicable if it does not represent more than one third of the staff member's total annual remuneration. ESMA Guidelines on sound remuneration policies under the UCITS Directive and AIFMD do not foresee additional criteria in addition to the absolute threshold.

Our members believe that, with regard to the threshold of EUR 50,000, it would be appropriate not to provide for additional criteria (only is absolute threshold should be maintained), in line with the provisions of the UCITS Directive and AIFMD. If a threshold is to be envisaged, our members consider it appropriate to aline the additional criterion set for the IFD with that of the CRD, thus providing in both cases that the derogation is only applicable if the variable remuneration does not represent more than one third of the total annual remuneration of the staff member.

<u>In addition, our members are of the opinion that the Discussion Paper should take into account the following critical aspects of the current discipline in terms of level playing field with other market competitors.</u>

The financial instruments that can be used for remuneration purposes under IFD can only be those provided for in art. 32(1), letters j) and k).

In particular, it is established that the variable component of remuneration - for risk takers – must be composed for at least 50% of:
i) shares, equity equivalents or, for unlisted investment firms, instruments whose value reflects the economic value of the company;
(ii) equity-related instruments or equivalent non-monetary instruments that are equally effective in terms of incentive alignment;
(iii) other instruments identified in Articles 1 to 5 of Delegated Regulation (EU) No 2155 of 13 August 2021 ('Regulation 2021/2155');
(iv) non-monetary instruments that reflect the performance of the assets of the portfolios managed.
Article 32(1)(k) of IFD allows investment firms that do not issue any of the instruments referred to in Article 32(1)(j) to use alternative arrangements, provided that the competent authority approves such use and that such arrangements achieve the same objectives as the instruments referred to in Article 32, paragraph 1(j).
This provision, which is always applicable unless the derogation criteria under Art. 32 (5) are met, does not take into account the business model, the ownership structure and the market liquidity of the company's stocks, thus creating an unlevel playing field with banks, asset management companies and other investment firms with unlisted shares.
First of all, managers of investment firms are usually entrepreneurs and shareholders. They are already heavily invested in the share capital of their own companies as business owners, unlike those of banks and asset management companies.
This fact significantly impacts managers' investments in the company's financial instruments and, as a result, they often have substantial portions of their own wealth already invested in the company's shares.
Remuneration rules (i.e. the introduction, applicable only to listed companies, of the obligation to pay 50% of variable remuneration in financial instruments) require this amount to be increased without taking into consideration the investments already done and, this way, discriminating managers of listed companies from those of unlisted ones.
Secondly, listed shares of these companies are often illiquid, with the consequence that risk takers have great difficulty in selling them. And the time required to sell such shares is lengthened not only because of the presence of deferral and retention periods but also because of the pressure that could be created on the stock.
It makes the situation worse the fact that the beneficiaries of financial instruments (excluding stock options) are obliged to anticipate the tax levy in the year of attribution, having then to wait for the end of the retention period and the sale of the shares to recover the cash. A sale that, in the case of employees of issuers of illiquid securities, is not immediately feasible for the abovementioned reasons.
In addition, some companies could also have in place shareholders' agreements with lock-up provisions for stabilizing governance and creating a particular link between the company and its main shareholders, aligning interests of both parties.
As a result, the managers (who are also risk takers) find themselves holding this increasing amount of shares in the company and the business risk for the company itself is significantly higher because they will have as a main objective the increase in the value of the share price which could cause a misalignment with prudent management objectives.
Moreover, this requirement creates an unlevel playing field towards asset management companies. These ones are only required to pay the remuneration in shares of funds managed. In case of closed-end funds the managers are already long term invested and

therefore it is possible to disapply the deferral rule. This is not possible, however, for managers of investment firms who have substantial portions of their own wealth already invested in the company's illiquid shares.

Finally, it is important to highlight that the financial instruments that can be used for remuneration purposes, as defined by the regulation, raise several critical issues of use:

1. the value of any stock options granted represents a low portion of variable remuneration and the exercise of the same with the consequent sale of the underlying securities may produce the same effects as the shares. In addition, a large number of stock options (under the conditions described above and specifically for those companies) would have a highly dilutive effect on the stock;
2. phantom shares produce, on the financial statements of the listed company (especially those of the type described above), risks of variability of results that cannot be managed, in consideration of the commitment to pay the employee an amount of cash equal to the value of the share at the end of the deferral and retention periods; in this way, each quarter the financial statements would be influenced by the fair value measurement of the underlying security;
3. with reference to bonds, art. 44a(5) of BRRD introduced the possibility for Member States to set a minimum denomination amount for subordinated eligible liabilities to retail clients (Italy sets the threshold at 200,000 euro). In addition, there are limitations contained in the regulations related to the reimbursement of these instruments;
4. finally, with regard to alternative arrangements, the EBA has recently expressed its opinion that these instruments cannot be used in the event that there are listed shares that can be used for remuneration purposes.

All these critical issues create concrete difficulties in the ability of certain companies (small cap companies with illiquid shares) to attract and retain talent in comparison with other companies in the same sector.

Moreover, as already explained, it creates a potential increase in business risk.

Hence, our members ask for a more adequately application of the principle of proportionality (supported on several occasions by both European and national authorities): in some cases the current legislative framework requires small intermediaries (who are not eligible for derogations) to bear excessive costs for the application of overly strict rules.