European Commission review of the prudential treatment of investment firms - Response to Inception Impact Assessment

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Invest Europe supports the principle of establishing a prudential regime better tailored to investment firms and welcomes initiatives to ensure the regime does not give rise to unnecessary complexity and disproportionate costs and requirements for firms which are small and do not conduct "bank-like activities". However, we have a number of concerns about some suggestions put forward by the EBA in its recent Discussion Paper[1].

The future regime will cover a large and heterogeneous group of investment firms, including a number of the private equity firms we represent. These managers do not carry out 'bank-like' activities and do not assume balance sheet risk. These firms include:

i. adviser/arranger MiFID firms outside of the scope of CRD IV
ii. AIFMs which obtained "top-up permissions" under Article 6.4 of AIFMD
iii. MiFID firms with limited authorisations to provide investment services
iv. a limited number of MiFID firms holding a "placing without a firm commitment" permission.

If the new regime is not calibrated correctly for each of these types of firms, it is likely to lead to an increase in regulatory capital requirements, especially for those firms in point (i) above, currently subject to a fixed initial capital requirement of €50,000 in some EU MS. This will create barriers for them to operate in the market. In order to avoid this unintended outcome, the design of the future regime will have to recognise the specific features of these different firms and take into account the prudential concerns they raise in a granular way. It should not look at the assets under management or advice of a firm as a proxy for risk but at factors such as the type of advice given or the type of clients it is provided to.

Future prudential requirements must acknowledge that the purpose of regulatory capital and liquidity requirements for investment firms is to facilitate an orderly wind-down of the firm. The EBA's proposals described in its Discussion Paper represent a fundamental change to current practice as they suggest that regulatory capital is for the continuity of the firm on a going concern basis and to address contingent legal and regulatory risk.

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[1] For further details, please refer to our response to the EBA Discussion Paper on this topic.

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Advisory firms are easily substitutable and their failure would not prejudice investors in the funds they manage. The same is true of private equity fund managers. The funds managed or advised are typically closed-ended and this also ensures an orderly transition to another manager/adviser. The nature of the underlying assets of the fund is important – unlisted businesses would still continue to operate. The existence of a professional indemnity insurance should be taken into account, as it provides an alternative way of covering a firm's potential liability to customers. All these factors need to be considered to identify the actual risks in the event of the failure of a non-bank investment firm, and the prudential treatment that would ensue.

We do not believe that there will be any need to introduce a liquidity regime for investment firms which do not conduct banking activities. The basic solvency test should ensure that the firm has sufficient liquid assets to meet its liabilities as they fall due. If it is considered that an additional liquidity regime is appropriate, then this should be addressed by rules that require best practice in liquidity risk management, rather than any specific quantitative liquidity buffer.

Finally, the amount of data collected by the EBA on private equity firms is likely to be insufficient. Our membership includes a large number of small firms and they do not always have the bandwidth to engage in the data collection exercise. Therefore, we urge the Commission to exercise caution about this potential "small-firm" bias. Moreover, a more extensive consultation exercise would be recommended to determine how to calibrate the new regime.

Contact

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About Invest Europe

Invest Europe is the association representing Europe’s private equity, venture capital and infrastructure sectors, as well as their investors.

Our members take a long-term approach to investing in privately held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe’s leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members’ role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry’s professional standards, demanding accountability, good governance and transparency from our members.

Invest Europe is a non-profit organisation with 25 employees in Brussels, Belgium.