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Submitted via email: cp21-26@fca.org.uk

17 September 2021

Dear Sir/Madam,

AIMA/ACC's response to Consultation Paper 21/26 – A new UK prudential regime for MiFID investment firms

The Alternative Investment Management Association Limited (AIMA)[1] and the Alternative Credit Council (ACC)[2] appreciate the opportunity to submit their comments to the Financial Conduct Authority (FCA) in relation to its Consultation Paper 21/26 (the 'CP') on a new UK prudential regime for MiFID investment firms (the 'IFPR').

As we expressed in our various responses to the FCA's consultations on the IFPR, we support the introduction of a prudential framework for investment firms that is as user-friendly as possible and one that will allow a level of flexibility and proportionality while protecting markets, clients and investors. We therefore welcome aspects of clarity which have come out of the FCA's recently published policy. For example, the introduction of the own funds' transitional provisions ('TPs') for CPMIs in the FCA's recently published second Policy Statement and its recognition of the challenges that firms not previously subject to an Internal Capital Adequacy Assessment Process,

[1] AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 1,900 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, www.aima.org.

[2] The ACC currently represents over 170 members that manage over $400bn of private credit assets. The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council. ACC members provide an important source of funding to the economy, providing finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure as well the trade and receivables business. The ACC's core objectives are to provide direction on policy and regulatory matters, support wider advocacy and educational efforts, and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits.

or its proposed replacement, the Internal Capital and Risk Assessment ('ICARA') will be subject to. In particular, while we regret that the FCA is unable to provide these firms with a TP to comply with the ICARA, we nevertheless appreciate the FCA's statement that it expects "firms to make their best efforts to comply". We also support the FCA's decision to allow large non-SNIs to rely on a group-level remuneration committee if certain qualifying conditions are met and we welcome the proportionate disclosure requirements as suggested in the CP.

We have, however, set out in Annex 1 our concerns and responses to various of the questions contained in the CP. In summary, our key concern is that **disproportionate and duplicative disclosure requirements, which in some circumstances could risk smaller firms disclosing, or allowing the reverse engineering of, confidential or private data.** In general, outside the context of relationships with retail investors, we do not believe that the proposed disclosure requirements will be wholly relevant to parties other than (prospective) clients and investors and the FCA. We do not feel it is proportionate and entirely relevant to provide access to the highly technical and complicated information by the wider public. Moreover, the information that is required to be disclosed is currently already provided to institutional investors on a confidential and regular basis. In addition, we note that the proposed requirements would result in an unlevel playing field between firms that have a website and those that do not and we believe that the former should be allowed to comply similarly by making the required information available through their annual reports, investor brochure or through similar means. Finally, the proposed requirements could also be in direct contradiction with regulatory disclosure limits applicable in other jurisdictions. While we strongly welcome and endorse the FCA's proposal not to require firms to publish their ratios of fixed to variable remuneration, we believe that the FCA's proposed qualitative disclosure rules could result in smaller firms potentially risking breaching applicable confidentiality and / or data privacy rules.

We also would like to reiterate the general observations that we have made in our previous responses to the FCA's first and second consultations on IFPR, chiefly the need to ensure that the UK's new prudential regime for investment firms continues to promote the UK as an attractive jurisdiction to establish and undertake investment firm business. We therefore continue to urge the FCA to be proportionate in its implementation and strongly encourage it to make necessary adjustments (when compared to the equivalent EU regime) to tailor the new regime to the specificities of the UK market.

We would be happy to elaborate further on any of the points raised in this letter or, indeed, join a call or provide further detail on any issue raised in our response, noting that aspects of the IFPR are detailed and technical. For further information please contact Jennifer Wood, Managing Director, Global Head of Asset Management Regulation & Sound Practices, at +44 (0) 20 7822 8380 or jwood@aima.org.

Yours faithfully,

Jiří Król
Deputy CEO, Global Head of Government Affairs, AIMA
Global Head of the ACC

Annex I

Responses to CP questions

In addition to the points raised in the letter, we have responded below to some of the individual questions asked in the consultation paper. Questions on which we had no comments have been omitted, but the order and numbering of the remaining questions has been retained for clarity.

Disclosure (Chapter 3)

1. Do you agree with the proposed scope and process of disclosure set out in this chapter?

In paragraph 3.5 of the CP, the FCA argues that "Public disclosures are a core part of market discipline, providing important information and transparency to enable markets to do well." While we fully agree with this statement where the information is relevant to the proper functioning of those markets, we do not agree with the FCA's general approach to public disclosure as outlined in the CP. In particular, we would also highlight the FCA's statement in DP20/2 where it says that "the benefit of disclosure is greatest when it applies to an investment firm that deals on its own account or issues securities that could be negatively affected by the way it manages its risks". The FCA's approach now appears to us to go beyond that sentiment.

Paragraph 3.18 of the CP notes that the disclosures will need to be easily accessible and understandable by stakeholders. We agree with the FCA's notion that it is important for relevant information to be accessed by (prospective) clients, investors and counterparties but we do not believe that the information that firms would be required to disclose would be relevant, or of importance, to other parties who have no vested interest in, or are in need of this information.

Moreover, we note that for many firms in scope of IFPR, any public website disclosure is duplicative of information that is currently already provided to institutional investors, whether under individually negotiated disclosures or under other regulatory regimes. These institutional investors are highly sophisticated and require detailed operational due diligence questionnaires and initial and annual operational due diligence meetings and do not generally require the additional disclosures that the IFPR would introduce (but would definitely request them if they did). As a practical matter, we believe it is disproportionate for the FCA to require duplication of information to be published on a public website where the (prospective) investors are institutional investors. We do not feel it is proportionate or entirely relevant to allow other parties (e.g., the wider public) to access a firm's disclosures on, for example, remuneration policies and practices, own funds (including their total K-factor split, especially where a firm's capital requirement is driven by its fixed overheads requirement), or a firm's risk management objectives and policies for the various categories of risk. It is not clear what broader purposes the disclosure of, in many instances, technical and complicated information serves to an audience such as the wider public which, we note, is not a client segment (i.e., retail investors) that our members target. We believe the FCA should exercise caution in imposing disclosure requirements except where there is a clear and proportionate benefit to the additional costs and administration involved in collating the relevant data, ensuring it is in a format suitable for publication and refreshing it year on year.

We further note that firms that do not have a website would, as proposed in paragraph 3.18 of the CP, be required to make their disclosures freely available through other means, such as an annual report or investor brochure. We do not understand why a distinction is made between firms that have a website and those that do not, which, in effect, creates an uneven playing field. We believe that firms that do have a website should be allowed to comply similarly by making the required information available through their annual reports, investor brochure or through similar means.

In addition, we note that the FCA's proposed public disclosure obligations present a significant conflict for UK firms that also manage funds in the U.S. in addition to performing services under Article 6(4) of the AIFMD. Such firms commonly use the investment adviser registration exemption provided by Rule 203(m)-1 under the Investment Advisers Act of 1940 (the "private fund adviser exemption") to be exempt from the requirement to be registered as an investment adviser in the United States. According to September 2021 data from the U.S. Securities and Exchange Commission (SEC), there are currently more than 500 UK managers relying on the private fund adviser exemption. Public availability information or details on an unregistered fund manager's advisory business, including some of the types of information proposed to be required to be made available publicly on their websites, may have significant regulatory repercussions since fund managers relying on the private fund adviser exemption are expressly prohibited from "holding out to the public" as an investment adviser. The SEC views a manager as holding out to the public as an adviser if the manager makes information about its advisory business generally available on the Internet, among other things. Fund managers websites listing anything other than the basic, factual information (address, phone, etc.) run the risk of being deemed to "hold out" for purposes of these requirements. Many of these managers currently comply by having a website with these permissible limited types of information and everything else is behind various sorts of viewership limits including often password protection. Therefore, the FCA's suggested disclosure requirements may cause some UK managers to be in direct contravention with these SEC-imposed limitations if the disclosures are mandated to be visible to the general public in all circumstances. Considering that firms who do not have a website are allowed to disclose the information through other means, we believe that a similar caveat should be allowed for in scope UK-based fund managers relying on the private fund adviser exemption, or other similar non-UK compliance requirements.

Finally, it appears that the FCA's proposed approach to quantitative disclosures for small non-SNIs will result in a significantly higher level of disclosure than is to apply to medium or small banks under the PRA regime which still categorises such banks as 'Level 2' and 'Level 3'. These banks are permitted to exclude the disclosures referred to in Article 450(1)(h)(ii) to (vi) of the Capital Requirements Regulation (CRR) and Article 450(1)(h)(i) CRR for Level 3 banks. This also introduces disclosures which were disapplied on proportionality grounds under BIPRU and IFPRU. Therefore, we ask the FCA to follow the current PRA approach such that large non-SNIs have full disclosure equivalent to a Level 1 bank but that the disclosures for small non-SNIs should be no more onerous than a Level 2 bank.

2. Do you agree with our proposed disclosures on risk management, own funds, own funds requirements and investment policy, including the use of templates? If not, please provide details of what should be disclosed or how the templates should be amended.

With regards to the investment policy disclosures, paragraph 3.33 of the CP and the draft rules in MIFIDPRU require large non-SNIs to disclose the required information where the firm holds investments which are comprised of shares traded on a regulated market and where the *firm* (our emphasis) holds more than 5% of the voting rights whether directly or indirectly. We note two issues with this requirement. First, we believe that this should relate to direct holdings of investments on a large non-SNI firm's own balance sheet rather than shares managed/advised for funds or clients. However, the references to "indirectly" and "shareholders represented" are not clear and we would be grateful for express confirmation that this should not include shares managed or advised upon under an investment management or investment advisory agreement. Secondly, and regardless of the outcome of our first point immediately above, this quantitative threshold is not universally adopted or replicated by other jurisdictions - with the exception of the EU through the IFR/IFD (see below) - and, as a result, UK-based large non-SNIs may be required to disclose their investments held in non-UK listed companies (but listed on overseas regulated markets assuming the broader definition of this term is used for these purposes) whereas they may not be required to disclose these in the jurisdiction of the listed company they hold shares in. We are concerned that there is no override where this requirement would lead to inappropriate information asymmetry.

Furthermore, we note that the FCA is seeking to replicate the European Banking Authority's (EBA) proposed investment policy disclosure requirements which it has recently consulted on. We welcome the FCA's proposal in paragraph 3.33 of the CP to not require firms to disclose their investment policy "if the shareholders represented by the firm at the shareholders' meeting do **not authorise** the firm to vote on their behalf" (emphasis added). While we fully support the FCA's proposed exception as quoted above, in our response to the EBA consultation we noted that investment firms may however choose not to exercise their voting rights for a wide range of valid reasons. Where firms do not exercise their voting rights, regardless of whether authorisation has been given by their clients, we would suggest that the proposed template permit a firm to state this. As a result, firms should no longer be obligated to make any voting behaviour disclosures. We note, however, that firms that do not vote their shares would nonetheless be required to disclose their qualifying holdings above 5% in the suggested template (which is perhaps also unnecessarily duplicative of disclosure and transparency filings which already need to be made). Firms that opt not to exercise voting rights do not tend to track the number of general meetings they may have been eligible to vote at and providing such disclosure seems unduly burdensome, without providing additional meaningful information. To that end, we ask the FCA to consider introducing a new field in IP2 that would allow investment firms to state that they have not exercised their voting rights. Requiring firms to provide details of the number of general meetings in scope when they have not exercised their voting rights, would create administrative burdens and costs to an extent that is not proportionate to the perceived benefit.

3. Do you have any specific suggestions on our proposed disclosures on governance arrangements and on remuneration?

Paragraph 3.54 of the CP states that "Our proposals aim to strike an appropriate balance between ensuring stakeholders have sufficient qualitative and quantitative information without requiring investment firms to disclose commercially or personally sensitive or confidential information." In this regard, we strongly endorse and welcome the FCA's proposal not to require firms to publish their ratios of fixed-to-variable remuneration. We agree that the publication of such ratios is neither meaningful nor helpful for the market and could raise more questions than answers.

We note that while these quantitative remuneration disclosures will only apply to non-SNIs, with large non-SNIs being required to disclose more detailed information, the disclosure of quantitative remuneration requirements can in fact be classified as commercially sensitive for these firms, in particular to those firms that are relatively small in terms of numbers of senior management and material risk takers ('MRTs'). For these firms, disclosing the split into remuneration (including severance payments, where for example there may be as few as one per year) awarded to senior management, MRTs and other staff seems overly excessive, disproportionate and would, in fact, run a real risk disclosing commercially sensitive and/or personally sensitive information (either in its own right or which can be reversed engineered by employees of the firm or others). This could result in a breach of applicable laws relating to data privacy, e.g., the UK's onshored version of the General Data Protection Regulation (GDPR) and potentially other overseas data privacy regimes for non-UK senior managers/MRTs. In the spirit of the FCA's proposed approach in relation to the disclosure of ratios of fixed to variable remuneration, it would be helpful if the FCA could reflect in its rules the notion that the IFPR disclosure rules are not intended to result in the actual or potential disclosure of "commercially or personally sensitive or confidential information" in relation to quantitative remuneration information. We consider that there would be a straightforward and proportionate way to address this concern and it would track current drafting in Article 51 of EU IFR. We would suggest a new guidance provision in MIFIDPRU 8.6.9 which would provide that MIFIDPRU 8.6.7 is without prejudice to national provisions relating to data privacy. While UK GDPR could be referenced, we believe that a broader term would also capture similar rules applicable overseas for internationally-based senior management and MRTs, which could differ from UK data privacy rules as they may evolve over time.

Furthermore, in relation to firms which are subsidiaries of non-UK investment firm groups and who have MRTs employed by another non-consolidation group member, we note that it is often the case, for example, that a UK firm which is a subsidiary of a U.S. parent firms would have a U.S. employee appointed to the board of the UK firm. In this case, although the individual is identified as an MRT of the UK firm, they derive no remuneration from that appointment. Consequently, it should be clear that such an individual's remuneration from the non-UK parent does not fall within the disclosure requirements as it is not remuneration from the UK firm to which the MIFIDPRU Remuneration Code applies.

In addition, we note that the CP appears to suggest that, in the case of investment firm groups, the remuneration disclosures would be required to be made on an individual basis by each MIFIDPRU investment firm, and, at least for UK parent entities treated as a non-SNI investment firm, also on a consolidation group basis. If this is indeed the correct interpretation of the remuneration disclosures, this will be, in effect, more onerous than the current requirements under the CRD/CRR regimes. We ask the FCA to clarify whether our conclusion is correct and if so, whether this is, or indeed should be, the FCA's intention.

Moreover, according to paragraph 3.45 of the CP, non-SNIs will be required to disclose the number of separate directorships held by each member of the management body. The FCA further notes that "it is not relevant whether the directorship is held in an entity that pursues a predominantly commercial objective." It is not entirely clear if this would then also require non-SNIs to disclose the directorships held with charitable organisations, homeowners associations, etc. If it is indeed the FCA's intention to include non-commercial directorships, we do not believe that disclosing these would pose a "potential conflict of interest" which is the FCA's rational for requiring firms to disclose the number of concurrent directorships held. We further note that the information that UK non-SNIs are required to disclose on the number of directorships held is already publicly available through Companies House so we do not entirely understand why the FCA wishes to duplicate firms' efforts in this instance.

In addition, we note that many (non-) executive directors typically sit on the boards of multiple entities in one or more investment structures. For example, a director may sit on a Cayman Islands-based master fund, while also sitting on the boards of its U.S. and non-U.S. feeder funds. In practice, for the most part, these specific fund structures do not hold separate, individual meetings but opt to combine or hold these concurrently for practical reasons as meeting agendas generally overlap and, in such cases, it would be misleading to characterise the time commitments as representing multiple separate directorships. There could also be other instances where the raw number of directorships held may not give any useful insight (e.g., for group corporate governance and management purposes, in some groups certain senior individuals sit on multiple affiliated company boards). Where a director sits on the board of multiple entities whether in an investment structure or management group, we do not believe that these entities should be required to disclose multiple directorships but should, instead, only be required to disclose a single directorship.

Own funds – excess drawings by partners and members (Chapter 4)

4. Do you agree with our proposal to require excess drawings by partners or members (of partnerships and LLPs) to be deducted from CET1 capital, except where the amount is already required to be deducted or deemed repaid under other MIFIDPRU rules. If not, please explain your reasons for disagreeing.

Our understanding of the aim of these provisions is to replicate current provisions relevant to partnerships and limited liability partnerships (LLPs) (which can be found, e.g., in the GENPRU/BIPRU and IPRU(INV) (and other) sourcebooks) which provide that firms should deduct the amount by which the aggregate of the amounts withdrawn by its members/partners exceeds the current year management profits of that firm (known as excess LLP members' drawings). However, on the basis of the commentary in the CP and the draft rules, this is not entirely free from doubt. We would be grateful if the FCA could confirm our understanding is correct.

Depositaries (Chapter 6)

10. Do you agree with our proposals for FCA investment firms that act as depositaries for funds? If not, how could we change them?

We note that the drafting in paragraph 6.9 of the CP is not entirely clear and, in particular, we disagree that a MiFID investment firm that provides depositary services cannot be an SNI firm. There are a number of MiFID investment firm depositaries that have broader permissions than the FUND 3.11.12R 'private equity' depositary regime.

In paragraph 11.39 of the CP, the FCA states: "We consider that FCA investment firms that act as depositaries are, by the very nature of their activities, interconnected to other financial institutions." The FCA does not expand on this statement in the CP or provide a rationale that such firms are indeed interconnected with other financial institutions. There are three firms in the UK that hold a MIFID investment firm licence and act as depositary and that are not part of larger financial institutions. Therefore, we disagree that such firms cannot be SNI firms if they meet the various threshold tests to be classified as an SNI firm.

Applications and notifications (Chapter 10)

Timing

The draft rules appear to omit any clarification relating to the timing of firms' first public disclosures under IFPR. We suggest that the FCA clarifies that the first disclosures should be published during the course of 2023, in respect of 2022, which is the first full year of application of the IFPR regime. In our view, IFPRU and BIPRU firms would make their final public disclosures under those regimes in 2022. It would not be appropriate to require firms to publish their first disclosures in 2022 as this would relate to a period during which IFPR was not yet in force and firms may not have the relevant data points in order to make the disclosures. Should that be the FCA's intention, we strongly support a position that such disclosures be made on a reasonable efforts basis.

Reporting currency

In addition, when filing their prudential returns (e.g., MIF001), the FCA requires firms to report all their figures in Sterling. We note that many firms in scope of IFPR have reporting or functional currencies which are in USD or EUR. Being required to report in Sterling will incur additional time to translate values accurately – especially given the change to quarterly reporting cycles – as well as posing a foreign exchange risk which would incur additional cost in hedging its resulting Sterling balance sheet exposures. Given that prior prudential regimes have allowed firms to choose their own reporting currency, we ask the FCA to allow firms to continue to do so.