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Dear Madam, Sir,

Please find attached additional comments to be considered as part of Invesco's response to the European Banking Authority (EBA) consultation on the Draft Regulatory Technical Standards (RTS) related to the implementation of a new prudential regime for investment firms.

Invesco welcomes the opportunity to contribute to the consultation, and thanks the EBA for its constructive engagement with industry. We look forward to continuing our constructive engagement with the EBA as it takes forward this work.

Yours faithfully,

Invesco response to the European Banking Authority (EBA) consultation on the Draft Regulatory Technical Standards (RTS) related to the implementation of a new prudential regime for investment firms

Additional comments

Draft RTS on the calculation of the threshold referred to in Article 4(1)(1b) CRR

- Accounting standards to calculate the total value of assets

Article 3 appears to suggest a waterfall approach is applied i.e. only if an institution cannot determine the value based on local prudential reporting, audited annual accounts as prepared under IFRS should be applied, and, if that is not available, the non-statutory financial statements should be used to calculate the total value of assets. We would encourage the EBA to confirm whether this interpretation is correct and advise if firms are at liberty to select which method from Article 3(2) to (4) they wish to apply.

Article 3(2) refers to prudential individual reporting, yet this term is not clearly defined. Given that this could be the subject of local regulations, there could be variation in the reports used and potential inconsistencies in the application of this statement. Without further clarity firms may not use the same basis for calculating the total value of assets for an institution. This may have most impact for firms with a number of entities in different countries. This would appear to conflict with the principle of harmonisation that is a stated objective of the regime. We would encourage the EBA to define this term and clarify if the report used for the consolidating entity should be used for this calculation. This would help ensure that application of the legislation is consistent between different jurisdictions that may have pre-existing rules for individual vs. consolidated reporting.

As an alternative to allowing differing local applications, the EBA could consider prescribing a uniform definition of assets that applies in determining the threshold amount. In order to ensure that the thresholds are risk sensitive and proportionate, the EBA should consider within the definition to allow:

1. Exclusion of assets that are deducted from own funds. Currently, an Investment firm that has a large deductible asset (e.g. Goodwill) could trigger the threshold amounts as a result. However, this would seem to "double-hit" a firm as the asset is already fully deducted for determining own funds and therefore any risk of harm is already fully addressed/nullified. If those same assets were then to result in the firm being subject to additional requirements, this would appear counter-intuitive. The EBA should therefore consider allowing assets that are deducted from own funds to also be deducted from the Total Assets definition in determining the meeting of the thresholds.
2. Allow the netting of Assets with Liabilities that are closely related and are largely offsetting. In some regions, the legal form of the funds combined with the applicable

accounting standard means that, as an agent, the asset manager temporarily holds a receivable from the client/fund (depending on whether the transaction is a subscription or redemption) and a vice versa payable to the fund/client. These are based on volumes of activity in and out of funds during the T+3 settlement period. This balance can be volatile during periods of large activity. However, given the mitigated nature of the risk, they should be considered from exclusion from the definition of Total Assets for the purposes of determining thresholds. This would remove significant volatility from the determination of Total Assets of asset managers and allow a more consistent and risk sensitive application.

We recommend that the requirements utilise the same basis of calculation for all thresholds. This RTS uses "total assets" while Article 32(4)(a) on Variable Remuneration uses "value of on and off-balance sheet assets". Invesco recommends the use of Net Assets/Shareholders Funds as calculated under accepted accounting frameworks as an appropriate metric for establishing thresholds. This would have the benefit of off-setting significant creation and redemption balances, a well-recognised metric, being subject to disclosure on an annual basis as part of the individual firm's disclosure requirement, and likely to be aligned to the Own Funds of the firm and therefore reflective of the risk profile of the firm.

<u>Draft RTS to specify the calculation of the fixed overheads requirement and to define the notion of a material change</u>

- <u>Materiality</u>

The draft requirements provide that a material change in fixed overheads is either a 30% change in the firm's projected overheads or a €2m change in the firm's own funds requirement based on fixed overheads. When considered against the materiality levels applied by audit firms (typically c.5% of Profits before Taxation) applying only the €2m change in fixed overheads requirement would lead to larger investment managers being required to change their fixed overheads requirement for changes in their cost base that could be considered immaterial. We believe that the intention of the fixed threshold is unclear, and that the regime would be better served by a percentage-based threshold.

We also encourage the EBA to clarify whether firms themselves should adjust their Fixed Overhead Requirement when the materiality threshold is met, or whether it can only be adjusted by the Competent Authority (as suggested by Article 13(2) of the IFR). Given the frequency of Competent Authority review and given that the materiality thresholds are objectively defined, the EBA should consider that Investment Firms can adjust the FOR, without direction from the Competent Authority, where the materiality thresholds are met in order to allow capital requirements be more sensitive to material changes in the business.

- <u>Bonus payments</u>

Article 1(4) provides additional guidance on the characteristics of bonus that can be deducted when calculating fixed overheads. Invesco believes that the objective of the requirement is to ensure that firms can only pay bonuses when net profits are available from which the bonus would be paid from, thereby ensuring that the payment of the bonus does not impact on the firm's capital position. However, the wording of Article 1(4)(a) does not clearly support this objective. The current drafting states that bonuses to be deducted "have already been paid to the employees in the year preceding the year of payment". It is unclear as to whether firms interpret this and review remuneration policies to ensure that discretionary bonuses are settled in a way that allows the firm to deduct the expense. Furthermore, Article 1(4)(b) seems to articulate the requirement that in order to be permitted to deduct the cost, a firm must not be obligated to pay a future bonus, and therefore has discretion to make future awards, but again is worded in a potentially more complex manner.

The initial assessment of Article 1(4) is that this is not expected to be an issue for firms as bonuses tend to be paid out of profits and do not tend to be paid should they lead to the firm then making a loss, thereby meeting the requirement of the second element of Article 1(4)(a).

In cases where a bonus is deferred the assumption would be that awards have been "paid for" in the year of award. Deferred awards, in the form of shares, tend to be held in trust for employees with the firm remitting cash to the trust on the award date. For accounting purposes, the cost of the deferred award is then spread to vesting date under accounting rules. There is potential that the accretion of the full cost of the award after the award date could lead to the firm making a loss in the year(s) after award. The current wording could lead to uncertainty as to whether the costs associated with the deferred element of the bonus would be allowable in the calculation of fixed overheads.

It is important to note that, although this may seem irrelevant as the FOR is normally calculated based on previous years expenses, what is being proposed can have a knock-on impact for the calculations of material changes in FOR, that would lead to a recalculation of requirements.

Based on the current drafting, the normal calculation of FOR would, in most cases, include a deduction of bonuses. However, the calculation of a projected FOR would not. This means that the calculation of previous years and current year are technically different. In addition, because of this, firms may breach the thresholds in Article 3 of the delegated regulation and have to calculate a FOR based on these projected figures.

- <u>Costs associated with items already deducted from capital</u>

From the deductions listed in Article 13(4) and Article 1(6), and the principles behind the ability to deduct them from total expenses, there is at least one type of deduction that is not included and should be added to the list. These relate to a 'deduction of expenses related to items that have already been deducted from own funds'.

The current drafting of the requirements, while consistent with the CRR definition of FOR, leads to items such as charges on intangible assets being included when the asset has been fully deducted from Own Funds. Any further charges or accelerated write down of these assets would have no impact on own funds as the corresponding reduction in profit would be offset by the reduction in the deduction required under Article 36 of the CRR. Following the same principle as being used for the deduction of bonuses.

The IA would recommend the inclusion of an additional permitted deduction in the list of deductions available when calculating the fixed overheads, this would be 'deduction of expenses related to items that have already been deducted from own funds'. These items would include, but not be limited to:

1. Charges related to Intangible Assets,
2. Charges related to Deferred Tax Assets
3. Losses related to Investments classed as holdings under Article 36 of the CRR

While this change would increase the deductions available, thereby lowering the fixed overheads of firms with certain assets on their balance sheet, it would provide greater consistency in relation to those costs that would cause the capital of the firm to be impacted in the event of a decrease in the scale of the business and resulting profits. Additionally, the inclusion of Deferred Tax Assets would remove any potential for charges relating to deferred tax assets being included in the calculation of fixed overheads as they fall outside the deduction permitted by Article 1(6)(c) of the RTS.

- Additional comments

Invesco would welcome additional clarification on the terms used in the deductible expenses. In particular:

- "Staff Bonus";
- "Other remuneration" to the extent that it is discretionary;
- Bonus charge is deductible if charged on current year's net profit – clarification needed to understand how to apply the deductions when a firm makes a loss and when staff bonuses are based on a firm's activities or Group performance rather than firm profits;
- Expenditures from 'taxes' – additional guidance on whether 'taxes' include corporation tax, and deferred tax; and
- Shared commission and fees payable – additional guidance on whether marketing commission and marketing fees paid are included in the deduction.

The RTS provide some more information on the permitted deductions, but there are some areas where further clarity is sought. Invesco recommends that the EBA's finalisation of the drafting include:

- Amending the materiality thresholds to ensure that only truly material changes in fixed overheads drive a change in the requirement;
- Clarifying the starting point of the calculation of fixed overheads;
- Including a complete list of permitted deductions in the RTS;
- Amending the list of permitted deductions to include expenses associated with items deducted from Own Funds; and
- Amending the wording around the deduction on bonuses by reverting to "fully discretionary" rather than the proposed draft wording.

– ENDS –