IA response to FCA Consultation Paper 21/26

A new UK prudential regime for MiFID investment firms

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.5 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. The UK asset management industry is the largest in Europe and the second largest globally.

The IA welcomes the FCA's approach to creating a tailored UK prudential regime for MiFID investment firms and the further clarity on how firms are expected to implement aspects of the regime. We set out our views on the current consultation below.

Questions

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

Solo or consolidated disclosures

We request clarity around whether disclosures should be on a solo or consolidated basis, as MIFIDPRU 8.1.8 seems to imply the need for both, but paragraph 3.19 appears to apply that firms have discretion: "Where this isn't possible, for example if the firm changes from disclosing on an individual to consolidated basis, the firm would need to clearly note this."

There needs to be a focus on both who may use this data and the purpose of these disclosures. For example, where disclosures on risk management are required for one or more solo entities and on a consolidated basis, this may cause confusion and add little benefit. However, for numerical disclosures, e.g. own funds and own funds requirements, solo and consolidated disclosures would be more meaningful. We would want to avoid the administrative burden of repeating two sets of disclosures and the IA would urge that the FCA is clear that a firm is able to determine whether disclosures are made on an individual or consolidated basis aligned to how it manages its risks. This would be more comparable to the status quo of disclosing certain Pillar 3 information for significant subsidiaries and would aid understanding.

In addition, for larger firms that have multiple entities within their group, the requirement to disclose information for each entity would be unduly burdensome if they are required to create a disclosure document for each MIFIDPRU firm. This is likely to be taking place alongside work on ICARAs and financial returns. The burden of multiple disclosures could be onerous on firms. In order to reduce unnecessary repetition, we would urge the FCA to

consider allowing firms to create one consolidated document with individual sections as necessary and appropriate.

Timing

The IA request the FCA to clarify that the UK IFPR disclosures will apply for the first time when the first financial statements under UK IFPR are published, so that these are aligned. For example, firms with a financial year ending 31 December would in 2022 publish disclosures pertaining to the year ended 31 December 2021 based on the current sourcebook (not MIFIDPRU). Disclosures pertaining to the year ended 31 December 2022 (the end of the first year of UK IFPR) would publish in 2023 disclosures for the 2022 year under the MIFIDPRU8 regime (if set out in MIFIDPRU8, or otherwise in the relevant sourcebook) – otherwise there would be a mismatch between the disclosure regime and the relevant prudential regime.

The IA would also request the FCA to clarify whether the disclosures, if done on a solo level, should be published at the same time as the financial statements of the investment firm's statements or the parent company statements. For some firms, they are issued at different points of the year. Similarly, for entities where the accounts are not published, it would be helpful if the FCA confirmed the equivalent date for submission.

Para 3.20 suggests that the disclosures should be made annually or where a significant change could change the content of the disclosures. We request clarity whether there is a materiality threshold that applies here. A change of business model would impact the Own Funds and K-factor requirements and would justify an update, but given the volume of qualitative disclosures, would a change in senior personnel managing risk also merit such an ad hoc/out of cycle update? The IA would argue that this should not be the case.

Proportionality

The IA are supportive of the idea of proportionality, but it is difficult to know what this means in practice. The IA suggests the FCA provide further guidance of expected good or poor practice.

The consultation requires the disclosure of voting rights according to country or territory. We request that the FCA provides a clear definition of 'Country or Territory' for Template IP1. This should include which attribute is used for country: country of issue, risk, incorporation or listing.

In FCA DP20/2[1] paragraph 11.102, the FCA advised that they "would support voluntary disclosure by investment firms of additional own funds requirements through the ICARA process or SREP in their public disclosures." They may also exercise the ability to request disclosure in exceptional cases. Paragraph 15.8 in FCA DP20/2 states if requested by the competent authority, investment firms should also disclose the result of its ICARA process, including the composition of any additional own funds requirement set as a result of the SREP.

These topics were not addressed in CP21/26. It would be helpful to understand from the FCA if their intention is to proceed with these proposals, and the circumstances under which a firm would be requested to publish the result of its ICARA process, including the composition of any additional own funds requirement set as a result of the SREP.

[1] FCA DP20/2 A new UK prudential regime for MiFID investment firms

ESG

We are supportive of not including ESG disclosures in the consultation, given the ongoing development of international standards and until the UK has implemented any new rules. However, if there is potential for the FCA to consult shortly on ESG related disclosure requirements which include additional voting behaviour disclosures, the proposed MIFIDPRU voting behaviour disclosure requirements should be delayed and implemented at the same time as those ESG related voting behaviour disclosure requirements in order to avoid unnecessary costs.

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.

Credit risk

Our 'Direct2Fund' proposals, were they to be implemented, eliminate the risk to consumers to the failure of an AFM by removing the investment firm as a counterparty to transactions with funds. Enabling the investor to transact directly with their chosen investment fund, as they do in other European fund domiciles, reduces the overall counterparty risk exposure rather than simply trying to mitigate the risk of a firm's failure and associated costs.

Investment policy

Linked to our request in the response to question 1, the IA recommend that this disclosure may be made at group level as opposed to the solo entity. Due to the reference to a 'indirect holding' where there is more than one group entity within scope, this may cause 'double-counting' making the disclosure potentially misleading. A group level disclosure is consistent with how firms disclose >5% holdings under the Transparency Directive and related FCA disclosure requirements.

In addition, we request that there is no requirement to provide solo voting behaviour disclosures when consolidated group voting behaviour disclosures are provided by the UK parent entity. Some firms already make similar disclosures as required by US rules, and are already making certain voting disclosures at a group level, and therefore would want to avoid unnecessary duplication. This is explicitly allowed under the FCA's proposals for TCFD disclosures (CP21/18), which allows firms to make their 'entry level' ESG disclosures by referring to disclosures made by another member of a firm's group. As drafted in CP21/26, this does not seem possible for the Investment Policy disclosures, as the FCA are mandating a specific disclosure template firms to use. The IA request that the FCA allow firms to cross-refer to other disclosures (e.g. by including a link on their website) to reduce their compliance burden, instead of using a prescribed template.

The IA also request clarity on the remit of the disclosure regime. Paragraph 3.33 of CP21/26 refers to shares traded on a regulated market and it is not clear if this refers to the UK market or global markets. If it is the latter, we would like consideration to be given to the fact that the major shareholding disclosure regimes in these jurisdictions may be based on a different method of calculation (i.e. all shares under management) and that firms will need to complete work on additional output in order to comply.

The inclusion of this requirement in IFPR may be relevant for firms which hold shares on their balance sheet, but duplicates what discretionary investment managers already report under the Shareholder rights directive (SRDII) in an inconsistent manner. SRD II already requires voting behaviour disclosures for shares that investment firms hold indirectly (i.e. in relation to discretionary investment management for clients). SRDII does not however require voting behaviour disclosure for shares held directly (i.e. on an investment firm's balance sheet) therefore rather than duplicate the requirement for indirect holdings with a slightly modified requirement (over 5% of shares as opposed to all shares), MIFIDPRU should only add the requirement for direct holdings.

For global investment managers, the IA do not consider there to be any benefit in disclosing voting behaviours based on whether companies have been admitted to trading in UK/EEA exchanges.

MIFIDPRU voting behaviour disclosure requirements should, wherever possible, be identical to those required by DTR5, the Shareholder Rights Directive and the Pensions and Lifetime Savings Association. The IA request the FCA to provide a comparison of the current proposals to existing UK requirements and to justify why any differences are beneficial. Given that the proposed MIFIDPRU8 rules overlap considerably with those under DTR 5 (which covers issuers trading on a UK regulated market), we would like to know what additional benefit these proposals bring, when the disclosures made under DTR 5 are made publicly available at the point of threshold crossings?

We welcome the clarity provided in CP21/26 that firms should only consider shares with voting rights that they can exercise. However, the phrase 'unless the shareholders represented by the form at the shareholders' meeting do not authorise the firm to vote on their behalf' may be too specific and potentially confusing. It would be helpful if the FCA cited examples of shares that are deemed in/out of scope. For example, what is the correct treatment for securities on loan the voting rights are with the borrower, but the investment firm has the right to recall these securities? Additionally, for shares used as collateral, there is no standard process for voting these shares. Can the FCA advise if these can be excluded from the calculation of voting rights?

It is unclear when the first disclosure is due and on a number of points IA members require clarity in order to commence with systems developments needed to collate this data. We therefore recommend that this disclosure commences from the first full reporting period under the regime, is from 1 January 2023.

In respect to Section 3.33 of CP21/26, due to investment decisions and client inflows/outflows, some firms can cross the 5% limit on multiple times during a year. It is unclear how to determine whether to disclose or not based on holdings that are not above 5% for the whole period. We would appreciate clarity on reporting voting where firms have not been above the 5% for the entire period. MIFIDPRU 8.7.4R does not provide clarity in respect of this. Can the final text confirm if these holdings should be included in the disclosure? If these are required, should investment firms differentiate these holdings in their report? It would also be helpful if the FCA would advise if each movement above / below the 5% threshold should be included in template IP1 for reporting purposes. The IA recommends that this is determined based on whether a firm indirectly holds 5% at the 'record date' of any meeting.

The consultation proposes that firms should disclose holdings where the proportion of voting rights held exceeds 5%. In order to provide consistency in the methodology for calculating holdings, it would be helpful if the FCA could confirm if the holding should be rounded up/down or truncated to 2 decimal places.

Template IP2.01 is used to describe voting behaviour and it is proposed that investment firms quantify the proportion of in-person votes used by the firm and the proportion of votes submitted by mail or electronic vote. This distinction does not provide any meaningful insight into a firm's behaviour therefore the IA suggests that this requirement is removed.

Template IP2.02 and template IP2.03 requires investment firms to summarise their voting behaviour on general meetings resolutions. It appears from the draft text of MIFIDPRU 8.7.1(2)(b) that this data set should include resolutions proposed by management, and not resolutions proposed by shareholders. We consider this distinction meaningful, because the aggregation of voting on management and shareholder resolutions is likely to be misleading (as a vote for a shareholder resolution typically implies a different view on the company to votes for management resolutions). Assuming it is the intention of the proposed regulation to require disclosures on management proposals only, we suggest that this be made clearer in the templates themselves. In particular, it would appear that that the final row in template IP2.03 could be removed, as this would replicate the data to be provided in template IP2.02.

FCA Glossary

The IA would like the FCA to provide a definition or guidance on 'shares held directly or indirectly' as per MIFIDPRU 8.7.1.

The FCA Glossary definition of regulated market will require updating for MIFIDPRU purposes. The principal definition of regulated market on the FCA Handbook is "a regulated market which is a UK RIE", with a UK RIE being a recognised investment exchange that is not a recognised overseas investment exchange. If it is solely those issuers on a UK regulated market, the point on duplication on DTR 5 stands even more.

Points of detail on the Template for Disclosing Investment Policy

IP1

- **Column 1: Country or territory** – should this be country of issue or country of incorporation?
- **Column 3: LEI** – we suggest this should be ISIN. This is much clearer and aligned with the instrument you are actually voting on; however, consideration needs to be given in what to do in cases of dual-listed entities.
- **Column 4: Proportion of voting rights held** – this should be calculated regardless of if all of them were exercised as reporting how many voting rights were exercised would be time-consuming to report and not add further value.

IP2.01

- **Row 2 'Number of general meetings in the scope of disclosure during the past year' and 3. 'Number of general meetings in the scope of disclosure in which the firm has voted during the past year'** are useful to have, as this resolves the issue if some meetings were not voted due to blocking, late notification or stock selling.

- **Row 4. 'Does the investment firm inform the company of negative votes prior to the general meeting?'** – Firms often apply a case-by-case approach; therefore clarity is asked for to determine what answers are permitted.

IP2.02

- **Number and percentage of resolutions the firm approved/opposed/abstain** –There needs to be clarification on voting decision in relation to management recommendations. If the management backs a shareholder proposal or recommends voting against their own resolution, and a firm followed their recommendation, this does not constitute dissent. In addition, there should be a guide on how to treat resolutions, where a company would propose to select one out of two proposals, like director slate election in Italy, where there would be two nominees for one seat. Additionally, clarification should be detailed where an asset manager votes differently at the same meeting. Sometimes different investment strategies take different decisions leading to a split in votes from the same firm.
- **Percentage –** We request clarification of whether this should be percentage of voted resolutions or all resolutions (including no vote).

IP2.03

- **Columns: Voted For/against/abstain –** The IA's members would prefer to report on votes cast in relation to management recommendations. In addition, it is not clear what needs to be reported: a number of resolutions or percentage?
- **Row – resolution type:**
    - **Row 5: Environmental, Social and Governance** – most resolutions are governance proposals. The IA recommends the FCA break down environmental and social-related proposals. Also, should be clarified if these are only management proposals or shareholder proposals as most environmental and social proposals are shareholder proposals.
    - **Row 7: External resolutions –** It is not clear if this is shareholder proposals.
    - **Row 6: Capital transactions -** Does this include share issuance or M&A?
- **Percentage of resolutions put forward by the administrative or management body that are approved by the firm** – It is not clear if this includes not voted meetings.

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

Remuneration

In regard to remuneration disclosures, the IA request an overriding provision in MIFIDPRU8 and other relevant sourcebooks that enables firms not to disclose certain qualitative or quantitative information if such information would identify an individual, or enable such an individual to be identified.

19G.1.16-19G.1.18 in the PS21/9 states that firms would apply remuneration requirements based on whether they are GCT (to the solo entity) and Prudential Consolidation (to the consolidated entity). There is no requirement to do both. The disclosure requirement for non-SNI firm is conflicting with the remuneration requirement based on 8.1.7 and 8.6.1. The IA recommend alignment of disclosure requirements proposed in this consultation with the remuneration requirement in PS21/9.

The IA request more information in regard to the requirement to disclose 'the amount of highest severance payment awarded to an individual MRT' for non-SNI firms. We would like more clarity on the on the purpose of this detail. We would also like to note this may potentially breach confidentiality in the event of a high-profile redundancy.

The IA also suggest the FCA provide guidance to allow firms to cross reference to other documents available e.g. remuneration and diversity policies which are already published online by the firm.

Diversity policy
The IA requests further clarity on paragraph 3.49 - to what extent will firms that form part of a group be able to rely on the diversity policy implemented by the parent company?

Governance
Firms will be seeking permission from the FCA to set up various committees on a group basis. It would be helpful if firms that are granted this permission can disclosure related information on a consolidated basis rather than replicate the arrangements for each entity within the group.

Certain MIFIDPRU firms are required to make disclosures on governance arrangements in their annual report. In order to reduce duplication, can the FCA confirm that firms are permitted to refer to other documents where the required information is provided?

Overriding provision
In regard to remuneration disclosures, the IA request an overriding provision in MIFIDPRU8 and other relevant sourcebooks that enables firms not to disclose certain qualitative or quantitative information if such information would identify an individual, or enable such an individual to be identified. Without such an exception, firms could be put in breach of their confidentiality and/or data protection obligations to individual employees by publicly disclosing the stipulated data.

Severance payments
The IA request more information in regard to the requirement to disclose '*the amount of the highest severance payment awarded to an individual MRT*' for non-SNI firms. We would like more clarity on the purpose of this detail. We would also like to note this may potentially breach confidentiality and data protection obligations in the event of a high-profile redundancy. The same concern arises in respect of the proposed obligation to disclose the total amount of severance payments awarded to MRTs and the number of individuals receiving them – if the number of payments that have been made is small, it could be possible to establish who the relevant individuals are, putting a firm in breach of its confidentiality and data protection obligations to individual employees.

Guarantees
The proposed requirement to disclose the '*Total amount of guaranteed variable remuneration awards made to MRTs and the number of individuals receiving them'* could be commercially damaging for firms. Firms may have paid a certain amount to hire suitable people into their organisation for commercially sensitive reasons and reduce the risk of them leaving - the firms' competitors would be able to discover this by reviewing the disclosures. Therefore the IA request that this requirement is removed from the final version of the disclosure requirements.

AIFMD

The IA notes that the proposed quantitative disclosure requirements go much further than the equivalent requirements under AIFMD (in particular, the requirements relating to the provision of an Annual Report by AIFMs contained in FUND 3.3.5R (5)). It appears to us to be disproportionate to impose a heavier disclosure burden on MiFID Investment Firms than is applied to AIFMs. We note also that the FCA has provided guidance to AIFMs that where it is not possible to provide materially relevant, reliable, comparable and clear information, that this information could be omitted '*while noting or explaining the basis for that omission*.' (General Guidance on the AIFM Remuneration Code). Equivalent guidance for MiFID Investment Firms would be welcome.

Cross-referencing

The IA also suggest the FCA provide guidance to allow firms to cross-reference to other documents available e.g. remuneration and diversity policies which are already published online by the firm.

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.

The IA has no comments on this section.

5. Do you agree that we have correctly identified all the onshored BTS and technical standard provisions that are relevant under the IFPR? If not, please explain which other BTS or individual technical standards provisions should be incorporated into MIFIDPRU.

The IA has no comments on this section.

6. Do you agree with our proposed changes to MIFIDPRU and the additional supplementary provisions in MIFIDPRU 3 Annex 7R that relate to the UK versions of CRR BTS related to own funds? If not, please explain what changes you would propose we make to ensure that the relevant technical standards provisions are operative under the IFPR.

The IA has no comments on this section.

7. Do you agree with our proposal to remove the core approach to determine the AVAs under the BTS for prudent valuation? If not,

please explain any operational reasons why you would wish to retain the core approach as a method to determine the AVA.

The IA has no comments on this section.

8. Do you agree with our proposed changes to MIFIDPRU that relate to the UK versions of the CRR BTS related to market risk and other related BTS? If not, please explain what changes you would propose we make to ensure that the relevant technical standards provisions are operative under the IFPR.

The IA has no comments on this section.

9. Do you have any other comments on the content of this chapter?

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

The IA has no comments on this section.

11. Do you agree with the proposed amendments to our rules that reflect the removal of FCA investment firms from the scope of the UK resolution regime?

The IA are broadly supportive of the proposals to descope MiFID investment firms from the UK resolution regime, abolish IFPRU 11, including the abolition of contractual recognition requirements, and introduce a more proportionate recovery planning requirement in MiFIDPRU 7 that integrates into key elements of the ICARA process (e.g. stress testing and wind down planning).

12. Do you agree with our proposals for consequential changes to the non-prudential modules covered in this consultation? If not, please state which specific provisions and provide reasons why you disagree.

The IA has no comments on this section.

13. Have you identified any other cross-references where a further consequential amendment could be needed to ensure the relevant provision still operates once IFPR is implemented? If so, please provide details.

The IA has no comments on this section.

14. Do you have any comments on our proposed approach to sanctions set out in paragraphs 9.16 to 9.18?

The IA has no comments on this section.

15. Do you agree with our proposal to apply the same approach to investigations and sanctions to nonauthorised parent undertakings and persons knowingly concerned in such contraventions? See paragraph 9.19

The IA has no comments on this section.

16. Do you agree with our proposal to require FCA investment firms and UK parent entities to submit a formal investment firm group notification to the FCA? Do you have any feedback on the notification form we have created for that purpose?

The IA has no comments on this section.

17. Do you agree with our proposal to introduce a generic MIFIDPRU application and notification form? Do you have any feedback on the forms?

The IA has no comments on this section.

18. Do you have any other comments on the content of this chapter?

The IA has no comments on this section.