Alder Capital's Response to CP 52

Introduction

Alder Capital welcomes the opportunity to comment on CP 52 and congratulates the Central Bank of Ireland ("Central Bank") on its openness and transparency in holding a consultation on this important issue. For ease of reading, Alder Capital has set out a high level summary of its comments at the beginning of this submission. The detail of the submission has been set out later in the document.

Definition for the Purpose of Alder Capital's Response to CP 52

The term "**Small Firm**" is used throughout this response to mean a MiFID authorised firm that meets the following criteria:

1. It is a stand-alone entity with no parent company and no subsidiaries;
2. It is not a stockbroker;
3. It does not deal for its own account or underwrite financial instruments and/or place financial instruments on a firm commitment basis, i.e. it is a firm of the type referred to in Article 20(2) of Directive 2006/49/EC; and
4. It does not hold or control client money or client assets.

Environmental Context

This consultation is taking place against the background of the systemic banking crisis that occurred in Ireland and which gave rise to the government having to call in the IMF, the EU and the ECB to seek a 'bailout'. MiFID authorised small firms that don't hold or control client money and that come within the scope of Article 20(2) of Directive 2006/49/EC played no part in this systemic banking crisis. To the best of Alder Capital's knowledge, **Small Firm**s performed extremely well in managing the risks they faced, in particular, solvency risk, liquidity risk and credit risk, under the enforced stress of Ireland's banking crisis.

According to the Central Bank of Ireland Strategic Plan 2010-2012, the "*Regulatory approach will … impose requirements in a way that is proportionate to the risk*" and further the plan makes clear that the crisis that the Central Bank is seeking to address is a *'banking crisis'* rather than widespread rule breaches and systemic failures by **Small Firm**s as defined above.

As **Small Firm**s, do not pose any significant systemic risk to the economy or the global financial system, Alder Capital submits that the proposed level of regulatory reporting is grossly in excess of U.S. reporting standards for similar firms in the U.S. and a disproportionate burden on **Small Firms** which will reduce their competitiveness compared with larger firms.

Summary of Comments

1. The proposals in CP 52 together with the current COREP, Financial Sanctions and Qualifying Shareholders reporting regimes (the "Combined CP 52 Reporting Regimes") require **Small Firms** to file 47 reports per annum.
2. Alder Capital has estimated that the cost of providing this number of reports each year is in excess of 100 hours per annum of staff time, EUR10,500 to establish systems to respond to the reporting requests and EUR10,750 per annum. Relative to the risk posed by **Small Firms**, this is a disproportionate and anti-competitive cost burden.
3. Alder Capital is regulated in the United States of America through its registration with the Commodity Futures Trading Commission as a Commodity Trading Advisor and its membership of the National Futures Association. By way of contrast with the 47 reports per annum demanded of the Combined CP 52 Reporting Regimes, for these two U.S. regulators, the firm is asked to file three reports per annum.
4. The principle of proportionality laid down in EU law requires the Central Bank to take into account the need for any burden, whether financial or administrative, falling on regulated firms, to be minimised and proportionate to the objective to be achieved. The firm is of the view that the principle has not been adhered to in relation to **Small Firms** and particularly **Small Firms** that do not deal with retail clients. The proposals might reasonably be described as 'one-size fits all' in nature and take absolutely no account of the substantial difference in risks posed by different MiFID firms.
5. A not insignificant amount of data is collected from **Small Firms** more than once across the reports. This is not a good use of valuable resources in these recessionary times. The Central Bank might like to consider operating a single data base for all of the firms it regulates and developing software that

would allow each internal department to compile its own reports from the database rather than allowing each internal department to independently request its own data from firms thereby asking **Small Firms** for the same data several times and wasting the valuable resources of **Small Firms**.

6. For many **Small Firms**, a significant number of fields have a 'zero' or 'not applicable' entry and it is not a good use of valuable resources to consistently enter 'zero' or 'not applicable' into cells that are redundant for **Small Firms**. Such cells should be locked for editing for **Small Firms** so as not to waste their valuable time and resources.
7. Alder Capital suggests that there be a 'free text' facility on each report that the firm is required to send to the Central Bank so that firms do not have to write separately to the Central Bank regarding entries on reports which arise from the firm's interpretation of questions.
8. Alder Capital suggests that there be a facility to correct entries on-line and notify the Central Bank automatically after the filing date where it comes to the attention of a firm that an entry was entered incorrectly.
9. The overall impact on **Small Firms** of the numerous reports required under CP 52 is anti-competitive and bears no relation to the risk posed by such firms.

Number of Reports

The proposals in CP 52 together with the current COREP, Financial Sanctions and Qualifying Shareholders reporting regimes require **Small Firms** to file 47 reports per annum.

Cost of Reporting

For **Small Firms**, data for each of the proposed returns must be sourced, compiled and filled into the Central Bank's template by one employee familiar with the day-to-day records of the **Small Firm** and, in the interests of good practice and reducing the probability of errors, reviewed by a senior manager to ensure that the figures are reasonable.

The cost of providing the proposed 47 reports each year is in excess of 100 hours per annum of staff time.

Based on an estimate of its own costs, Alder Capital estimates that it will cost EUR10,500 to establish systems to respond to the additional reporting requests set out in CP 52 and a further EUR10,750 per annum thereafter.

Relative to the risk posed by **Small Firms**, this is a grossly disproportionate and anti-competitive cost burden on **Small Firms** that pose no systemic risk to the economy or the global financial system.

International Comparison of Regulatory Reporting Requirements

Alder Capital is regulated in the United States of America through its registration with the Commodity Futures Trading Commission and membership of the National Futures Association. By way of contrast with the reporting demands of CP 52, for these U.S. regulators, the firm is asked to file three reports per annum. By international standards, the proposals in CP 52 are grossly disproportionate and bear no resemblance to the risk posed by **Small Firms**.

The Principal of Proportionality

The principle of proportionality is enshrined in both national administrative law and EU law. In relation to CP 52, the principle requires the Central Bank to take into account the need for any burden, whether financial or administrative, falling on regulated MiFID firms, to be minimised and proportionate to the objective to be achieved.

Taking into account the proposals in CP 52 and the current requirements for COREP reports, Financial Sanctions reports and Qualifying Shareholder reports, a **Small Firm**, will now have to compete 47 reports per annum.

This is a grossly disproportionate imposition on **Small Firms** that played no part in and managed their credit, liquidity and market risk very well during the banking crisis in Ireland.

From a review of CP 52 there is no evidence of the principle of proportionality in operation for **Small Firms**. Despite the claims in CP 49 that one of the Central Bank's priorities is risk-based supervision and that it does not intent to create a 'no failure' regime, there is no evidence of those principles in CP 52 as the reporting requirements do not distinguish between the significant differences in risk between different MiFID firms.

For **Small Firms**, the proportionality of the Liquidity Report has to be questioned; the work in estimating such figures on a quarterly basis is quite significant and the data produced is of little use to anyone particularly where the firms carry a significant cushion of regulatory capital, are of no systemic importance, don't deal with retail clients and are simply engaging in fee-based transactions without taking any risks that would imperil the Irish or global financial system.

Imposing on **Small Firms** the reporting requirements that ought to be in place for credit institutions that have the potential to create a fiscal and economic crisis for the country and the eurozone is a disproportionate and misdirected response to the recent Irish banking failures.

Organisation of Reporting Requirements

The Central Bank might like to consider operating a single data base for all of the firms it regulates and developing software that would allow each internal department to compile its own reports from the database rather than as appears from CP 52 allowing each internal department to independently request its own data requirements from firms.

Where each department of the Central Bank independently collects its own reports there are further costs imposed on the industry and on the Central Bank. Industry is asked to file certain items of data more than once and the Central Bank must presumably carry out an internal reconciliation of the same data arising from different reports. This increases the Central Bank's costs which have to be paid for in part by **Small Firms**.

Serious consideration has to be given to the approach to data collection because of its direct cost implications for **Small Firms** in filing the reports and in the additional levy costs to pay for the Central Bank staff who reconcile internal reports on an on-going basis because of the design and approach to data collection and database management.

The following are examples of the double collection of data arising from the current collection system and that proposed by the Central Bank in CP 52:

- The Supplementary Financial Reporting Return ("SFRR") seeks to split out the total assets and liabilities figures (as submitted in FINREP returns) into their fixed and current elements. Thus the components of these aggregates are being collected in the SFRR and the aggregates are being collected in the FINREP return.
- Total assets and total liabilities are collected in the SFRR, the COREP return and the FINREP returns.
- In the Monthly Key Data Report ("MKDR"), 'Debtors as at month end' and 'Bank and cash' are sought on a monthly basis and then sought again in the SFRR.
- In the FINREP, firms are asked to input five items of "Financial data" which has already been collected by the MKDR report.
- Income, in one form or another, is required in five different types of reports.
- Cash balances are requested in four different types of reports.
- Assets under management are requested in two different types of reports.

This double collection of the same data is particularly wasteful of the time and valuable resources of **Small Firms** and indeed of the Central Bank which presumably will have to conduct extensive internal reconciliations of data across multiple reports providing the same information.

This concept of collecting the same data more than once is anti-competitive in its nature as it creates a very significant barrier to entry and as it drives up the costs of **Small Firms** disproportionately.

As an alternative, the Central Bank might like to consider collecting the components of the aggregates and populating the aggregates in its central database or as and when its database is queried.

Needless Filling of Empty Fields in Data Reporting Templates

For **Small Firms,** many of the fields in the reports will consist of a 'zero' or 'not applicable' entry.

For example, for **Small Firms** that are not part of a group structure and fall within Article 20(2) of Directive 2006/49/EC, information is sought in the SFRR on inter-company creditors, inter-company debtors; trading book creditors, trading book debtors (gross), trading book debtors (provision), trading book debtors (net).

Similarly, the Liquidity Report requires over 200 'Inter-group' items to be filled in with a 'zero' or 'not applicable' and checked by a senior manager at the firm.

In the Monthly Key Data Report ("MKDR"), firms that are not authorised to hold client assets are asked for 'client assets held'. Again, **Small Firms** that do not deal with retail clients are asked to enter a zero twelve times per annum into the on-line return template for the MKDR.

Filling in 'zero' and 'not applicable' entries multiple times is a waste of a **Small Firm's** time. These fields ought to be prefilled or locked for editing by the Central Bank based on the login details of the **Small Firm** so as not to waste the time of **Small Firms**.

In the interests of proportionality and in recognition of the fact that the costs of its activities fall heavily on **Small Firms**, the Central Bank ought to remove these fields from the on-line display for firms for which such entries are redundant.

Post Filing Date On-line Correction Facility

There ought to be a facility to correct entries on-line and notify the Central Bank automatically after the filing date where it comes to the attention of a firm that an entry was entered incorrectly.

'True & Fair' View

In a disproportionate 'one size fits all' reporting regime, every report imposed on **Small Firms** should provide for a text box where explanatory notes may be added.

Such notes may be required to provide: (i) a firm's interpretation of any ambiguous language in a question; (ii) explanations to aid the Central Bank's interpretation of entries in fields; and (iii) information on any unusual matters that may arise from time to time.

Failure to do so is likely to lead to firms having to send a written note explaining report entries to their supervisory team which will mean that the full records relating to each report may not be available in the electronic record system.

Competition

It is important to recognise that there are costs associated with the extensive reporting requirements suggested in CP 52; direct costs to the **Small Firms** that have to complete the forms and indirect costs arising from the levy placed on the **Small Firms** to pay the costs of regulatory staff who review the forms. According to the Government website www.betterregulation.ie, "*It was estimated by another EU Member State in 1995 that the cost of 'red tape' absorbed by small business works out at EUR3,600 per annum for each person employed. For larger firms, the comparative figure was put at EUR153*."

The proposed extensive reporting requirements place a disproportionately higher burden on **Small Firms**. The reporting requirements proposed in CP 52 are insensitive to the very low risks posed by **Small Firms** and deter new entrepreneurs and distract existing entrepreneurs from innovation and expansion.

According to Article 157 of the Consolidated Treaty of Rome[1],

> *The Community and the Member States shall ensure that the conditions necessary for the competitiveness of the Community's industry exist. For that purpose, in accordance with a system of open and competitive markets, their action shall be aimed at: …*

[1] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:321E:0001:0331:EN:PDF

> *— encouraging an environment favourable to initiative and to the development of undertakings throughout the Community,* ***particularly small and medium-sized undertakings,*** [Emphasis added]

In the light of Article 157, Alder Capital believes that it would be important for the Central Bank to consider carefully the effect of the proposed reporting regime in CP 52 on small and medium-sized undertakings as Article 157 requires that *Member States* ***shall*** *ensure that the conditions necessary for the competitiveness of the Community's industry exist. For that purpose, in accordance with a system of open and competitive markets, their action shall be aimed at: …*
— encouraging an environment favourable to initiative and to the development of undertakings throughout the Community, ***particularly small and medium-sized undertakings,***

The key words in the Article are 'shall ensure' and 'particularly small and medium-sized undertakings'.

Comments on Specific Reports Proposed in CP 52

Asset Concentration Report ("ACR")

Alder Capital can understand why an ACR would be required for credit institutions and for MiFID firms with trading books and counterparties as such exposures may be a multiple of the capital of such firms. **Small Firms**, as the term is defined above, do not engage in trading or banking activities that give rise to exposures which are a multiple of their 'own funds'.

From 1 January 2011, investment firms which do not deal on their own account or underwrite on a firm commitment basis, are no longer required to monitor and control their large exposures *in accordance with* Articles 106 to 118 of 2006/48/EC; rather they monitor and control their large exposures via their ICAAP and identify, assess and apportion adequate capital for any large concentrations they face.

For **Small Firms** entitled to performance fees, their biggest large exposures may arise from strong positive performance over a quarter which gives rise to a large exposure to one of its clients. Unlike a large exposure in banking where the failure of a borrower to repay a loan gives rise to a significant impairment in the bank's 'own funds', there will be no impairment to a **Small Firm's** *existing* 'own funds' if it does not collect performance fees earned and so such concentrations of exposure are less of a risk to a **Small Firm's** 'own funds' compared with a similar sized loan exposure in a credit institution.

Following on from the welcome derogation from the requirements of Articles 106 to 118 of 2006/48/EC for **Small Firms**, the Asset Concentration Report is a disproportionate re-imposition on **Small Firms** of a requirement that was rescinded by the EU and is certainly not consistent with the Central Bank's statement in CP 49 that "*One of the Central Bank's priorities is risk-based supervision*."

By contrast, the biggest risk that **Small Firm's** face is the counterparty risk for deposits of their 'own funds' held with credit institutions authorised and regulated in the EU. Failure of such a credit institution would have a significant impact on the 'own funds' of a Small Firm.

Alder Capital submits that the ACR is more appropriate for firms that pose systemic risk and to impose it on **Small Firms** is disproportionate to the risk and anti-competitive.

Error & Breach Notification Report ("E&BNR")

If an E&BNR must be filed *immediately upon discovery* of an error or breach, then why is it necessary to have a quarterly report confirming whether there have been any errors or beaches identified in the previous quarter other than those reported to the Central Bank via the E&BNR?

If there is a requirement to report errors or breaches as and when they occur, then a failure to do so is presumably an enforcement matter. It is grossly disproportionate and bears no relation to the risks posed by **Small Firms** to ask **Small Firms** to spend their valuable resources filling in quarterly forms to say that there were no errors and breaches in the quarter other than those reported using the E&BNR.

For **Small Firms** the E&BNR is disproportionate to the risk that they pose and a costly imposition on the competitiveness of **Small Firms**.

ICAAP Report ("ICAAPR")

The ICAAPR is only required once per year and is proportionate.

Pillar 3 Disclosures Report ("P3DR")

The P3DR is a welcome cost-saving development for **Small Firms** compared with the requirement to send a registered or courier-receipted letter to the firm's supervisory team on an annual basis.

ICCL Report

The ICCL ought to be able to provide the Central Bank of details of MiFID firms that have no eligible clients. The ICCL already collects the number of eligible clients from Alder Capital. The question arises as to why the Central Bank cannot obtain this data from the ICCL directly via file transfer as opposed to burdening every individual firm in the industry with a requirement to fill in the same information again.

Small Firms that have no eligible clients are already burdened by a levy imposed by the ICCL for which the clients of the firm receive absolutely no value. **Small Firms** that have no eligible clients as evidenced by their ICCL levy payment should not be asked to complete this report as it is a disproportionate additional burden on top of a levy for which their clients receive no benefit.

Conclusion

Alder Capital thanks the Central Bank for the opportunity to comment on its proposals in CP 52. The firm trusts that for **Small Firms,** particularly **Small Firms** that do not deal with retail clients, the disproportionate-relative-to-risk nature, the anti-competitive nature and the extraordinary number of reports required relative to U.S. requirements of the proposals will be rescinded.