March 2023

Prudential points of interest in applications and in ongoing supervision

DeNederlandscheBank
EUROSYSTEEM

Department of Supervision of Investment Firms and Investment Funds

Contents

This PDF is clickable, use the tabs and buttons to navigate.

Background

We have noted for some time that a large proportion of applications for declarations of no objection and licence applications lack sufficient substantiation in terms of prudential aspects. In addition, in our ongoing supervision we have noted a relatively large number of capital deficits.

Applications

An incomplete and/or poorly substantiated licence application gives rise to unnecessary questions or discussions with applicants, resulting in longer processing times.

The capital deficits identified in ongoing supervision can almost always be prevented if there is sufficient knowledge about prudential capital requirements.

Next steps

In this presentation, we highlight the prudential requirements that are most frequently applied incorrectly and/or that are insufficiently known. This may help to prevent prudential issues such as capital deficits in the future. In addition, it will speed up application processing times and save time for both us and applicants.

Licence application process

The roles of DNB and the AFM

You submit your licence application to the Dutch Authority for the Financial Markets (AFM). The AFM then asks DNB to assess and advise on the prudential aspects of the application. In preparing our advice, we pay particular attention to the prudential requirements that will apply to the applicant. This means we assess whether the applicant has sufficient capital and liquidity to meet the relevant capital and liquidity requirements and also ask questions about this. We look at the applicant’s operational management with regard to the capital and liquidity requirements: how will the applicant comply with these on an ongoing basis? We also look at the applicant's management of financial and prudential risks.

Documentation required

On the following pages we will list and explain the documentation that must be submitted for adequate processing of licence applications, along with a number of specific areas for attention, most of which also apply in our ongoing supervision.

We only handle complete files

You should provide at least the following documents, taking the prudential aspects into account.

- (Opening) balance sheet and profit and loss account audited by an independent external auditor.
- Budget for the first three years.
- Calculation of applicable capital requirements under the IFR for at least the first three years.
- Substantiation showing compliance with the capital requirements (pursuant to Article 9 of the IFR), addressing applicable deductions under the CRR.
- Shareholders' agreement and articles of association.
- Internal control document describing how laws, regulations and reporting requirements are complied with.
- Business plan.

←
→

Balance sheet & budget

(Opening) balance sheet audited by an independent external auditor

The balance sheet and profit and loss account are the starting point for our assessment of your licence application. To ensure the reliability of these figures, you must also submit an independent auditor’s report on the company's balance sheet and profit and loss account. If the company has been newly established, a pro forma balance sheet and profit and loss account, supplemented by proof of deposit of the contributed capital, will suffice.

Budget for the first three years

Your company's budget must not just consist of a numerical statement. We expect you to submit a clear budget substantiation of the company’s projected income and expenditure, broken down by investment service or activity. We note that companies tend to overestimate their projected income in particular, meaning that in the first years after obtaining the licence, the available capital may be insufficient to cover the risks.

Capital requirements (1)

Calculation of capital requirements pursuant to the IFR.

The calculation consists of the permanent minimum capital requirement, the K-factor requirement (if applicable) and the fixed overheads capital requirement (FOR) The highest requirement then applies for setting the capital requirement. Based on the capital requirement for the first full year, we determine the company's required capital. Both the capital requirement and the capital to be held for this requirement must be correctly determined. If this is not the case, we cannot issue a positive opinion to the AFM.

(1) Minimum own funds requirement

Investment firms can check on page 14 of the IFR-IFD fact sheet(available in Dutch only) which minimum own funds requirement belongs to which licence. Depending on the situation, this requirement is €75,000.00, €150,000.00, or €750,000.00.

Investment fund managers can check the minimum own funds requirements that apply to them on Open book on Supervision. Depending on the situation, this requirement is €125,000.00, €300,000.00, or €730,000.00.

Capital requirements (2)

(2) K-factors

The calculation of K-factors must have a reliable substantiation. In the case of IFR Class 3 companies, the K-factors do not apply, but you must provide a reliable substantiation based on Article 12(1) of the IFR as to why the company classifies as an IFR Class 3 company in the licence application. See the EBA’s Single Rulebook for more information.

We have encountered cases in which the calculation of K-factors is incorrect because firms are insufficiently aware of the relevant legislation.

(3) Fixed overheads capital requirement (FOR)

To calculate the FOR, you must in principle include all costs as fixed costs as per the budget and/or audited profit and loss account. You must be able to substantiate any deviations based on the RTS on the FOR prepared by the EBA.

We increasingly see applicants setting the FOR too low. This is partly due to fewer cost items qualifying as "variable" under the RTS.

Calculation of own funds (1)

Calculation of own funds under the IFR

Own funds consists of the sum of:

- **CET1 capital** (e.g. paid-up share capital, share premium, reserves, verified profit),
- **AT1 capital** (additional capital subject to very strict conditions), and
- **Tier 2 capital** (e.g. approved subordinated loans).

- If you plan to issue CET1 instruments whose terms differ from any pre-existing CET1 instruments, you must confirm this with us in advance.
- Due to their complexity, we recommend that you always confirm with us in advance if you plan to issue AT1 and/or Tier 2 instruments.
- If you already have AT1 and/or Tier 2 capital when applying for a licence, you will need to provide a legal substantiation as to why the instruments meet the applicable requirements.

Calculation of own funds (2)

Key points of attention for calculating own funds

- Your company must take into account the applicable requirements and be aware that the own funds may differ from shareholders' equity for accounting purposes.
- Preference shares deserve special attention as they never count as capital. For further explanation, see our Open Book on Supervision page on capital requirements for investment firms and the 2021 capital requirements study (available in Dutch only).
- To enable us to check whether you have taken into account the requirements, both the shareholders' agreement, articles of association, any **side letters** and the company's subordinated loan contract must be submitted with the application.
- For subordinated loans, the following requirements must also be taken into account:
  - Minimum maturity of 5 years
  - Interim repayment is only possible following our prior permission
  - The eligible part that counts towards own funds is capped at 1/3 of the available Tier 1 capital,
  - The eligible percentage for own funds depends on the remaining maturity: 100% for up to 5 years, 80% for up to 4 years, etc. See the Capital Requirements Regulation for a more detailed explanation, especially articles 62, 63 and 92.

←
→

Calculation of own funds (3)

Own funds deduction items
When calculating minimum own funds, it is important to assess the balance sheet items on the asset side that qualify as deduction items. These items must be deducted from own funds. We have noted that companies often fail to deduct (all of these) items. In particular, this concerns the following items (non-exhaustive list):

- Goodwill
- Deferred tax assets
- Current losses
- Loans to shareholders whose repayment is linked to the company's dividend distributions or, if any, cash rounds.
- Financial participating interests (not applicable to solo reporting of investment firms that also report on a consolidated basis).
- Individual non-financial participating interests for the part greater than 15% of own funds.
- Group of non-financial participating interests for the part greater than 60% of own funds.
- (Other) intangible assets where the exceptions mentioned in this RTS may be taken into account. We recommend you confirm your calculations with us in advance.

AO/IC

Internal control structure

From a prudential point of view, the internal control structure must include at least the following components:

- A description of operational management that corresponds to the licence applied for.
- A description of the role of the CFO and/or CRO on their responsibility regarding risk management.
- A description of the management of prudential risks, including a description of the Internal capital adequacy assessment process and internal risk-assessment process (ICARAP). The ICARAP does not apply to small and interrelated companies (licenced to provide investment services a and d).
- A description of the procedure for having the annual figures audited and provided with an audit opinion by an external auditor after which they will be shared with the AFM (and with DNB via My DNB).
- The reporting obligation to DNB, both with regard to the timely reporting of prudential incidents (including capital and liquidity deficits and claims) and the timely submission of supervisory reports. For the latter, see also the user documentation with respect to the Reporting Service for investment firms and fund managers.

←
→

Business plan

Business plan
We have noted that business plans are not always complete. We expect you to include the following points as a minimum:

- What is the company’s object?
- Who are the target group?
- What is the company's added value?
- The marketing plan.
- Competitive analysis.
- The services which the company will offer.
- The financial plan (see also the slides on the budget).
- For HER: which products will be traded, in which markets and in which way.

Investment holding company

A legal entity with an interest of > 50% in an investment firm applying for a licence is required to submit an analysis on whether it qualifies as an investment holding company.

- When does an applicant (in principle) qualify as an investment holding company?
  - The applicant is based in the EU, and
  - more than 50% of at least one of the activities (balance sheet size, turnover, number of employees or capital) of the holding company and its subsidiaries is financial in nature.

- We have prepared a step-by-step guide to perform this analysis. See our Open Book on Supervision for more information on activities that are considered financial in nature.

- An investment holding company must meet the same prudential requirements as the investment firm at the consolidated level.

- Consolidation concerns financial participating interests and non-financial participating interests if it concerns a tied agent or a party providing ancillary services to the investment firm.

DNO applications

Applicants for a declaration of no objection (DNO) are required to provide certain documents, see the explanatory notes to the application form. We have noted that the following documents are regularly lacking, which delays our assessment of the application.

- Financial statements of the applicant at the solo level not older than 12 months.
- Statement of assets if a natural person submits the application, provided with a statement by an external auditor.
- Organisation chart clearly distinguishing between economic and legal interests (expressed as percentages).
- Clear description of the reason for the application and all parties involved.
- Explanation of how the applicant is funding the holding.
- Clear organisation chart.
- Extract from the Trade Register of the Chamber of Commerce.
- Overview of risks for the investment firm or UCITS holders.
- Overview of funds (if applicable).

Questions

Any questions?

- You can discuss complex applications with us in advance.
- Any questions? You can reach us at the following email address: natin-bobi@dnb.nl

Relevant sections of the law (non-exhaustive)

- Section 2:96 of the Financial Supervision Act (*Wet op het financieel toezicht – Wft*): Licensing requirement for investment firms
- Sections 2:54 (AIF) and 2:67 (UCITS) of the *Wft*: Licensing requirement for investment fund managers
- Article 7 of the IFR: Prudential consolidation
- Article 9 of the IFR: Composition of own funds
- Article 10 of the IFR: Qualifying holding outside the financial sector
- Article 11 of the IFR: Own funds requirements
- Article 13 of the IFR: Fixed overheads capital requirement (FOR)
- Article 14 of the IFR: Permanent minimum capital requirement
- Articles 15-24 of the IFR: K-factor requirement
- Article 93(1) of the CRR: Start-up losses/start-up costs.
- Article 28(1) of the CRR, in particular items h, j and m for (cumulative) preference shares
- Article 36(1)(a) of the CRR: Start-up losses
- Article 36(1)(b) of the CRR: Intangible assets (including goodwill)
- Articles 36(1)(c) and 38 of the CRR: Deferred tax assets
- Article 45(a) of the CRR and Article 9 of the IFR: Financial participating interests
- Article 28(1)(b) of the CRR: Cash round
- Article 9(8) of the AIFMD and Section 63b(2) of the Decree on Prudential Rules for Financial Undertakings (*Besluit prudentiële regels Wft – Bpr*): Liquidity of AIFMD managers.

←

DISCLAIMER

To read more about the status of this statement, see the Explanatory guide to DNB's policy statements on Open Book on Supervision.