

Implications of CRR II on the reporting requirements of private equity funds

Importance of adequate investor reporting is increasing for private equity funds

In order to keep current and attract new investors from the banking sector, private equity funds will need to provide adequate reporting in accordance with CRR II.

The Challenge

With the enforcement of the new Capital Requirements Regulation ('CRR II' - EU-Regulation 2019/876) on 28 June 2021, institutional investors from the banking sector will face increased regulatory requirements for making investments into funds.

The key take-aways from the upcoming changes to the CRR for private equity funds are certainly the increased requirements for adequate reporting in order to avoid high risk weights, which would make an investment into the fund more expensive and unattractive for bank investors, and the introduction of the new standard approach for counterparty credit risk (SA-CCR), which will need to be applied to derive the risk weighted positions of derivatives.

Both topics will be highly relevant for investors, so that funds, which do not provide adequate reporting will definitely be at risk of losing current investors.

Basically, the scope of the new regulation with regards to the concerned recipients can be interpreted as the following: if a fund qualifies as 'collective investment undertaking' (CIU) under the terms of Art. 4 (1) No. 7 CRR (UCITS and AIFs generally fulfill these criteria) the risk positions of the fund must be derived following the requirements of Art. 132 CRR II. Otherwise the risk weight will result in 1250% according to the fallback approach, making the fund extremely expensive and unattractive for investors, due to

the resulting need for high capital backing. This regulation will also apply to private equity funds, if these qualify as CIU and therefore it will no longer be possible to use much lower flat risk weights, which was generally possible under CRR I.

In case the risk weights are calculated by an external party, the calculations need to be disclosed (upon request) to the regulatory authority, in order to avoid an additional surcharge of 20%, and the calculations need to get audited by an external auditor.

The Outlook

Going forward we expect to see that private equity funds will be asked by their investors to provide adequate reporting in accordance with CRR II. This means that private equity funds will need to derive a risk weight on fund level based on the risk weights of each individual investments (so-called look-through approach).

In addition, in case derivatives like FX forwards or interest rate caps are used, the risk weights of these derivatives cannot be calculated using the relatively simple mark-to-market approach going forward, but the new more complex standard approach for counterparty credit risk (SA-CCR) must be applied.

The implementation of the new SA-CCR to calculate risk weights for investments in derivatives will certainly be a challenge, due to the increased complexity of the approach. The SA-CCR is replacing the widely used mark-to-market approach and will onwards be requested by investors, which might force funds to switch their service-provider.

The Solution

Since especially investments in private equity funds might become increasingly unattractive for institutional investors without adequate reporting, it will be very important to act accordingly.

Private equity funds will require a competent business partner with a full-service concept to cover the upcoming requirements in accordance to CRR II:

- Look-through approach to avoid fallback to 1250% risk weights
- Disclosure of calculations (upon request) to avoid surcharge of 20%
- Full process to provide external auditor certificate
- Application of SA-CCR for derivatives
- Provision of final reports to WM Datenservice

In order to fulfill the upcoming requirements, it will be crucial to have a business partner with a software solution in place with a high degree of automatization.

With the steadily growing range of new regulatory requirements, a reliable business partner with deep understanding of the regulatory environment will be become even more important. Due to the increased complexity of new requirements, the demand for service-providers, who have a focus on mere data processing might decrease, whereas the demand for providers with a holistic consulting approach, who offer reporting as a service, will increase.

It is important that service-providers understand the data, which is required for the different regulatory reports and know exactly the impact of this information on the investor level.

Since the regulatory impact, implied by each reporting, plays a significant role in the decision making of investors in the European area, it is very important to avoid adverse regulatory treatment due to missing data. Therefore, a business partner who is able to enrich funds' data, will lead to beneficial results for investors.

With an adequate reporting solution, service-providers can help funds to keep current and attract new investors.



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