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European Banking Authority
Attn. Lars Overby

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REFERENCE
Response to EBA/CP/2021/23

DATE
16 July 2021

SUBJECT
Consultation on the Draft RTS on reclassification of investment firms as credit institutions

Dear Mr. Overby,

Optiver appreciates the opportunity to respond to the consultation paper on the "*Draft Regulatory Technical Standards on the reclassification of investment firms as credit institutions in accordance with Article 8a (6)(b) of Directive 2013/36/EU*" (the "**Second Classification RTS**"). If adopted by the European Commission, the final RTS may have a significant and long-lasting impact on the attractiveness and competitiveness of the European financial markets in general and for large, non-bank market makers in particular - market makers that do not have clients, hold no client assets, and have market making agreements to provide liquidity on exchanges in listed, centrally cleared instruments. An activity that has never caused any systemic risk or financial stability concerns.

We have chosen in our response to respond briefly to the third of the three questions and to respond additionally in a manner that outlines more fundamental concerns that we have with the proposals in this Second Classification RTS. Our concerns are mentioned in the next paragraphs.

In the final paragraph we present a proposal for an alternative solution that we think is more adapted to the actual risks that most investment firms performing MiFID activities (3) and (6) pose to European markets and investors. This alternative solution would also contribute to the political objective of strengthening EU-based capital markets capabilities.

If the EBA has any questions regarding this response, or would like to have a further discussion on our analysis and suggested changes to the Calculation RTS, please contact Willem Sprenkeler, Head of Public Affairs at +31 20 708 7493 or willemsprenkeler@optiver.com.

THIRD QUESTION IN THE SECOND CLASSIFICATION RTS

Question 3: Based on the provisions included in Article 5.6 and 7 of the draft RTS, do you anticipate any operational issues concerning the calculation of consolidated or combined assets. Please provide concrete examples

Answer:

There are still some significant short-comings that arise as a result of how the proposed RTS tries to implement the rules set out in the level 1 legislation. While we can see the logic in excluding obviously large (>EUR 30bn) entities from the calculation of the EUR 30bn group wide threshold, the reference to 'undertakings' in the RTS can have consequences that bear little relation to the risks. Sensibly, the RTS excludes an EU investment firm with assets of EUR 1bn from being considered a credit institution if it is part of a non-EU group with EUR 40bn in assets in New York. However, were there to be a split into two separate undertakings with a Holding above these *two undertakings* in New York, that EUR 1bn EU investment firm must duly register as a credit institution. Therefore, we think that 'third-country undertaking' should actually mean a group of undertakings under consolidated supervision outside the EU, to arrive at more sensible outcomes in line with the objectives of the RTS. In order to avail of the sensible protections granted by the phrase in the level 1 legislation "that individually have total assets less than EUR 30bn", small EU investment firms may find themselves dependent on their US or Asian parent refraining from making some straight forward company re-organisations such as the one mentioned in the example above and we think this will be a large operational headache for firms in Europe.

We think that there will be a lot of push-back from large non-EU companies with operations in Europe to this RTS and with a simple explanation that the word "undertakings" can be understood to mean "group of undertakings under consolidated supervision outside the EU" we think the same policy objectives can be achieved and a lot of absurd outcomes avoided.

CONCERNS WITH THE PROPOSED APPROACH FOR THE CALCUATION OF THE THRESHOLD

Level playing field

We would first like to show our appreciation to the EBA for addressing the level playing field issue that became apparent during the consultation of the first version of the draft RTS. With the approach proposed in the Second Classification RTS, investment firm groups with their Holding in the European Union ("**EU Groups**") will now have to calculate their total assets in the same way as groups with their Holding outside of the European Union ("**non-EU Groups**"). In terms of the calculation of the threshold there will now indeed be a level playing field.

However, **EU Groups will still be at a significant disadvantage compared to non-EU Groups**. The reason for this is that at soon as the EUR 30bn is passed, the investment firm in an EU Group will have to apply for a banking license and (according to article 109 CRD and article 11 CRR) apply the CRD/CRR framework on a consolidated basis to all their relevant entities in the EU Group worldwide. While, even though the investment firm in the non-EU Group will also have to apply for a banking license, the application of the CRD/CRR framework in case of that non-EU Group will be limited to their EU investment firm. As there are no other jurisdictions in the world that apply a Basel-style prudential framework on investment firms, the non-EU entities of these non-EU Groups will be subject to a much more proportional regime outside of the EU.

Proposed calculation method leads to strange outcomes

The proposed RTS would exclude an EU investment firm with assets of EUR 5bn from being considered a credit institution both if it is (1) part of a group where there is EUR 24bn in assets in New York, or (2) where there are more than EUR 30bn assets in New York. But there is an awkward regulatory question to be dealt with when considering how that firm in New York can grow its assets from EUR 24bn to EUR 30bn without having the EU investment firm first register as a credit institution and then attempt to cancel its registration again when the New York entity continues to grow its' assets past the EUR 30bn figure (as according the new art. 4(1)(b)(ii) of CRR the New York entity will fall out of the calculation again).

Unfavourable treatment of option position under IFRS

In our response to the first consultation, we asked for confirmation that we could use other accounting methods for our non-EU entities (e.g. calculate the assets of our US entities using US-GAAP, which allows for more accurate off-setting of positions). However, in the Second Classification RTS the EBA explicitly states that all non-EU local GAAPs-based values should be adjusted in order to reflect either IFRS or other EU member state GAAP. The IFRS accounting methodology however does not provide for meaningful off-sets of position in derivatives and is therefore not a prudent measure of the actual risk within the derivatives portfolio leading to artificially large balance sheets for in particular market makers.

THE INTENT OF THE LEVEL 1 TEXT WAS TO ONLY LOOK AT EU ASSETS

As we explained in our response to the first consultation we continue to think that for the calculation of the total asset threshold, firms should only have to include the assets of their EU entities and any EU branches of non-EU subsidiaries of EU entities. And **we are convinced that it was also the intent of the level 1 text to only look at EU assets**.

Relevance of non-EU entities that are not subsidiaries of EU firms from an EU prudential perspective

The aim for regulation is to capture prudential risks that materialise on EU markets or that affect EU clients of investment firms. Clearly, and by way of example, the market making activities on the Tokyo Stock Exchange of a Japanese subsidiary of a holding company that also has an EU investment firm subsidiary trading on Borsa Italiana or Euronext Paris will not have any prudential implications for the EU financial markets.

Opinion of the European Central Bank

We feel it was also the intent of the original Commission proposal to require firms to only calculate the EU assets. Why else would the ECB have stated in their opinion to an early draft of the Level 1 text that "*the proposed regulation should provide clarification as to how the assets are to be calculated, <u>i.e. including the assets of Union branches of third country groups and third country subsidiaries of undertakings in the Union</u> arising from their consolidated balance sheet*" (ECB opinion on the legislative proposal CON/2018/36 of August 22, 2018). In their response the co-legislators included in art. 4(1)(1) of CRR (inserted via IFR art. 62(3)) a provision stating that for a *"[...] third party group, the total assets <u>of each branch</u> of the third country group authorised in the Union shall be included in the combined total value of the assets of all undertakings in the group*". If all entities and their assets worldwide would already have been in scope of the calculation, the ECB's concerns would clearly have been superfluous.

Ignoring the assets of entities that have assets >EUR 30bn

Another indication for the initial intention of the legislation is the fact that – according the new art. 4(1)(b)(ii) CRR - for the calculation of the EUR 30bn Class 1 threshold, firms can exclude the assets of subsidiaries in third countries that individually have assets *greater* than EUR 30bn. That language can only be explained if the text was indeed written with the intent that it would apply in the EU context, as a firm in another EU member state with assets >EUR 30bn will be regulated as a credit institution in that member state. Only for banks this would also be the case in major jurisdictions elsewhere in the world, as they have all implemented the Basel framework. But nowhere in the world – except for the EU - are *investment firms* with assets >EUR 30 bn required to apply for a banking license. So why would they then be excluded from the EU calculation originally?

WHAT IS THE IMPACT IF WE DO NOT GET THIS RIGHT?

Capping the growth of EU investment firms

The proposed approach poses many problems for relatively large European investment firms. **The classification rules effectively put a cap on the growth of EU Groups**, as passing the EUR 30bn threshold would suddenly bring the whole group worldwide under a prudential regime that was never designed for them, but was tailored to the activities of banks taking deposits and lending money. Classifying these investment firms as credit institutions would also subject them to the *bank* recovery and resolution regime, make them contribute to the EU *bank* resolution fund, make them comply with the Network and Information Security Directive (NIS) and bring them in scope of all other, future (Basel) regulations designed for *banks*. So, EU investment firms will really have no option but to (1) at some point stop growing to prevent passing the Class 1 threshold, or (2) move their holding outside of the EU to safeguard at least their non-EU operations from a disproportionately burdensome regulatory regime that was designed for credit institutions. **As the EU is politically committed to growing its capital markets capabilities in the context of the CMU, this proposal appears to create all the wrong incentives for that political objective.**

Reduced liquidity in instruments that are balance sheet heavy

Liquidity providers/market making investment firms are in particular impacted by the proposed classification regime. Indeed, the nature their business involves taking up positions that are fully hedged (so low-risk) but that in accordance with IFRS do have to be accounted for on both sides of the balance sheet. **An unintended consequence of the new proposals may therefore be that more and more market makers will choose to focus their liquidity provision on instruments (e.g. futures) that do not lead to significant balance sheet increases under IFRS and reduce market making activities in instruments that do (e.g. shares, options, government bonds).** Optiver is aware of certain investment firms that, as a result of the sudden increase in volumes and volatility when the COVID19 crisis kicked in last year, took the decision to actively manage their balance sheet to prevent their assets from passing the Class 1 threshold. This decision meant refocusing away from market making activities and start focusing on those trades that added the least to total assets and/or off-loading certain positions to create more flexibility on the balance sheet.

PROPOSALS

In light of the above, and to avoid implementing a prudential framework that is wholly disproportionate for most investment firms active in the EU, we suggest the following recommendations – which are consistent with the Level 1 text - for the Second Classification RTS:

Proposal 1 - focus on EU Activities

a) A provision making clear that the threshold in point (a) of Article 8a(1) CRD is determined by reference to the total value of the consolidated assets of an EU entity that is authorised to carry out specified activities;
b) A provision making clear that the threshold in point (b) of Article 8a(1) CRD is determined by:
    i. identifying all the EU entities in a group that are authorised to carry out specified activities (step 1);
    ii. eliminating those EU entities identified in step 1 which are subsidiaries of another entity identified in step 1 (to prevent double counting);

iii. calculating the consolidated assets of each of the remaining entities identified at step 1 (including the assets of their EU and non-EU subsidiaries);
iv. eliminating those remaining EU entities whose consolidated assets are equal to or greater than EUR 30bn (consistently with the requirements of point (1)(b)(ii) of Article 4(1) CRR and point (b) of Article 8a(1) CRD);
v. summing the total consolidated assets of the remaining entities;
vi. finally, for both EU and third-country headquartered groups, adding to that sum the assets of authorised EU branches of non-EU entities (for consistency with the requirements of point (1)(b)(ii) of Article 4(1) CRR).

Optiver believes that this solution would meet the original intent of the Level 1 legislation, as well as providing a solid prudential framework for investment firms and the prudential risks of these firms for EU financial markets and its market participants.

It would also prevent national Member States from having to adopt national regimes to mitigate the disproportionate impact of applying the full banking framework on firms that do not take deposits or lend money to customers. Such initiatives - and we know of at least one Member State already working on such a national regime - would not contribute to a further harmonisation of the EU single rulebook for financial markets and create an unlevel playing field even within the EU.

Proposal 2 – adjustment for non-EU assets

As set out in the 'Third Question in the Second Classification RTS' section on page 2, Optiver highlights the potential unintended consequences of applying the EUR 30bn threshold on an underlying basis for third country investment firms. Optiver strongly believes that the application of the reclassification RTS should be independent of the legal structure that the Investment Firm Group chooses to apply within the third country jurisdiction. Optiver would therefore propose that the definition of 'undertaking' should be adjusted to the following, or similar wording:

'relevant undertaking' means the following:

i) any EU undertaking carrying out the activities referred to in point (1)(b) of Article 4(1) of Regulation (EU) No 575/2013; or,
ii) any group of non-EU undertakings, carrying out the activities referred to in point (1)(b) of Article 4(1) of Regulation (EU) No 575/2013, under consolidated supervision outside the EU with the intention to consolidate investment firm assets on a per jurisdictional basis outside of the EU.