**The CNMV's Advisory Committee has been set by the Spanish Securities Market Law as the consultative body of the CNMV. This Committee is composed by market participants (members of secondary markets, issuers, retail investors, intermediaries, the collective investment industry, etc) and its opinions are independent from those of the CNMV.**

**REPLY BY THE ADVISORY COMMITTEE OF THE CNMV TO THE EBA'S DISCUSSION PAPER ON DESIGNING A NEW PRUDENTIAL REGIME FOR INVESTMENT FIRMS**

The EBA's discussion paper is within the context of the advice that the European Commission requested as to whether or not the current prudential regime for investment firms, consisting basically of applying the banks' prudential regime, with some amendments, is appropriate.

The EBA issued a first report to the EC, jointly with ESMA, in 2015. Subsequently, through the national authorities, it obtained more specific information from European investment firms in order to draw up a more detailed report for the EC.

Within this process, the EBA issued this discussion paper to request feedback on a number of proposals for a new prudential treatment of investment firms in such areas as the calculation of minimum own funds, instruments in which those funds should be materialised, liquidity requirements, risk concentration, consolidated supervision, corporate governance, and remuneration policies.

The Advisory Committee acknowledges that this is a broad area with notable technical components that must be fine-tuned within a legislative process that may follow upon this work by EBA and ESMA.

In any case, it has the following comments to make about this Discussion Paper:

[**Question 1. What are your views on the application of the same criteria, as provided for G-SIIs and O-SIIs,**](#_bookmark12)[**for the identification of ‘systemic and bank-like’ investment firms? What are your views on both qualitative**](#_bookmark12)[**and quantitative indicators or thresholds for ‘bank-like’ activities, being underwriting on a firm commitment**](#_bookmark12)[**basis and proprietary trading at a very large scale? What aspects in the identification of ‘systemic and bank-**](#_bookmark12)[**like’ investment firms could be improved?**](#_bookmark12)

We consider the criteria set out in the Discussion Paper to be appropriate, without prejudice to the content of our answer to the next question.

[**Question 2. What are your views on the principles for the proposed prudential regime for investment**](#_bookmark19)[**firms?**](#_bookmark19)

We consider the establishment of specific rules for investment firms to be a very positive development. It is an important step forward in regulating this class of entities, which do not engage in banking activities and which are mainly service providers (though some trade for their own account). Therefore, it is not the quality of their assets that determines their level of risk, or their coverage with equity, as in the case of banks; rather, what needs to be covered is their operational risk (a broad term).

Consequently, we welcome the fact that the DP has identified this reality appropriately. We believe that the identification of specific risks, such as RtC, RtM and RtF, is a good analysis of the potential sources of risk, and that they do in fact identify liabilities that may arise for investment firms as a result of their service activity.

However, we do not agree that the conclusion should be reached by adding up a percentage of each risk type. We have the following comments in this regard:

* Operational risk is hard to measure. It would have been advisable to include a realistic, evidence-based assessment of the level of own funds required to cover it. Current regulatory requirements as to own funds to cover operational risk occasionally require amounts far in excess of the losses actually observed in recent years.
* The DP does not refer to fraud risk specifically. Although it is a facet of operational risk, the fact is that, when compared with other risks, it may render the amount of own funds of a small or mid-sized firm irrelevant since a case of fraud may result in the total disappearance of those own funds.
* It is not realistic to imagine that a firm can be liquidated in the space of four months. These processes normally take much longer — years, even. Also, while a firm is in liquidation, it does not incur many of the expenses associated with a going concern (wages, suppliers, etc.). However, though not very accurate, a percentage of the fixed overheads may itself be indicative of a firm's level of activity and, as such, may serve as a benchmark in this respect, if we are aware of its limitations. However, it is proposed that this benchmark be maintained for all firms providing Class 2 and 3 investment services, which would lead to the same regime for both Classes.
* Operational risk can be reduced very significantly with properly supervised organisational and internal control measures. Such measures represent a cost for the system in general (firms and supervisor) that should be offset by lower requirements as to immobilised own funds, enabling firms that accredit good internal control and compliance systems to conduct their business efficiently and grow. Also the cost of investment guarantee schemes, which are directly aimed at reducing the risk to clients in the event of insolvency, could also be reflected in a reduction in own funds requirements. Both considerations might lead to a "down-lift" coefficient, and not just an "up-lift" coefficient, as the DP proposes.
* The rules on own funds should not prevent small and medium-sized firms from growing. Requiring an unnecessarily high percentage of own funds with respect to the volume of activity may limit growth of the business. This constraint should be avoided by applying realistic, evidence-based amounts so as not to hamper growth, which might also be beneficial to the market as a whole.
* An appropriate example is the regulation on minimum own funds for collective investment scheme management companies, where the requirement is a minimum amount plus a very small percentage of the assets under management.
* To achieve a more evidence-based approach to this, it would be advisable to: (i) review cases of insolvency that have arisen among EU investment firms, and examine the reasons, the consequences, and the role of own funds; and (ii) assess the level of losses that EU investment firms have actually incurred in each activity as a result of operational risk. It is very important to review past experience in this connection.
* This is an extremely important issue since a more accurate assessment of risks for investment firms should not lead to an increase in own funds requirements such as to render the firms barely viable. The amounts resulting from the existing regulations and the new regulations should be calculated rigorously for specific cases, followed by an analysis of whether those amounts are justified. In this case too, it is very important to review past evidence.
* As regards investment firms' compliance with the other prudential requirements (liquidity, consolidation, corporate governance, remuneration, etc.), we refer to them in the specific questions on those matters.

[**Question 3. What are your views on the identification and prudential treatment of very small and non-**](#_bookmark29)[**interconnected investment firms (‘Class 3’)? If, for example, such class was subject to fixed overheads**](#_bookmark29)[**requirements only, what advantages and drawbacks would have introducing such a Class 3? Conversely,**](#_bookmark29)[**what advantages and drawbacks could merging Class 3 with other investment firms under one single**](#_bookmark29)[**prudential regime with ‘built-in’ proportionality have?**](#_bookmark29)

The criteria for distinguishing between Classes 2 and 3 are not easy to implement and we believe that newly-created investment firms that are small (in terms of assets under management, amount brokered or custodied, etc.) should be allowed to grow.

To that end, as indicated earlier, fixed overheads could also serve as a benchmark for Class 2 firms, which would result in enhanced treatment of Classes 2 and 3 for these purposes. Thus, when certain thresholds are exceeded, a percentage of these volumes (based on evidence) would be calculated and the higher of the two (percentage of fixed overheads or percentage of revenues) would be set as the minimum.

[**Question 4. What are your views on the criteria discussed above for identifying ‘Class 3’ investment firms?**](#_bookmark30)

See reply to previous question.

With regard to the features that can enable one class to be distinguished from another:

* Items a) and b) should be merged since firms have client securities and cash solely for the purpose of providing securities custody and administration services. This is a service whose impact on the own funds calculation should be included in the general rules that are finally implemented.
* As for item h), it is not clear whether the impact of belonging to a wider group should increase or decrease the requirements. This circumstance should not affect own funds requirements at an individual level. However, the measures proposed by the DP in this respect (paragraphs 152 and 153) would be applicable.
* As for item i), it does not appear appropriate, in a single EU capital market, for passporting to be "penalised" with higher own funds requirements.
* Regarding item j), although the use of tied agents requires additional internal control, it is not clear that it poses a greater risk with regard to allocating a firm to Class 2 or 3, since the quantitative risk that they pose would already have been calculated within the total risk.

[**Question 5. Do you have any comments on the approach focusing on risk to customers (RtC), risk to**](#_bookmark58)[**markets (RtM) and risk to firm (RtF)?**](#_bookmark58)

As noted above, the risks are well identified; although it is difficult to assess the impact of each one on capital adequacy calculations (and, therefore, on the firm's ability to honour its obligations to clients and the market), percentages that hamper business development without justification should be avoided. In this connection, we refer to our answer to question 2.

Moreover:

* Brokerage should not be measured by the number of brokered transactions. An order may be executed in several transactions, and this method is difficult to evaluate. Moreover, much will depend on the product that is being traded. The brokered volume would be a much more sensitive metric.
* The RtM criteria are too theoretical and not granular enough. These risks are normally collateralised and netted beforehand. This is the case in OTC transactions under framework contracts with collateral, and also in transactions with central counterparties and markets. Therefore, those risks need to evaluated more granularly on a case-by-case basis.
* As for RtF, it is an operational risk that can be reduced efficiently through qualitative rather than quantitative means, and a method should be designed to calculate a "downlift" as well as an uplift.

[**Question 6. What are your views on the initial K-factors identified? For example, should there be separate**](#_bookmark59)[**K-factors for client money and financial instruments belonging to clients? And should there be an RtM for**](#_bookmark59)[**securitisation risk-retentions? Do you have any suggestions for additional K-factors that can be both easily**](#_bookmark59)[**observable and risk sensitive?**](#_bookmark59)

See response to questions 2 and 5.

Moreover, the K-factor requirement as regards securitisation risk-retention does make sense.

[**Question 7. Is the proposed risk to firm ‘up-lift’ measure an appropriate way to address the indirect impact**](#_bookmark60)[**of the exposure risk a firm poses to customers and markets? If not, what alternative approach to addressing**](#_bookmark60)[**risk to firm (RtF) would you suggest?**](#_bookmark60)

The methodology proposed in the DP and the underlying idea are appropriate.

However, this idea should also allow for "down-lifts", as discussed above. A small firm with adequate internal controls in real terms greatly limits operational risk. This needs to be reflected in the prudential regime, which, in fact, focuses on assessing that operational risk.

[**Question 8. What are your views on the ‘built-in’ approach to delivering simpler, proportionate capital**](#_bookmark61)[**requirements for Class 3 investment firms, (compared to having a separate regime for such firms)?**](#_bookmark61)

See response to questions 2 and 5.

[**Question 9. Should a fixed overhead requirement (FOR) remain part of the capital regime? If so, how could**](#_bookmark62)[**it be improved?**](#_bookmark62)

Although there are several valid options, taking FOR as the reference is positive since, in itself, it is a reflection of the firm's level of activity and operational capacity.

 Nevertheless, it should only be used if it can be cross-checked with an actual metric of business volume (e.g. percentage of revenues).

[**Question 10. What are your views on the appropriate capital requirements required for larger firms that**](#_bookmark63)[**trade financial instruments (including derivatives)?**](#_bookmark63)

There are no investment firms of that size in Spain. Nevertheless, the criterion in this case should be counterparty risk, which should be assessed after netting all legally nettable items and deducting any existing hedges and collateral.

[**Question 11. Do you think the K-factor approach is appropriate for any investment firms that may be**](#_bookmark64)[**systemic but are not ‘bank-like’?**](#_bookmark64)

Yes, but always with the major nuances and limitations set out in response to questions 2 and 5.

[**Question 12. Does the definition of capital in the CRR appropriately cater for all the cases of investment**](#_bookmark69)[**firms that are not joint stock companies (such as partnerships, LLPs and sole-traders)?**](#_bookmark69)

In these cases, the criteria should be more in line with those of other investment firms,

[**Question 13. Are the cases described above a real concern for the investment firms? How can those aspects**](#_bookmark70)[**be addressed while properly safeguarding applicable objectives of the permanence principle?**](#_bookmark70)

In Spain, this would apply only to natural persons who are financial advisors, for which there is a specific prudential regime.

[**Question 14. What are your views on whether or not simplification in the range of items that qualify as**](#_bookmark72)[**regulatory capital and how the different ‘tiers’ of capital operate for investment firms would be**](#_bookmark72)[**appropriate? If so, how could this be achieved?**](#_bookmark72)

Investment firms are usually small or medium-sized entities whose capital is made up of capital stock and reserves. Therefore, the Committee has no specific comments about the usefulness or otherwise of other capital instruments.

[**Question 15. In the context of deductions and prudential filters, in which areas is it possible to simplify the**](#_bookmark76)[**current CRR approach, whilst maintaining the same level of quality in the capital definition?**](#_bookmark76)

No additional comments as regards the treatment of goodwill, holdings in financial companies or the regime for pension funds set out in the DP.

[**Question 16. What are your views overall on the options for the best way forward for the definition and**](#_bookmark78)[**quality of capital for investment firms?**](#_bookmark78)

In line with the approach adopted throughout the DP, it is more appropriate to have a specific regime on capital definition and quality for investment firms that is clearly distinct from the banks' prudential regime.

[**Question 17. What are your views on the definition of initial capital and the potential for simplification? To**](#_bookmark80)[**what extent should the definition of initial capital be aligned with that of regulatory capital used for**](#_bookmark80)[**meeting capital requirements?**](#_bookmark80)

The Committee believes that the definitions of initial capital and regulatory capital should be aligned.

[**Question 18. What aspects should be taken into account when requiring different levels of initial capital for**](#_bookmark81)[**different firms? Is there any undesirable consequence or incentive that should be considered?**](#_bookmark81)

At present, initial capital depends on the activities that the specific investment firm can undertake. This is a good approach although, if the current criteria were revised, it would be necessary to assess those amounts to ensure that they do not constitute an unnecessary disincentive to the development of new firms (particularly in the Capital Markets Union scenario) while ensuring that new firms are appropriately capitalised.

[**Question 19. What are your views on whether there is a need to have a separate concept of eligible capital,**](#_bookmark86)[**or whether there is potential for simplification through aligning this concept with the definition of**](#_bookmark86)[**regulatory capital used for meeting capital requirements?**](#_bookmark86)

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[**Question 20. Do you see any common stress scenario for liquidity as necessary for investment firms? If so,**](#_bookmark100)[**how could that stress be defined?**](#_bookmark100)

No. The availability of liquidity to honour their debts as they fall due is something that each investment firm must evaluate as part of the task of management. Nevertheless, the current regime (10% of liabilities less balances with clients that have their own prudential regime) is unproblematic.

[**Question 21. What is your view on whether holding an amount of liquid assets set by reference to a**](#_bookmark101)[**percentage of the amount of obligations reflected in regulatory capital requirements such as the FOR would**](#_bookmark101)[**provide an appropriate basis and floor for liquidity requirements for ‘non-systemic’ investment firms? More**](#_bookmark101)[**specifically, could you provide any evidence or counter-examples where holding an amount of liquid assets**](#_bookmark101)[**equivalent to a percentage of the FOR may not provide an appropriate basis for a liquidity regime for very**](#_bookmark101)[**small and ‘non-interconnected’ investment firms?**](#_bookmark101)

See response to question 20.

[**Question 22. What types of items do you think should count as liquid assets to meet any regulatory**](#_bookmark102)[**liquidity requirements, and why? (Please refer to Annex 4 for some considerations in determining what may**](#_bookmark102)[**be a liquid asset).**](#_bookmark102)

Cash and securities that have a liquid market should be classified as liquid. The references listed in Annex 4 appear to be reasonable but, if they are applied, they should be specified sufficiently to ensure they do not entail complex calculations or accessing information that is costly or difficult to find or assess.

[**Question 23. Could you provide your views on the need to support a minimum liquidity standard for**](#_bookmark103)[**investment firms with the ability for competent authorities to apply “supplementary” qualitative**](#_bookmark103)[**requirements to individual firms, where justified by the risk of the firm’s business?**](#_bookmark103)

As discussed above, the liquidity ratio is not so necessary in investment firms since this is an issue for a firm's management to decide. However, if it is implemented, the regime should be as simple as possible.

This does not prevent the authority, in certain cases, from requiring broader compliance with this ratio, or imposing a higher ratio.

[**Question 24. Do you have any comment on the need for additional operational requirements for liquidity**](#_bookmark104)[**risk management, which would be applied according to the individual nature, scale and complexity of the**](#_bookmark104)[**investment firm’s business?**](#_bookmark104)

There does not appear to be any need.

[**Question 25. What are your views on the relevance of large exposures risk to investment firms? Do you**](#_bookmark109)[**consider that a basic reporting scheme for identifying concentration risk would be appropriate for some**](#_bookmark109)[**investment firms, including Class 3 firms?**](#_bookmark109)

We agree with the EBA's position as set out in the DP.

[**Question 26. What are your views on the proposed approach to addressing group risk within investment**](#_bookmark114)[**firm-only groups? Do you have any other suggested treatments that could be applied, and if so, why?**](#_bookmark114)

We agree with the EBA's position as set out in the DP.

[**Question 27. In the case of an investment firm which is a subsidiary of a banking consolidation group, do**](#_bookmark115)[**you see any difficulty in the implementation of the proposed capital requirements on an individual firm**](#_bookmark115)[**basis? If so, do you have any suggestion on how to address any such difficulties?**](#_bookmark115)

No specific difficulties are envisaged, although the consolidation method would have to be regulated.

[**Question 28. What other aspects should the competent authorities take into account when addressing the**](#_bookmark120)[**additional prudential measures on an individual firm basis under the prudential regime for investment**](#_bookmark120)[**firms?**](#_bookmark120)

See response to questions 2 and 5.

[**Question 29. What examples do you have of any excessive burden for investment firms arising from the**](#_bookmark126)[**current regulatory reporting regime?**](#_bookmark126)

At present, small or medium-sized investment firms with simple businesses must draw up numerous statements setting out concepts (such as credit risk) that are not relevant to them, and they must ascertain which items are computable — and which are not — in forms that are lengthy, tedious and difficult to complete, requiring levels of disaggregation that are unjustified.

This requires devoting staff, incurring costs, the risk of errors, and the feeling that the regime is not really adapted to the firm's business, without achieving greater or better disclosures to the supervisor.

[**Question 30. What are your views on the need for any other prudential tools as part of the new prudential**](#_bookmark127)[**regime for investment firms? And if required, how could they be made more appropriate? In particular, is**](#_bookmark127)[**there a need for requirements on public disclosure of prudential information? And what about recovery**](#_bookmark127)[**and resolution?**](#_bookmark127)

As indicated above, internal control and compliance measures are an efficient way of significantly reducing operational risk. This fact should be clearly reflected in a reduction of the requirements regarding immobilising own funds.

Moreover, reporting capital levels to the supervisor and the public (by means of a specifically-designed document) is necessary in the former case and desirable in the latter.

Class 2 and 3 investment firms should be expressly excluded from the recovery and resolution regime and should not be obliged to contribute to the corresponding fund.

The current obligation in this connection is clearly disproportionate. Not because of size but because of the type of activity, type of firm, business model, etc., which also requires proportionate application that, in this case, should lead to exemption from the recovery and resolution regime.

[**Question 31. What are your views on the relevance of CRD governance requirements to investment firms,**](#_bookmark130)[**and what evidence do you have to support this?**](#_bookmark130)

It is correct to say (as the DP does) that investment firms must have strong internal control and compliance systems and their shareholders, directors and senior management must fulfil suitability requirements.

Nevertheless, all corporate governance requirements should be reviewed in a more detailed way in the light of this new prudential regime for investment firms.

For example, the same restrictions on the number of directorships should not apply to small firms, nor should the requirements be made so strict as to make it very difficult for small and mid-sized firms to engage directors.

As for remuneration policy, we refer to our answers to questions 32 and 33.

[**Question 32. As regards ‘systemic and bank-like’ investment firms, do you envisage any challenges arising**](#_bookmark131)[**from the full application of the CRD/CRR remuneration requirements, and if so, what evidence do you have**](#_bookmark131)[**to support this? For all other investment firms, what are your views on the type of remuneration**](#_bookmark131)[**requirements that should be applied to them, given their risk profiles, business models and pay structures?**](#_bookmark131)

Because of the nature of their business, investment firms have activities that can only be remunerated on a variable basis. The current regime prevents this. This impedes the development of legitimate business models that do not affect the firm's future viability and were simply not analysed appropriately before imposing a regime designed for large banks.

Therefore, the Committee agrees with the EBA position, as set out in the DP, of subjecting investment firms to remuneration policies related to compliance with standards of conduct, but not to corporate governance, as it would be disproportionate.

[**Question 33. What is your view on a prudential remuneration framework for other than ‘systemic and**](#_bookmark133)[**bank-like’ investment firms that should mainly aim to counteract against conduct related operational risks**](#_bookmark133)[**and would aim at the protection of consumers?**](#_bookmark133)

See response to question 32.

[**Question 34.**](#_bookmark135)

[**What are your views on having a separate prudential regime for investment firms?**](#_bookmark135)

[**Alternatively, should the CRR be amended instead to take into account a higher degree of proportionality?**](#_bookmark135)[**Which type of investment firms, if any, apart from systemic and bank-like investment firms, would be better**](#_bookmark135)[**suited under a simplified CRR regime?**](#_bookmark135)

As the DP notes, a simplified CRR regime has some advantages (experience, investments, coherence within bank groups).

However, it is clearly better to have a special system for investment firms so that they have specific EU-wide regulation that allows for greater sensitivity to risk and also provides for more efficient supervision.

All this under the principle that the resulting capital requirements should be sufficient but also allow the business to develop. This issue, not analysed in the DP, is of vital importance.

The CRR regime is complex, wordy and inappropriate for investment firms, but it has not led to capital requirements that are incompatible with business development. Nor is there evidence of the need for higher capital (see the proposal for analysis in this connection, set out in the answer to question 2). On the basis of this evidence, the new system should avoid imposing unnecessary or unjustified increases.

[**Question 35. What are the main problems from an investment firm perspective with the current regime?**](#_bookmark136)[**Please list the main problems with the current regime.**](#_bookmark136)

As indicated, complexity, inadaptation to the business profile, excessive assessment work and useless reporting, an incorrect vision of firm's capital situation vis-à-vis their real risks, very complex reporting that is very difficult to understand, etc.

Moreover, the current calculation of operational risk is clearly very high and not commensurate with past experience of problems and costs under this heading.