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ASSOCIATION
INVESTMENT MATTERS

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Dear Sir or Madam,

RE: EBA Discussion Paper on a new prudential regime for investment firms (EBA-DP-2016-02)

The Investment Association is delighted to provide input to your consultation.

Yours faithfully,

Johannes Woelfing

Regulatory & Legal Specialist

The Investment Association is a company limited by guarantee registered in England and Wales. Registered number 04343737. Registered office as above.

CONSULTATION RESPONSE

ABOUT THE INVESTMENT ASSOCIATION

The Investment Association is the trade body that represents UK investment managers, whose 200 members collectively manage over £5.5 trillion on behalf of clients.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs.

The UK is the second largest investment management centre in the world and manages 37% of European assets.

More information can be viewed on our website.

PRELIMINARY REMARKS

We supported the conclusions and recommendations of the EBA Report from 2015, particularly concerning the development of a prudential regime for "non-systemic" investment firms. As the EBA Report highlighted very clearly, there are a number of issues with the current regime.

The current capital requirements regime has been primarily designed to ensure the stability of banks and is not suitable for the majority of investment firms, given their fundamentally different risk profile. The principal risk run by our members is operational risk, which is why we believe a differentiated prudential regime to be necessary.

When capitalised, managed and supervised properly, even large investment firms, in contrast to banks, do not need to be rescued with taxpayers' money to prevent the public from harm when their businesses become unviable, provided that the regime ensures that clients' assets and monies are appropriately segregated.

Institutions running an agency based business model can, under a suitable and well-designed prudential framework, always be wound down in an orderly manner without external adverse effects.

Any discussion of prudential regulatory measures should start with a clear understanding of the risks, which these measures are looking to address. The overall approach set out in the EBA's report from 2015 and in the discussion paper, which developed this approach further is therefore an important and positive step in the right direction.

We believe the recommendation to develop a separate prudential regime for "non-systemic" investment firms provides an ideal opportunity to establish a framework which is designed to address the nature of the activities of investment firms and the risks which they present to the regulatory system. The Investment Association will support supervisors and legislators in their efforts to create a new prudential regime for investment firms, which helps institutions to improve their risk management and provides transparent and efficient rules for the calculation of capital requirements, however more in depth work on a new regime for investment firms is needed.

We are keen to provide further assistance in this process and we welcome, therefore, the opportunity to respond to EBA's proposals for a new prudential framework for investment firms.

QUESTION 1.

What are your views on the application of the same criteria, as provided for G-SIIs and O-SIIs, for the identification of 'systemic and bank-like' investment firms? What are your views on both qualitative and quantitative indicators or thresholds for 'bank-like' activities, being underwriting on a firm commitment basis and proprietary trading at a very large scale? What aspects in the identification of 'systemic and bank-like' investment firms could be improved?

We think the distinction between category 1 and category 2 firms should be based on the business model of firms, which can vary significantly between different types of investment firms.

The most important fundamental prerequisite for the identification of a systemic important institution is significant balance sheet exposure. A quantitative analysis as it is currently undertaken in accordance with the EBA O-SII guidelines[1] helps to identify systemically important institutions by identifying business models, which could potentially cause systemic risk.

EBA proposed in its report from 14 December 2015[2] to create a category of firms engaging in bank-like activities. Bank-like activities are according to the EBA report 'bank-like' intermediation and underwriting of risks at a significant scale. Such activities expose institutions to credit risk, primarily in the form of counterparty risk, and market risk for positions taken on own account. Firms, which are not engaging in these bank-like activities, are unlikely to meet the criteria of the guidelines. Most investment firms and the vast majority of investment firms are typically not engaging in these activities, are not exposed to these risks.

The guidelines are, therefore suitable to distinguish between systemic, bank-like investment firms and the rest of the investment firm universe.

QUESTION 2.

What are your views on the principles for the proposed prudential regime for investment firms?

The Investment Association believes that an appropriate prudential regime for investment firms has to be based on the nature of their business, reflecting the fundamental differences to banking and taking into account their economic function. The rules should therefore address operational risk as a key risk, and aim to minimise any disruption and return assets to the owners in a gone concern situation. Market and credit risk are not considered significant concerns for a typical asset manager. We, therefore, welcome EBA's proposals and would encourage the EBA and the European legislators to continue their work and to follow the approach EBA has taken in its first report in 2015 and in the current discussion paper.

The proposals in the EBA discussion paper are a first step in the process of designing a new prudential regime for investment firms. We agree with the EBA's concept of basing prudential

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[1] Guidelines on the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD) in relation to the assessment of other systemically important institutions (O-SIIs) – EBA/GL/2014/10 of 16 December 2014.

[2] EBA Report on investment firms – Response to the Commission's call for advice of December 2014 (EBA/Op/2015/20), available on the EBA website: https://www.eba.europa.eu/-/eba-issues-recommendations-for-sound-prudential-regime-for-investment-firms

requirements on the risks inherent in the business of investment firms and not copying across a poorly adapted version of a capital requirements regime designed for large international banks.

The proposed principles are not yet a guarantee that the final framework will work as an appropriate prudential rulebook, but we agree with most of the points the EBA made in chapter 4.2.2 paragraph number 12 a) – f).

We suggest with regard to EBA's principle a) not to draw conclusions whether investment firms managing assets on behalf of third parties may be systemic. The global debate whether investment firms should be considered systemic is led by the FSB and IOSCO and we would suggest to base future regulation on their findings. We appreciate that some investment firms may engage in bank-like activities and that these investment firms can pose different risks to customers and markets. It is essential that the criteria to identify these firms are absolutely clear and based on activities, not on size or a potential designation of an investment firm as systemic.

Regarding principle b), we would suggest clarifying further the purposes of capital requirements for investment firms. EBA noted already in its report from December 2015 that the purpose of capital requirement standards for investment firms is a strengthening of the soundness and stability of investment firms on a 'going concern' basis.

Capital requirements should, according to paragraph 12 b) of the discussion paper ensure the continuity of services. We support EBA in its efforts to improve stability in financial markets but don't think investment firms should be regulated on a going concern basis. The first and most important objective of a prudential regime for investment firms should be the protection of investors and markets. It is not necessary to protect the balance sheets of investment firms to achieve this objective.

We would encourage EBA to define the point to which continuity of services is necessary to protect investors and markets. Investment firms should be able to fail and a prudential regime should be designed to ensure that firms have enough resources to transfer their businesses or to return the assets they are managing. There is no benefit in protecting the balance sheet of investment firms for the sake of continuity alone.

The EBA expresses its view under paragraph 12 c) that prudential requirements for investment firms have to take into account the additional risk associated with holding client money and securities. We appreciate that handling or holding client money and securities can give rise to additional risk and that it is appropriate for a capital requirements regime to reflect these risks. Firms holding the relevant client money permissions are currently subject to very different requirements in different member states. Client money and securities have to be kept in segregated accounts in a number of member states. Firms in other member states are not required or legally not able to hold client money in ring-fenced accounts. The risk for investors to lose their assets is limited to breaches of conduct or transitional periods where clients' assets (money or securities) are ring fenced. We think it is necessary to treat these risks differently to situations where client's assets are not protected in insolvency.

We agree with the principles under e) and f).

The EBA introduces in paragraph number 12 f) the concept of risk to the firm itself and we understand that less well-capitalised firms might act differently under higher pressure and might be more susceptible to weaker controls and higher risk taking. An appropriate prudential framework should, however, cover all potential risk for markets and investors. There is no need to protect the firm itself, which should just be wound down in an orderly fashion. We see therefore no immediate need to include further capital requirements for commercial decisions made by firms with regard to their balance sheet exposures. We will come back to this point in our response to question 5.

Our members are currently all subject to prudential requirements. Most of the firms are regulated in accordance with CRD/CRR. Managers of collective investment vehicles are subject to capital requirements deriving from UCITS or AIFMD. We have no evidence that these capital requirements are insufficient for investment firms.

We agree, however, with EBA's assessment, that some risks for investment firms subject to CRD/CRR may not be reflected fully, or indeed, at all, in the current CRD/CRR framework. A revised regime could be easier to implement and more effective in ensuring that firms hold capital which allows them to wind down in an orderly manner when necessary.

QUESTION 3.

What are your views on the identification and prudential treatment of very small and non-interconnected investment firms ('Class 3')? If, for example, such class was subject to fixed overheads requirements only, what advantages and drawbacks would have introducing such a Class3? Conversely, what advantages and drawbacks could merging Class 3 with other investment firms under one single prudential regime with 'built-in' proportionality have?

Please see our response to question 8.

QUESTION 4.

What are your views on the criteria discussed above for identifying 'Class 3' investment firms?

For the above question, it would be useful to receive detailed comments on each of the following items, which would preclude an investment firm from being in 'Class 3':

a) holding client money or securities,

b) ancillary service of safekeeping and administration (B1),

c) dealing on own account (A3),

d) underwriting or placing with a firm commitment (A6),

e) the granting of credits or loans to an investor (B2),

f) operating a multilateral trading facility (or MTF) (A8),

g) the MiFID II activity of operating an organised trading facility (or OTF), h) being member of a wider group,

i) using a MiFID passport, and

j) using tied agents.

None of the listed activities should preclude a firm to fall under Category III.

QUESTION 5.

Do you have any comments on the approach focusing on risk to customers (RtC), risk to markets (RtM) and risk to firm (RtF)?

We agree with the concept of a set of reasonably simple and observable capital proxies. It is essential that the calibration of these proxies is accurate. We appreciate EBA's efforts to create a simpler framework which is easier to comply with and easier to apply by supervisors coherently, but

all efforts to develop a prudential regime for investment firms which reflect risks better will be in vain if the K-factors are not representing the risks properly.

RISK TO CUSTOMERS

We agree that investment firms can cause risks for their customers and that these risks need to be addressed. Firms and supervisors have a broad range of measures at hand to minimise risks and to address situations in which risks materialise. Capital requirements are only one of the tools available to address the risk to customers. We agree with the principle that customers of investment firms need to be protected, but we are concerned that a number of the K-factors proposed in this section are not reflecting these risks appropriately. Please see also our response to question 6.

RISK TO MARKETS

The vast majority of investment firms are not dealing on their own account. The proposed "K-factor" of proprietary trading activities (PTA) is, therefore, not relevant for these firms.

RISK TO FIRMS

The EBA introduces the concept of risk to the firm itself (RtF) in chapter 4.2.2 paragraph number 12 f). We understand that a firm that is leveraged significantly may behave differently to a firm, which is not. This may change the risk profile of a firm, but only additional risk to customers and additional risk to markets should trigger additional capital requirements. The new framework should cover these risks under these categories and we would ask EBA at this point to allow a good degree of commercial judgement by firms.

Firms, which are growing, accessing new markets or planning acquisitions, will probably need to borrow to achieve their goals. The additional risk that might arise from these undertakings should firstly be addressed by holding capital against risk to consumers and risk to markets. There is no additional value in protecting the balance sheet of firms. A balanced capital adequacy regime protects investors, markets and financial stability without hindering innovation and growth unduly. It is, therefore necessary to develop a framework that allows firms to take commercial decisions, afford them the opportunity to grow and to borrow when necessary, without triggering automatically a penalising double counting of risks and increased capital requirements if there is no incremental risk to markets and investors.

QUESTION 6.

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

ASSETS UNDER MANAGEMENT

European legislation does not currently provide a harmonised definition of assets under management (AUM) that could be used as a basis for a calculation of capital requirements. We appreciate that managers managing large portfolios may potentially cause more harm to a greater number of customers, but we don't think that an AUM figure is currently a suitable and comparable metric.

We would need a clear definition of AUM if AUM were to be used to determine capital requirements. Such a definition cannot be based on the sheer value of assets alone. The risk profile of different managers managing portfolios of the same size will depend on a multitude of factors like the number of transactions, the instruments held in a portfolio, the size of orders and volume of redemptions and subscriptions. EBA will have to provide a clear definition of AUM taking the different factors into account.

The new regime will also have to address the volatility of AUM figures. Volatile exchange rates are just one example for a situation causing abruptly significant changes of AUM figures. The final prudential framework has to provide methods allowing a smoothing of the capital requirements based on figures, which might change on a daily basis.

ASSETS UNDER ADVICE

We have similar concerns with regard to the K-factor based on assets under advice (AUA). AUA can be used as a metric for operational risk, but the K-factor has to be adjusted to the specific situation of the firm and the type of customers.

CLIENT MONEY HELD

Many investment firms currently hold client money and all are subject to strict requirements with regard to this business. In the UK client money is subject to the FCA's CASS rulebook[3]. The safeguards in place for client assets differ and we would suggest that the different levels of safeguards be reflected in the calculation of capital requirements for client money held (CMH).

A situation in which client money is not protected in the case of insolvency is not comparable with a scenario where client money is handled by investment firms, but ring-fenced. These are completely different risk situations. Conduct breaches and operational risk are the most significant risks for client money, which is not ring-fenced.

Client money, which is not held in segregated accounts, is exposed to a far wider range of risks. The new prudential regime has to take this into account and should additionally incentivise firms to optimise their client money policies. We would suggest permitting a significant down scalar where client money is ring-fenced.

LIABILITIES TO CUSTOMERS

This K-factor will be negligible for most investment firms. Present EU and global FSB standards ensure that any securities lending activities are properly collateralised. There might be scenarios under which the LTC K-factor could be useful, but it has to be calibrated properly and permit a reduction to zero where firms are mitigating risks by other means.

CUSTOMER ORDERS HANDLED

We assume the AUM K-factor will cover this for investment firms.

QUESTION 7.

Is the proposed risk to firm 'up-lift' measure an appropriate way to address the indirect impact of the exposure risk a firm poses to customers and markets? If not, what alternative approach to addressing risk to firm (RtF) would you suggest?

We consider an uplift factor, as noted above in our response to question 5 as unnecessary for firms, which are not leveraged significantly. An uplift factor may make sense for investment firms which are dealing on own account and which have significant balance sheet exposures. The proposed risk to firm uplift measure would only be appropriate if the use of the uplift factor would be limited to these business models. Additionally, we would encourage EBA also to allow for downscaling factors. Firms should have an incentive to be well capitalised and to improve their risk management.

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[3] Available on the FCA website https://www.handbook.fca.org.uk/handbook/CASS/

QUESTION 8.

What are your views on the 'built-in' approach to delivering simpler, proportionate capital requirements for Class 3 investment firms, (compared to having a separate regime for such firms)?

We think that a new prudential rulebook should cover all investment firms and should be based on the risks inherent in their business model. Size is not necessarily a suitable criterion for the application of different standards. The new prudential framework has to be proportionate and to be adaptable enough to cover also firms, which are identified as Category III firms. The creation of a separate regulatory category for these firms appears to be a suitable solution to guarantee a proportionate and simple application of the new rules, as long as the whole system is coherent. We are, therefore supportive of a 'built-in' approach with sufficient transitional arrangements between classifications and possibilities to disapply disproportionate requirements where appropriate. A separate framework for Category III firms would bear a significant risk to create cliff edge situations. A smooth transition between categories minimises opportunities for regulatory arbitrage.

QUESTION 9.

Should a fixed overhead requirement (FOR) remain part of the capital regime? If so, how could it be improved?

We don't see the immediate need for reviewing the method for calculating a minimum "floor"; i.e. the calculation of fixed-overhead requirements as the eligible capital of at least one quarter of the fixed overhead requirements (FOR) of the preceding year.

QUESTION 10.

What are your views on the appropriate capital requirements required for larger firms that trade financial instruments (including derivatives)?

We don't think that being a large firm or trading financial instruments, including derivatives make a firm bank-like. The business models of large firms are not necessarily different from smaller firms. The new framework should be designed in a way, which allows a proportionate and easy application on a very broad range of firms. Risk profiles are not linked to the size of firms. It is therefore not necessary to treat these firms as fundamentally different. Please see also our response to Question 11.

QUESTION 11.

Do you think the K-factor approach is appropriate for any investment firms that may be systemic but are not 'bank-like'?

We would support a new prudential framework for investment firms, which is tailored to the risks investment firms might pose. Such a regime has to be flexible enough to be suitable for the whole range of investment firms.

The current CRD /CRR regime is designed for banks and it is applied to all banks in Europe. It addresses, at least to a certain extent, systemic risk posed by institutions subject to CRD/CRR and allows, also to a certain extent, the disapplication of a number of onerous requirements where appropriate.

A similar approach should be taken in the new regime for investment firms. The prudential regime has to address the risks inherent in the business model. Supervisors and firms gathered sufficient experience with the CRD/CRR regime. Legislators should now be in a much better place to design a new regime, avoiding the numerous flaws of the CRD/CRR regime. The new regime should be adaptable enough to cover very large investment firms as well as firms which might be considered systemic.

The potential systemic risk posed by an investment firm will be very different to systemic risk posed by an internationally active large bank. CRD/CRR may or may not provide the tool kit to address the systemic risk in the banking world, but it is not addressing risks arising from activities by investment firms. A new prudential framework for investment firms will, therefore, be much better suited to address the potential systemic risk posed by investment firms. Investment firms which are considered to be systemic, but not bank-like should be covered by the new prudential framework for investment firms and should not remain to be subject to CRD/CRR.

Regarding the "systemic" nature of non-bank entities, we would ask EBA to take into account the ongoing discussions around the "structural vulnerabilities from asset management activities" at the FSB and IOSCO[4].

QUESTION 14

What are your views on whether or not simplification in the range of items that qualify as regulatory capital and how the different 'tiers' of capital operate for investment firms would be appropriate? If so, how could this be achieved?

The new prudential regime should allow high quality, permanent capital to be fully recognised as regulatory capital.

High quality has the attributes of no maturity dates; holders cannot demand repayment and holders are subject to the risk of capital loss on a winding up. This may extend beyond CET1 to appropriate hybrid AT1 and tier 2 instruments. This type of capital remains available to allow firms to wind down in an orderly manner when necessary.

QUESTION 16

What are your views overall on the options for the best way forward for the definition and quality of capital for investment firms?

In line with the response to question 14, the principal test for the quality of capital should be whether it remains available to allow firms to wind down in an orderly manner when necessary. This may extend beyond CET1, but the capital must have the attributes that we discuss in that question.

QUESTION 20.

Do you see any common stress scenario for liquidity as necessary for investment firms? If so, how could that stress be defined?

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[4] In this regard, please refer to the published responses to the latest FSB consultation on "Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities" of June 2016; available at: http://www.fsb.org/2016/10/public-responses-to-the-june-2016-consultative-document-proposed-policy-recommendations-to-address-structural-vulnerabilities-from-asset-management-activities/

It is hard to envisage common market stress scenarios, given that the balance sheets of our member firms are not used in their business models. Stress testing scenarios will have to be developed for individual firms, taking into account the broad range of investment firms and different strategies.

QUESTION 21.

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

We agree that firms should be able to demonstrate they have sufficient liquidity, as well as the capital to manage an orderly wind down. It would be helpful for firms to have clear and simple rules to base the liquidity requirements on. FOR has proven to be a useful and practical basis for the calculation of liquidity requirements and we don't see the need to introduce a different measure.

QUESTION 22.

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

For the purposes of an overall liquidity adequacy rule, liquidity resources should not be confined to the amount or value of a firm's marketable, or otherwise realisable, assets. Firms should have the possibility to assess the adequacy of their resources and should have regard to the overall character of the resources available which enable them to meet their liabilities as they fall due.

Any assets which are marketable, or otherwise realisable and which enable a firm to generate funds in a timely manner should count as liquid assets. Additionally, firms will have to maintain a prudent funding profile in which assets are of appropriate maturities, taking account of the expected timing of liabilities; and be able to generate unsecured funding of appropriate tenor in a timely manner.

QUESTION 25.

What are your views on the relevance of large exposures risk to investment firms? Do you consider that a basic reporting scheme for identifying concentration risk would be appropriate for some investment firms, including Class 3 firms?

Balance sheet exposures might generate a type of concentration risk, but the final prudential regime will have to find a balanced way to mitigate these risks. A large exposure regime that unnecessarily complicates the operating models of cash-rich investment firms simply due to the size of cash balances at banks would increase operational risk as a result. Significant cash positions can arise periodically in business as usual situations. Investment firms may build up significant cash positions for a short period of time whenever they raise an invoice for their management fees. A large exposure regime has to take peak scenarios into account and must not complicate day-to-day business unnecessarily.

QUESTION 26.

What are your views on the proposed approach to addressing group risk within investment firm-only groups? Do you have any other suggested treatments that could be applied, and if so, why?

We support the position proposed by the EBA and would suggest that for category II and III investment firms the current 'investment firm consolidation waiver' becomes the default position under the new regime. An aggregation of solo positions rather than a full consolidation will lead probably to an increased position for the group as a whole but would have the merit of being a significantly reduced operational burden. The new system should still allow for full consolidation, but it would not be appropriate to make this the default position.

QUESTION 27.

In the case of an investment firm, which is a subsidiary of a banking consolidation group, do you see any difficulty in the implementation of the proposed capital requirements on an individual firm basis? If so, do you have any suggestion on how to address any such difficulties?

The IA believes that all individual firms should be able to meet the regime's requirements on a solo entity basis. Risks to customers should not be mitigated by capital held in a parent banking entity, which may be deploying that capital in a range of non-related risk activities. Investment firms should not automatically be in scope of regulatory consolidation for a banking group. It is unnecessary to include these firms into a CRD consolidation group when they are not running balance sheet risk. It should, however, be possible for these firms to apply for a solution that, where a regulator is confident that CRD related processes deliver at least as stringent a regime, allows full consolidation.

QUESTION 28

What other aspects should the competent authorities take into account when addressing the additional prudential measures on an individual firm basis under the prudential regime for investment firms?

The new regime for investment firms will have to set clear quantitative criteria for capital add-ons. Firms have to be able to predict their capital requirements and capital requirements should not be used as a supervisory enforcement mechanism.

QUESTION 29.

What examples do you have of any excessive burden for investment firms arising from the current regulatory reporting regime?

It is excessively and unnecessarily burdensome for firms to provide a complete decomposition of the balance sheet and the resulting exposures where the business models do not necessarily use the balance sheet like banks would.

QUESTION 30.

What are your views on the need for any other prudential tools as part of the new prudential regime for investment firms? And if required, how could they be made more

appropriate? In particular, is there a need for requirements on public disclosure of prudential information? And what about recovery and resolution?

We don't believe that recovery and resolution should be the focus of a prudential regime for firms, which conduct agency business. Instead, the ability to wind the firm down in an orderly fashion, so as to avoid RtC and RtM must be the primary intention.

QUESTION 33.

What is your view on a prudential remuneration framework for other than 'systemic and bank-like' investment firms that should mainly aim to counteract against conduct related operational risks and would aim at the protection of consumers?

The IA does not support limits on the amount of remuneration or the ratio of fixed to variable remuneration for firms who are running an agency business. However, some RtC can crystallise post event, and after the normal accounting and remuneration round within an organisation. Therefore the IA believes that some element of deferral and clawback provisions can be appropriate. Firms whose remuneration structures demonstrate a stricter long-term alignment between the interest of the recipient and those of the client should be regarded as posing a lower RtC and should be incentivised to apply such remuneration policies by allowing a down scalar to reflect the reduced RtC.

The remuneration requirements maximum ratio of fixed to variable remuneration was introduced under CRD IV to prevent individuals from being incentivised to take inappropriate risks. Investment firms are taking risks for their investors in accordance with investment mandates. Risk takers in investment firms running an agency business have no incentives to breach these mandates. A higher proportion of variable remuneration incentivises individuals only to take risks in accordance with agreed investment mandates. The maximum ratio of fixed to variable remuneration is, therefore, not improving financial stability; on the contrary, the maximum ratio increases fixed costs for all institutions and prevents firms from cutting cost in stress scenarios. We don't see any merit in such a cap for any institution, but it is particularly disproportionate for investment firms running an agency business.

QUESTION 34.

What are your views on having a separate prudential regime for investment firms? Alternatively, should the CRR be amended instead to take into account a higher degree of proportionality? Which type of investment firms, if any, apart from systemic and bank-like investment firms, would be better suited under a simplified CRR regime?

The EU legislative landscape is already extremely complex and changes to the CRR to introduce proportionality judgements will only increase that complexity for firms and for competent authorities. The IA believes that the new prudential regime for investment firms should be established in its own right with a clear statement of the firm types to which it applies. The CRD/CRR should have clear exclusion statements within them, excluding all firms covered by the new regime. The current CRD/CRR regime was poorly adapted to the business of investment firms and needed numerous exemptions to be workable. The CRD/CRR regime is rightly developing in lockstep with the recommendations of the Basel Committee, but it is not the responsibility of the Basel Committee to take into account the specific needs and developments of investment firms. Each review of CRD/CRR bears, therefore, the risk to lead to a prudential framework, which is even less suitable for investment firms.

QUESTION 35.

What are the main problems from an investment firm perspective with the current regime? Please list the main problems with the current regime.

The current framework causes significant operational burdens for investment firms calculating their exposures; in particular, the standardised credit risk calculation is not suitable for investment firms. Firms with no trading book business may be required under the current standardised credit risk calculation to hold capital against credit risks for settlement balances where the risks are negligible. The risk weightings for these risk are higher than those applied to mortgages where there is a genuine credit risk.

The leverage ratio and the CRD/CRR disclosures requirements are equally unsuitable for investment firms.

The current pillar II framework is mainly based on a qualitative analysis by national supervisors. The framework lacks sufficient guidance for firms to predict these pillar II requirements and this lack of clear guidance for firms and supervisors leads to significant inconsistencies in supervision.