EBA Consultation on a new prudential regime for investment firms

AMAFI General comments and Question 4 Appendix

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities. Nearly one-third of members are subsidiaries or branches of non-French institutions.

AMAFI welcomes the opportunity to comment on EBA's Discussion Paper published on November 4th, 2016 on the design of a new prudential regime for investment firms, and to make suggestions on the way the current regime could better achieve the objectives of simplification and proportionality.

Before responding to the specific questions of EBA's consultation document, AMAFI would like to point out the following general comments.

GENERAL COMMENTS

We welcome very much the EU initiative in favour of a revision of the prudential regime applicable to investment firms and agree with the comments formulated in the first EBA report[1] regarding the complexity of the current regime. In order to cope with the diversity of businesses conducted by investment firms in terms of (i) activity and licensing, (ii) size and (iii) products, a revised regime should be based on the key principles of simplification and proportionality. It should also aim at ensuring a consistent prudential rules and own funds requirements applicable to all investment firms.

The new approach detailed in the discussion paper deserves great focus as it is based on a risk-based approach, seeking to capture the potential risks borne by clients and/or markets due to the firm's business. However, it differs substantially from current prudential principles derived from CRD/CRR. Such an approach leads to 6 comments:

1. Given that the proposed regime would lead to an entirely new framework, the time allowed to the stakeholders to assess its impact is too short. We understand the EBA's tight schedule constraints but we believe three months is too short to adequately assess the impacts of the new regime.

[1] EBA/op/2015/20, Report on Investment firms, December 2015.

2. Any new regime must preserve the consistency between regulatory capital requirements applied to various institutions exercising similar activities even with different legal statuses (bank, investment firm etc.). At this stage it is not possible to ensure it is the case due to the absence of calibration. Therefore the regulator should pay particular attention to the potential effects of distorted competition between investment firms, systemic investment firms and credit institutions providing investment services.

3. Any situations where two sets of obligations would apply would not be acceptable. This means that appropriate solutions have to be found in the case of an investment firm that is part of a larger group as otherwise such a firm would have to implement a k-factor approach at individual level and a contribution to the CRR regime of the group at consolidated level. This would also be true in situations where an investment firm would have to apply k-factors for own funds calculations and CRD governance rules for risk management and internal control. This would miss the target for simplification of prudential rules for investment firms.

4. Regarding proposed k-factors, we are surprised that the activity of market-making is not encompassed, while investment firms play an important role in providing liquidity to the financial system. In any case, the role of market-making has to be taken into account specifically in the k-factor approach. In this respect the PTA k-factor is not appropriate and we suggest splitting it into two metrics.

5. It is critical that such a future regime maintains the current possibilities for investment firms belonging to a banking group to be supervised on a consolidated basis without any additional constraints. It is also critical that regime allow investment firms to opt for consolidated supervision as a full substitute to individual supervision. This is especially true of groups of investment firms where the various activities are exercised by different legal entities, are this usually leads to significant intra-group transactions. The unity of a group means it should be seen as single actor of the financial system.

6. The Discussion Paper mainly focuses on solvency and liquidity rules. However we consider that the implementation of the new regime requires encompassing the whole aspects of a prudential regime: governance, remuneration, Pillar 2, Pillar 3, recovery and resolution and the level of supervision...

For all these reasons, we consider the k-factor approach cannot be considered as a good alternative to the current regime until its metrics are further qualified and calibrated and the above-mentioned issues are considered. We really believe that this cannot be achieved in a reasonable lapse of time. By contrast, the current CRR regime could be more easily tailored to ensure further simplicity and proportionality in a reasonably short period of time and could provide an adequate framework during the transition period towards a future regime.

In our comments under questions 34 and 35, we suggest various options for amending the current regime for non-systemic investment firms in this respect:

- Remove the CVA capital charge for Class 2 and Class 3 investment firms.
- Keep exposures to CCPs and intragroup trades out of scope of the large exposure capital charge regime.
- Allow investment firms to apply either current CRR methodologies or revised approaches for counterparty credit risk and market risk.
- Keep the leverage ratio an element of Pillar 2 for investment firms.
- Exempt investment firms from CRR liquidity requirements.
- Remove prudent valuation adjustments.

In our opinion, greater simplification should apply to capital requirements computation, to reporting and to corporate governance including remuneration policies. We seek to provide various specific proposals in this paper. A summary of the key features of our proposal is summarised in the table below.

	CLASS 1 FIRMS	**CLASS 2 FIRMS**	**CLASS 3 FIRMS**
DEFINITION	Systemic firms	Other investment firms	Small and non-interconnected firms
CLASSIFICATION CRITERIA	G-SII or O-SII (same as systemic banks)	Other that Class 1 and Class 3	Multi-criteria approach based on: - Nature of licence - No client assets detention - Total assets (< EUR 100m) - Size of trading book (cf. art 94 §1 CRR) ***Cf. Q4***
OWN FUNDS DEFINITION	No change from current	No AVA / prudent valuation filters	No AVA / prudent valuation filters
CAPITAL REQUIREMENTS	No change from current	CRR simplified ***Cf. Q34-Q35***	FOR regime (wind-down approach) ***Cf. Q3-Q4***
LIQUIDITY REQUIREMENTS	No change from current (LCR/NSFR)	Pillar 2 and reporting-only approach based on: - 30-day cash inflows & outflows - liquid assets (larger definition)	Pillar 2 and reporting-only approach based on: - 30-day cash inflows & outflows - liquid assets (larger definition)
LARGE EXPOSURES REQUIREMENTS	No change from current	No change from current	No capital requirements (reporting only)
LEVERAGE RATIO	No change from current	Pillar 2 (reporting only)	No requirement
REPORTING GRANULARITY	Current or close to current	Limited	Low
GOVERNANCE	CRD governance requirements	CRD requirements with proportionality	MiFID II Rules
REMUNERATION	CRD governance requirements	CRD requirements with no maximum variable remuneration	MiFID II Rules
BRRD	No change from current	Pillar 2	No requirement

Regarding categorisation, our views are based on the following principles:

- Institutions that are currently out of the scope of CRD/CRR should remain out of the scope of the new regime (local firms, firms with a licence limited to reception-transmission of orders and investment advice).

- Class 3 should be appreciated via a combination of criteria, among which absence of client assets detention, size of balance sheet and size of trading book.

- Regarding balance sheet size, we believe that a EUR 100m threshold should be considered. The EUR 2m threshold mentioned in the paper is much too low and would lead too many small firms with little impact on the market to remain in Class 2. We believe an adequate segregation between Class 2 and Class 3 would enable supervisors to focus much more on institutions with a higher level of risk and/or multi-component business model which deserve more accurate supervision that smaller, single-activity firm.

We also stress the importance of applying the proportionality principle in the areas of Pillar 3 and Recovery and Resolution, based on the specifics of the investment firms market.

Finally, national supervisors should be allowed to rely on flexibility and proportionality in their supervision of investment firms, taking into account the idiosyncratic features of each firm, such as licence, size, business model, risk appetite, interconnectedness, number and types or counterparties, etc., in a context where national specificities regarding the investment firms market remain substantial.

QUESTION 4 APPENDIX

As explained in our answer to question 4, we suggest the following classification for investment firms.

Table Question 4 - Classification table

CURRENT CATEGORY	CURRENT REGIME	RECOMMENDED CATEGORY UNDER NEW REGIME	JUSTIFICATION
Local firms	Not subject to CRD/CRR	Not subject to the new regime	All positions are cleared by a clearing member
Firms that only provide reception/transmission of orders and/or investment advice	Not subject to CRD/CRR	Not subject to the new regime	No business that poses risks
Firms providing only reception/transmission and investment advice registered under the insurance mediation directive (directive 2002/92/EC)	Not subject to CRD/CRR	Not subject to the new regime	No business that poses risks
Firms that perform, at least, execution of orders and/or portfolio management	Subject to CRR Article 95 (2)	Category 3 below a EUR 100m total assets; Category 2 above EUR 100m	Limited market footprint below a certain threshold
Investment firms not authorised to perform deals on own account and/or underwriting/placing with firm commitment that do not hold client money/securities	Subject to CRD/CRR	Category 3 below a EUR 100m total assets; Category 2 above EUR 100m	- Limited market footprint below a threshold - No client assets held
Investment firms dealing on own account with no external customers and with a small trading book	Subject to CRD/CRR with simplified rules for operational risk	Category 3 if the size of their balance sheet and off-balance sheet trading book meets the criteria set out in CRR, art. 94 §1[2]. Category 2 otherwise	No risk to the system
Investment firms authorised to perform deals on own account and/or underwriting/placing with firm commitment that do not hold client money/securities	Subject to CRD/CRR	Category 3 if : - total assets are below EUR 100m; - AND the size of their balance sheet and off-balance sheet trading book meets the criteria set out in CRR, art. 94 §1. Category 2 otherwise	- Limited market footprint below a threshold - No client assets held

[2] The condition set by article 94 §.1 CRR is the following: “the trading-book business meets both the following conditions: (a) it is normally less than 5 % of the total assets and EUR 15 million; (b) it never exceeds 6 % of total assets and EUR 20 million.