Banking & Payments Federation Ireland

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RE: EBA Consultation on IFR Discussion Paper

Dear Mr Campa, dear Ms Ross,

Banking and Payments Federation Ireland (BPFI)[1] welcomes the opportunity to respond to the European Banking Authority's (EBA) draft discussion paper (DP) on the Investment Firms Regulation and Directive (IFR/D). BPFI represent a diverse set of members, including various forms of credit institutions (retail, custodial and wholesale) as well as investment firms that are subject to the IFR/D regime that have a breath of business models including firms that deal on own account, facilitate underwriting of securities, and offer wealth management and other investment services to clients. Collectively our members are significant providers of liquidity across EU trading venues and play a key role in the development of EU capital markets[2], for example through the underwriting and syndication of the Next Generation EU bonds.

At the outset, we want to reiterate our full support for the introduction of the IFR/IFD regime. Having a proportionate prudential framework for investment firms, designed to better reflect the nature, size and complexity of these entities is a welcome step forward in the development of EU financial services regulation. Any future review should, in our view, build upon this existing regime and make targeted adjustments to ensure a more refined, future-proof framework that is tailored to the risks and business models of investment firms.

More broadly, it is crucial that over the next five years the EU regains global competitiveness, in particular by developing deeper and more liquid capital markets so that EU companies and the broader EU economy can grow and flourish. To achieve this, however, it is crucial that policymakers reflect on the functioning and attractiveness of EU markets and thoughtfully adapt the regulatory framework where necessary. It should be noted that regulatory requirements can influence firms' growth prospects and impact the development of capital markets. This is particularly important considering that other major jurisdictions do not apply banking regulation (e.g. Basel framework) to investment firms in the same manner as done within the EU.

1Banking and Payments Federation Ireland (BPFI) is the voice of banking, payments and investment firms in Ireland. Representing over 100 domestic and international member institutions, we aim to mobilise the sector's collective resources and insights to deliver value and benefit to members, enabling them to build competitive sustainable businesses, which support customers, the EU economy and society.

2 BPFI members predominantly operate in fixed income, equities, ETFs, derivatives and FX market segments.

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In light of this, we have sought to direct our comments on the most important questions and topics from our perspective, which we believe should be adapted within the IFR/D. As such, we have focussed our response to the DP on a number of key thematic issues relevant to the development of EU markets and to our members. These can be summarised as follows:

- **Maintain IFR/D as a prudential regulatory framework that is appropriately calibrated to investment firms' business models specifically.** Applying bank specific requirements to investment firms is not appropriate in our view and should be further revised. Unfortunately, at present, many requirements for investment firms are still interlinked to the bank prudential framework, despite the initial intention of creating a separate proportionate prudential regime for investment firms. We also note that there are new recommendations within the DP to further link the framework with that applied to banks, which we think should be avoided or only done with careful consideration as to whether the bank regime is truly relevant and properly calibrated. For example, rules related to resolution, or the Fundamental Review of the Trading Book (FRTB), were designed specifically to address concerns within the banking sector, whose business model is vastly different to that of most investment firms. Furthermore, we believe the way in which the banking regime is developing under the Basel Committee will make it increasingly difficult to reconcile to the business models of investment firms. As such, we recommend that policymakers work overtime to establish a fully distinct piece of legislation for investment firms, separate to that of CRR/CRD. A key part of this should be that prudential requirements for investment firms should be based solely on a going concern basis, as opposed to a gone concern framework for banks. The primary focus of the regime for investment firms should therefore be orderly winding-down and the disapplication of BRRD to investment firms. Such requirements need to be harmonised to avoid any inconsistent application across the EU whereby firms located in certain jurisdictions would be subject to differing resolution/wind-down requirements. This includes the frequency of resolution/wind-down planning.

- **Investment firms should have the optionality to apply FRTB & CVA.** Under IFR, Class 2 investment firms currently calculate market risk under Art 22 by using either:

    - the standardised approach under CRR2
    - the alternative standardised approach (ASA) under CRR3
    - the alternative internal model approach under CRR3

Having these options is positive and something we support. We recognise that in the DP the EBA state that *"investment firms will continue to use the current standardised approach (i.e. the method envisaged in the CRR2) and will not be subject to the new simplified standardised approach envisaged in the CRR3"*. However, we also note that the DP in paragraph 141 states: "*...the review of the IFR should amend the relevant provisions in order to introduce the simplified standard approach for investment firms*". We believe such a change to IFR would be potentially problematic for many investment firms and not proportionate to their size and complexity. The SSA is simply the current standardised approach under CRR2 (which investment firms currently use to calculate K-NPR), with the addition of multipliers (1.3 for fixed income and 3.5 for equity) under Article 325(2). Replacing the current standardised approach under Art 22(a) with SSA would result in a very substantial increase

in market risk capital requirements for the majority of investment firms, which we believe warrants further analysis and consideration before being proposed to the European Commission. Investment firms would either have to significantly increase capital to cover the higher capital requirement, or be forced to switch to using the ASA under FRTB, which would involve substantial cost and operational uplift to support more complex data calculations and controls. This could deter firms from growing their EU operations, contrary to the political objectives of developing deeper and more liquid capital markets. The application of FRTB to the calculation of market risk does not transfer easily to most investment firms' business models, considering they were designed with credit institutions in mind. In our view, this framework is more relevant to traditional credit institutions, which the Basel committee impact assessed when originally developing the rules. We are of the view that the current market risk options already available in IFR are appropriate and should remain unchanged. Were there a desire to move firms toward the FRTB, we believe the best approach would be to maintain the FRTB alternative standardised approach as an option for investment firms subject to NCA approval, as laid down in paragraph 145 (b) of the DP. We also believe optionality should be provided to investment firms in respect to CVA methodologies. We would therefore support Option b under paragraph 154 should the EBA propose one.

- **Refine the liquidity requirements to better align them with investment firms' business model.** We would underline that the calculation of liquidity requirements under IFR/D is clear and well understood by members. Nevertheless, we believe there is an opportunity to adjust certain aspects of the rules as they apply to investment firms, for instance, the types of assets that are eligible to qualify as liquid assets and how liquidity requirements should apply to certain types of investment firms. As acknowledged within the DP, there is a need to reflect on whether the current liquidity requirements are fit for purpose and if they are appropriate for all business models, including those firms that do not have external clients. Under the current rules, the definition of liquid assets is linked to the methodology designed for credit institutions to calculate their liquidity coverage ratio (LCR). In our view, this is a very bank specific metric related to unencumbered assets, which was developed with a specific business model and risk profile in mind, and which does not reflect the types of liquid assets that may be relevant for investment firms. For example, Commission Delegated Regulation (EU) 2015/61 determines which liquid assets a credit institution may hold to meet its liquidity requirements. It does not directly refer to the types of liquid assets that are relevant for investment firms. Such entities' main assets are its trading book positions in financial instruments. These positions are usually held with a number of prime brokers who have a margin requirement which sets the minimum value of the net equity that the trading firm must maintain with the prime broker to support the positions that are held. The excess of the net equity over the margin requirement is then considered to be the amount of available liquid assets. However, the requirements in Delegated Regulation (EU) 2015/61 do not refer to these assets, so it is not clear that these assets can be used to meet the liquidity requirement under IFR. As such, we believe certain adjustments could be made to better reflect how investment firms manage their assets and shift away from the perspective of a universal bank where there can be much more significant long-term funding maturity mismatch. By way of an example, we would argue that a portion of trade receivables could be deemed liquid assets (subject to a haircut) if receivable within 30 days for broker dealers, similar to the regime adopted by the FCA in the UK. Separately, we would also welcome further

guidance for how firms should assess liquidity requirements under Pillar 2 and how stress testing should interact with Pillar 2 capital requirements. Having further clarity on the above would help both firms and supervisors better understand the regulatory requirements, while at the same time, ensure a level playing field across the EU Single Market. On the other hand, we are not convinced that thew Fixed Overhead Requirement (FOR) should be extended beyond one month as suggested. Before recommending such a change, we believe the EBA should undertake further quantitative analysis to substantiate the costs and benefits of this proposal.

- **Adjust remuneration rules to ensure a level playing field across sectors.** In line with comments outlined above, we believe that remuneration rules should also be decoupled from that of CRR/CRD and should be better aligned with the remuneration rules in the UCITS and AIFMD frameworks to ensure they are proportionate to the size and business model of investment firms and do not impact firms' ability to attract and retain talent. Specifically, we would make the following recommendations:

  - We believe the €100mn threshold size which triggers enhanced remuneration and governance requirements should be increased to at least €1.5bn. At present, the requirements take limited account of business model type or the capacity of the firm. For example, no distinction is made between entities which trade on own account or those who invest on behalf of clients, while more broadly the rules capture more staff than what was originally intended by the EBA (e.g. 10%).

  - The quantitative threshold to classify someone as identified staff should be removed in order to align the framework with that of AIFMD and UCITS. This would ensure a level playing field across similar financial services sectors. Failing that, it should at least be moved in line with CRD (e.g. EUR 750,000 only and no requirement to run an exclusion process for investment firms as laid down in Commission delegated regulation 2021/2154) or set higher, given the number of staff with no impact on the risk of the firm who may be well remunerated. The current threshold places investment firms at a competitive disadvantage, especially those with strong technology capabilities to AIFMD/UCITS firms and technology companies.

  - Full alignment with AIFMD/UCITs should be pursued in respect of: 1) rules requiring firms obtain regulatory approval to exclude staff earning above €750k from the scope of identified staff 2) removal of minimum retention periods for vested deferred remuneration and 3) the prohibition on dividends to allow accrual should be permitted.

  - For firms with a balance sheet above €15bn we believe the remuneration rules should be aligned with that of the other threshold classes. While we understand the objective of the various balance sheet thresholds, it unfortunately impacts the level playing field between investment firms with the same, or similar, business models due to the fact that bank-like remuneration rules can apply to

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Class 1 minus investment firms. This could therefore result in some investment firms having to apply stricter remuneration requirements than their competitors due to an arbitrary balance sheet threshold, impacting the level playing field between investment firms and their ability to attract and retain staff.

- **Create a standalone K-Factor framework within IFR and recalibrate certain calculations.** We believe the time is right for policymakers to specify and calibrate k-factors on their own within the IFR/D regime without having to refer to any CRR/CRD concepts. While we understand the rationale for cross-referencing to CRR/D (e.g., to reduce the provisions of IFR/D), we think fully separating the two regimes has added benefits considering revisions of the frameworks are not always done in parallel, while the objectives of reviews can also be influenced by other factors (e.g. turmoil in the banking market may lead to a revision of own funds definitions, which then fails to take into consideration how this may affect investment firms). In addition to this, we note that within the DP it is suggested that new K-factors could be developed for risks not yet captured by the existing rules, while other existing factors may need to be recalibrated, like K-CMG. In our view, any new K-factors – such as for MTFs – needs to be justified with further analysis in order to maintain the intended objective of keeping the IFR framework as simple as possible. In terms of the current K-Factor regime and the areas highlighted in the DP, we would highlight the following:

    - Refinements should be made to the K-CMG factor as signalled within the DP. It is our view that the rationale of K-CMG is sound and should in theory offer firms an alternative method for calculating risk to market for those which trade through a clearing member. However, the high-water mark (third highest amount during a period of 3 months) and the additional multiplier of 1.3 mean that the use of K-CMG is not a practical alternative to the K-NPR methodology, with very few firms actually using the calculation. This is an unfortunate outcome as the K-CMG methodology was originally intended to be a more suitable methodology for investment firms than the CRR based alternative K-NPR. Due to the high-water mark coupled with the 1.3 multiplier, K-CMG unfortunately overstates the actual level of risk of a portfolio, which can lead to firms being reluctant to provide liquidity in times of stress. We therefore suggest that K-CMG could be amended by removing the 1.3 multiplier or by using a high-water mark average over a 3 month period for example. In addition to this, we also believe that K-CMG should reflect the current nature of the market risks on a firm's book, similar to K-NPR.

    - The calculation of K-AUM in Article 17 IFR is based on gross market value of positions. This is not in line with how most investment firms assess AUM, which is viewed in terms of the Net Asset Value (NAV) of the portfolio. This can lead to confusion in reporting AUM outside of IFR, since the gross number reported would be much higher than AUM reported elsewhere e.g., for compliance related returns. We therefore suggest that the K-AUM calculation is amended to reflect the NAV of the portfolio, instead of gross market value.

- The scope of K-TCD should exclude all contracts cleared through a CCP. Currently only derivative contracts cleared through a CCP are exempt from the calculation. For example, this should be expanded to repurchase transactions cleared through a CCP.

- Adjustments to K-DTF coefficients for stressed market conditions could be explored as it is currently overly cumbersome and leads to disproportionate outcomes, resulting in firms not applying the methodology. That being said, we would underline that at times firms internal pillar 2 assessments of operational risk may be higher than the K-DTF amount and in such circumstances, this will ultimately lead to the excess being included in the Pillar 2 Requirement and in the firms' overall capital requirements. Separately, we believe the duration adjustment for interest rate derivatives in K-DTF should also be applicable for bonds. This would correct a mismatch where firms hedging a portfolio of government bonds with bond futures would take a much higher DTF charge for the bonds traded compared to the futures. Concerning the calculation of operational risk via K-DTF, it is noted that there is a proposal to revert to the basic indicator approach currently used as part of the capital requirement calculation for banks under the CRR/CRD. This proposal would not align with the objective of the IFR/IFD in creating a standalone calibrated approach to capital requirements for investment firms. Any approach should focus on working within the K-Factor framework as set out within IFR/IFD to ensure a distinct and business model proportionate result is achieved to the calculation of operational risk capital.

- **Contribution to resolution funds.** The Irish resolution fund applies to all credit institutions, authorised branches of non-EEA firms and investment firms that are in scope of the EU's Bank Recovery and Resolution Directive (BRRD) – excluding those which fall under the Single Resolution Mechanism (SRM). The calculation of the fund is done in accordance with various EU delegated acts and SI No 226 of 2023. Specifically, in-scope investment firms' contribution to the fund is defined within thresholds aligned to balance sheet size. Having this fund should bring more stability into the system generally and help fund resolution cases should they occur. This is a sensible approach for firms which hold client deposits. However, for investment firms which either deal on their own account as principal traders or support loan origination through underwriting, competent authorities preferred strategy, should the investment firm get into difficulty, is usually not to start a resolution process. Instead, the firm will typically opt to commence a wind-down plan and/or appoint a liquidator, in line with the regulatory expectations. Therefore, it seems unreasonable for firms to have to contribute potentially significant amounts to a scheme which neither it nor its creditors will ever be likely to benefit from. At the same time, it is our understanding that in other EU jurisdictions contribution amounts are much smaller for investment firms, impacting the level-playing field within the EU. As the EBA will be aware, the EU wide methodology is set out in Commission Delegated Regulation (EU) 2015/63. Article 10 of this delegated regulation sets out a simplified approach for small institutions, which is defined as those whose total liabilities minus own funds and covered deposits is below EUR 300m, among other criteria. Firms that do not meet the

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criteria for the simplified approach have a much more complicated methodology, which includes calculating derivative exposures under specific methodologies related to CRR rather than IFR. It appears that in some EU jurisdictions the simplified approach is applied to all firms regardless of size. This means issues such as requiring external legal opinions on derivative netting sets under CRR are not relevant to these firms, among other additional costs. Taking this into consideration, we would recommend that investment firms contributions to resolution funds should be specific to those firms which hold retail client funds and who will be resolved by NCAs.

- **Ensure that reporting requirements is fully harmonised at EU level.** We note that within the DP, the EBA suggest potentially extending the reporting requirements for investment firms to financial information or allowing NCAs obtain this information and requiring Class 3 firms to report on a quarterly basis like other firms. We would point out that financial information is already reported to some competent authorities, like Ireland, in the FINREP submission, which has the same frequency as IFREP. As such, we do not believe firms should be required to submit similar information in IFREP. More broadly, the EBA should avoid any situation whereby different NCAs apply different reporting regimes. Reporting requirements should be fully harmonised within the IFR to avoid a situation whereby certain jurisdictions reporting requirements is more onerous than others. Having these regulatory discretions only results in undermining the level playing field within the single market, something which has been specifically questioned by Enrico Letta in his recent report to EU leaders. Harmonised reporting would also aid the EBA in making comparisons of financial data across member states on a like for like basis.

- **Threshold classification for small firms needs to remain simple and should avoid any additional burden.** We note that within the DP questions are raised in respect to the categorisation of investment firms (e.g. reporting requirements for monitoring purposes) and how firms should be treated between Class 2 & 3 status. Our overarching consideration is to ensure simplicity in the framework, while avoiding over burdening smaller firms with additional regulatory requirements. In light of this, we would underline the following:

    - Removing the €5bn reporting threshold is unnecessary in our view and will only create additional reporting requirements for relatively very small and non-complex firms with limited added benefit. As acknowledged by the EBA, the obligations to report and comply with the various thresholds within the IFR is for each individual firm. Considering the €5bn threshold is well below that of the €15 bn or €30bn thresholds, we think the reporting of such information is highly unlikely to result in changes to firms' classification, thereby not materially contributing to the regulatory framework from either a firm or supervisory perspective. Extending such reporting to all firms below €5bn is also unduly burdensome as the reporting can be complex for entities with subsidiaries that are not under IFRS, and any requirement that all firms conduct monthly consolidation is also potentially quite burdensome, particularly from a cost benefit perspective. Additionally, we believe National Competent Authorities

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(NCAs) should have the adequate knowledge and oversight of firms located in their jurisdiction to determine if they should re-classify.

- We do not believe further additional criteria should be added to the categorisation of Class 3 investment firms under Art 12 of the IFR. Considering Class 3 firms are considered small and non-complex, adding additional criteria seems counterintuitive to the intention of the categorisation system. It should also be borne in mind that such firms have limited resources and any further complexity to the regulatory framework will undoubtedly come at additional cost. Separately, when it comes to the concern raised around potential arbitrage opportunities due to the scope of the asset calculations, we would underline that co-legislators have addressed these issues in the recent review of CRR, by clarifying that assets to be taken into account should be only EU assets. In order to ensure consistency within the framework, we believe further changes to the scope of assets are unnecessary – especially considering the lack of a regulatory framework for investment firms at a global level and the fact that this could undermine the intention of developing a proportionate regulatory regime for investment firms.

- Regarding firms transition between Class 2 & 3, having a “transition” period between the two classifications seems sensible but we would suggest that it should be extended beyond three months (potentially to 5-6 months) so that firms have sufficient time to meet any new requirements. While we acknowledge that firms should have an understanding of their regulatory obligations and an overview of an increase in activity that could have an impact, there are times where a transitional period may be appropriate, like in more volatile markets. Any such transition period could be granted at the discretion of the NCA to ensure its appropriate use.

We hope that will find our comments above helpful and would be happy to discuss them further with you and/or your colleagues should that be desirable.

Yours sincerely,

Brian Hayes
CEO, Banking and Payments Federation Ireland