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EBA FINAL draft Regulatory Technical Standards

on own funds requirements for investment firms based on fixed overheads under Article 97(4) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)



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1. Executive Summary

The EBA is mandated in Article 97(4) of Regulation (EU) No 575/2013 (CRR) to develop, in consultation with the European Securities and Markets Authority (ESMA), draft regulatory technical standards (RTS) on own funds requirements for investment firms with limited authorisation to provide investment services, as set out in Articles 95 and 96 of the CRR. Specifically, investment firms are required to hold eligible capital of at least one-quarter of the fixed overheads of the previous year, or projected fixed overheads in the case of an investment firm not having completed business for one year. These final draft RTS outline the calculation of fixed overheads and other aspects relevant for this purpose.

These final draft RTS are also relevant to management companies, as defined under the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive, and alternative investment fund managers (AIFMs), both internal and external managers of alternative investment funds (AIFs), as defined under the AIFM Directive (AIFMD)¹.

The aim of these final draft RTS is to harmonise calculations of capital requirements and to provide a clear definition of fixed overheads. The CRR does not introduce any new or additional own funds requirements for investment firms, as the requirements will not differ from those set down in Directive 2006/49/EC.

These final draft RTS also aim to harmonise the conditions under which competent authorities can make adjustments to the capital requirement in a case where there has been a material change in the business activities of an investment firm. A change in business activities is considered material if the fixed overheads change by at least 20% or there is an absolute change of EUR 2 million in the capital requirement.

The approach for calculating fixed overheads proposed by these final draft RTS is a so-called subtractive approach, whereby variable cost items are deducted from the total expenses as calculated according to the applicable accounting framework. The subtractive approach ensures that changes to the accounting framework are automatically taken into account and cannot be arbitraged by changing the accounting categorisation. It can also be used in cases where a firm does not use the International Financial Reporting Standards (IFRS) accounting framework and is, therefore, appropriate for smaller or limited-authorisation investment firms, towards which these draft RTS are, to a large extent, targeted.

The introduction of the subtractive approach changes the existing practices in some EU Member States, where a so-called additive approach is already in place. The additive approach consists of adding up a number of pre-defined accounting items, but the existence of many different national

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¹ Article 7(1)(a)(iii) UCITS Directive (2009/65/EC) and Article 9(5) AIFMD (2011/61/EU) require management companies and AIFMs to have own funds that must at no time be less than the amount prescribed in Article 21 of Directive 2006/49/EC (now Article 97 of the CRR).



accounting standards makes this approach impractical; furthermore, the additive approach is considered less prudent. This approach was also considered less appropriate by most market participants who responded to the public consultation.

These final draft RTS also propose the inclusion of the use of tied agents in the calculation of fixed overheads, because business carried out through a tied agent exposes an investment firm to risk in the same manner as business carried out by the investment firm itself. Furthermore, there should not be incentives for firms to reduce their capital requirements through the use of these agents. Therefore, a firm should maintain a capital component for tied agents. As calculating fixed overheads for tied agents in the same manner as for investment firms themselves would pose many practical problems, the use of a fixed percentage of all fees per tied agent is introduced instead. This addresses the fact that tied agents have some element of variability in some cases but probably cannot be considered a fully variable cost item.

As required in Article 97 of the CRR, the EBA has consulted ESMA on these final draft RTS in order to ensure that a consistent framework for investment firms shall be implemented.



2. Background and rationale

The EBA has developed these final draft RTS in accordance with the mandate contained in Article 97(4) of the CRR.

These final draft RTS complement the text of the final draft RTS on own funds, submitted by EBA on 26 July 2013², but they focus only on certain investment firms with limited authorisation to provide investment services.

Background and regulatory approach followed in the draft RTS

Until the adoption of the CRR, the regulatory framework of own funds was derived from the so-called Capital Requirements Directive (CRD), in particular Articles 56 to 67 of Directive 2006/48/EC and Articles 12 to 17 of Directive 2006/49/EC, as transposed by each Member State. Even though most of the business activities of investment firms are covered by Directive 2004/39/EC (MiFID) and have to be authorised under MiFID first, certain investment firms are excluded from the scope of the CRR/CRD framework, e.g. local firms and investment firms as set out in Article 4(2)(c). Therefore, the CRR's definition of 'investment firm' is more limited than that of MiFID. The CRR/CRD regulate prudential supervision of investment firms, which includes provisions for own funds requirements.

These final draft RTS are also relevant to management companies, as defined under the UCITS Directive, and AIFMs, both internal and external managers of AIFs, as defined under the AIFMD. Article 7(1)(a)(iii) of the UCITS Directive and Article 9(5) of the AIFMD require management companies and AIFMs to have own funds that must at no time be less than the amount prescribed in Article 21 of Directive 2006/49/EC (now Article 97 of the CRR).

These final draft RTS are related to Article 97(4) of the CRR, which states that the EBA in consultation with ESMA shall develop draft RTS to specify in greater detail:

- 1. the calculation of the requirement to hold eligible capital of at least one-quarter of the fixed overheads of the previous year;
- 2. the conditions for the adjustment by the competent authority of the requirement to hold eligible capital of at least one-quarter of the fixed overheads of the previous year; and
- 3. the calculation of projected fixed overheads in the case of an investment firm that has not completed business for one year.

Pursuant to Article 95(2) of the CRR, investment firms with limited authorisation to provide investment services, referred to in Article 95(1), shall calculate their total risk exposure amount either as the sum of points (a) to (d) and (f) of Article 92(3) of the CRR after applying Article 92(4),

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² http://www.eba.europa.eu/regulation-and-policy/own-funds/draft-regulatory-technical-standards-on-own-funds



or as the result of 12.5 multiplied by the amount of one-quarter of their fixed overheads for the preceding year, whichever is higher. For investment firms referred to in Article 96(1) of the CRR, the total risk exposure amount shall be calculated as the *sum* of the items referred to in points (a) to (d) and (f) of Article 92(3) of the CRR after applying Article 92(4) and 12.5 multiplied by the amount of one-quarter of their fixed overheads for the preceding year. This means that in both of these cases the amount of own funds shall be calculated taking into account the amount of fixed overheads for the previous year.

The provisions included in these final draft RTS focus on the items that comprise the amount of fixed overheads of the previous year based on the most recent audited annual financial statements. Where there is a change in the business of an investment firm that the competent authority considers material, the competent authority may adjust the requirement for eligible capital, as provided for in Article 97(2) of the CRR. A change in business activities is considered material if the fixed overheads change by at least 20% or there is an absolute change of EUR 2 million in the capital requirement. These RTS also elaborate on the calculation of projected fixed overheads; this projection shall be used where an investment firm has not completed business for one year.

The EBA has developed these final draft RTS on the basis of the CRR. As required in Article 97 thereof, the EBA has consulted ESMA on these RTS in order to ensure a consistent framework for investment firms. The EBA has to submit these final draft RTS to the European Commission (EC) before 1 March 2014.

The nature of RTS under EU law

These final draft RTS are produced in accordance with Article 10 of the relevant EBA regulation³. Pursuant to Article 10(4) of the regulation, these final draft RTS shall be adopted by means of a regulation or decision.

In accordance with EU law, EU regulations are binding in their entirety and directly applicable in all Member States. This means that, on the date of their entry into force, they become part of the national law of the Member States and that their implementation into national law is not only unnecessary but also prohibited by EU law, except in so far as this is expressly required by them.

Shaping these rules in the form of a regulation will ensure a level playing field by preventing divergent national requirements and will facilitate the cross-border provision of services; currently, an institution that wishes to take up operations in another Member State has to apply different sets of rules.

³ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010, establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision No 2009/78/EC.



3. EBA FINAL draft Regulatory Technical Standards on own funds requirements for investment firms based on fixed overheads under Article 97(4) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)



EUROPEAN COMMISSION

Brussels, XXX [...](2012) XXX draft

COMMISSION DELEGATED REGULATION (EU) No .../..

of XXX

[...]

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds Requirements for Investment Firms based on Fixed Overheads



COMMISSION DELEGATED REGULATION (EU) No .../..

of XXX

[...]

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds Requirements for Investment Firms based on Fixed Overheads

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012⁴, and in particular third subparagraph of Article 97(4) thereof,

Whereas:

- (1) Regulation (EU) No 575/2013 establishes, among other matters, prudential requirements for investment firms in order to ensure that investment firms are safe and sound and comply at all times with the capital requirements. Own funds requirements are covered by Article 92 of that Regulation which seeks to ensure that risks stemming from business activities are covered by a sufficient amount of own funds. According to Article 97 of that Regulation investment firms can use an alternative method based on fixed costs to calculate the total risk exposure. It is therefore necessary to establish the methodology for calculating fixed overheads and the list of items that would be included in the calculations in order to have a common approach in all EU member states.
- (2) In order to ensure that investment firms are able to organise an orderly winding down or restructuring of their activities, they should hold sufficient financial resources to withstand operational expenses over an appropriate period of time. During the winding down or restructuring, an investment firm still needs to continue its business and be able to absorb losses which are not matched by a sufficient volume of profits, to protect investors. While some costs (such as staff bonuses) may decrease other costs (such as legal expenses) may increase. Considering that not all investment firms use International Financial Reporting Standards (IFRS) and in order to avoid regulatory arbitrage, it is essential to follow a prudent approach for calculating own funds for these firms, whereby changes to

OJ L 176, 27.6.2013, p.1.



the accounting framework are automatically taken into account and cannot be arbitraged by changing the accounting categorisation. As a result, and in order to more adequately reflect the effect of the variable expenses in the own funds, rules on the own funds of these firms should be based on an approach whereby variable costs are deducted from total expenses.

- (3) Given that investment firms make use of tied agents and the business carried out through tied agents exposes investment firms to risks in the same manner as the business carried out by the investment firms themselves, rules on the own funds requirements for investment firms based on fixed overheads should provide for the inclusion of costs relating to tied agents to reflect the above risks. Nevertheless, given that costs related to tied agents have some element of variability but cannot be considered a fully variable cost item but it would be disproportionate to include the full amount of the costs related to tied agents to the own funds requirements, these rules should provide for the inclusion only of a percentage of these costs in the own funds requirements. Further, in order to avoid double-counting of amounts relating to tied agent fees, these rules should provide for the deduction of the fees related to tied agents before the addition of this percentage to the own funds requirements.
- (4) In line with Regulation (EU) No 575/2013, which provides that competent authorities can make adjustments in capital requirements where there has been a material change in the business activities of the firm and in order to ensure that competent authorities apply the same conditions across the EU, it is necessary to establish certain criteria on what consitutes a material change. As firms vary in their size, there are some very small firms or firms in a start-up phase for whom it would be unnecessarily burdensome to impose adjustments in their capital requirements, given that changes are bound to be frequent for them. Therefore minimum thresholds should be established so that these firms are exempted from the adjustments in capital requirements if their capital requirements fall below the threshold.
- (5) The provisions in this Regulation are closely linked to the provisions of Commission Delegated Regulation xx/xxx [draft RTS on Own Funds submitted to the COM on 26 July 2013], since they deal with own funds requirements for institutions. To ensure coherence between those provisions, and to facilitate a comprehensive view and compact access to them by persons subject to those obligations, it is desirable to include all regulatory technical standards required by Regulation (EU) No 575/2013 on own funds in a single Regulation.
- (6) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (7) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010. The European Banking Authority has also consulted the European Securities Markets Authority (ESMA) before submitting the draft technical standards on which this Regulation is based.



HAS ADOPTED THIS REGULATION:

Article 1

Amendments to Regulation xx/xxx [EBA draft RTS on Own Funds submitted on 23 July 2013]]

Regulation (EU) No xx/xxxx [EBA draft RTS on Own Funds submitted on 23 July 2013] is amended as follows:

A new 'Chapter 5a' is inserted after Article 34 [numbering follows the order of the Articles that are the legal bases, as they appear in the CRR]:

CHAPTER 5a

Own Funds based on Fixed Overheads

Article 34a-

Calculation of the eligible capital of at least one quarter of the fixed overheads of previous year according to Article 97(1) of Regulation (EU) No 575/2013

- 1. For the purposes of Article 97(1) of Regulation (EU) No 575/2013 investment firms shall calculate their fixed overheads of the preceding year, using figures resulting from the applicable accounting framework, by subtracting the following items from the total expenses after distribution of profits in their most recent audited annual financial statements, or, where audited statements are not available, in annual financial statements validated by national supervisors:
 - (a) fully discretionary staff bonuses;
 - (b) employees', directors' and partners' shares in profits, to the extent that they are fully discretionary;
 - (c) other appropriations of profits and other variable remuneration, to the extent that they are fully discretionary;
 - (d) shared commission and fees payable which are directly related to commission and fees receivable, which are included within total revenue, and where the payment of the commission and fees payable is contingent upon the actual receipt of the commission and fees receivable;
 - (e) fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing, registering or clearing transactions;



- (f) fees to tied agents in the sense of point 25 of Article 4 of Directive 2004/39/EC of the European Parliament and of the Council⁵, where applicable, notwithstanding the provisions of paragraph 3;
- (g) interest paid to customers on client money;
- (h) non-recurring expenses from non-ordinary activities.
- 2. Where fixed expenses have been incurred on behalf of the investment firms by third parties other than tied agents, and these fixed expenses are not already included within the total expenses referred to in paragraph 1, these fixed expenses shall be allocated based on the underlying expenses of the third party, when such a break-down is available, and investment firms shall subsequently add their applicable share of the fixed expenses to the figure resulting from paragraph 1. When such a break-down is not available, the investment firms shall add these expenses according to the business plan to the figure resulting from paragraph 1.
- 3. Notwithstanding point (f) of paragraph 1, where the investment firm makes use of tied agents, the investment firm shall add 35% of all the fees related to the tied agents to the figure resulting from paragraph 1.
- 4. Where the firm's most recent audited financial statements do not reflect a twelve month period, the firms shall divide the result of the calculation of paragraphs 1 to 3 by the number of months that are reflected in the financial statements and shall subsequently multiply the result by twelve, so as to produce an equivalent annual amount.

Article 34b-

Conditions for the adjustment by the competent authority of the requirement to hold eligible capital of at least one quarter of the fixed overheads of the previous year according to Article 97(2) of Regulation (EU) No 575/2013

For the purposes of Article 97(2) of Regulation (EU) No 575/2013, competent authorities shall consider that a material change has occurred in the business of an investment firm since the preceding year as follows:

- (a) For either of the following types of firms:
 - (i) investment firms whose current own funds requirements based on fixed overheads are equal to or more than EUR 125 000;

⁵ Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1).



(ii) investment firms whose own funds requirements based on current fixed overheads are less than EUR 125 000 but which, based on projected fixed overheads, equal or exceed EUR 150 000,

where one of the following conditions is met:

- (i) the change in the business of the firm results in a change of 20% or greater in the firm's projected fixed overheads;
- (ii) the change in the business of the firm results in changes in the firm's own funds requirements based on projected fixed overheads equal to or greater than to EUR 2 million.
- (b) For investment firms whose own funds requirements based on current fixed overheads remain below EUR 125 000 but which, based on projected fixed overheads, are less than EUR 150 000, where the change in the business of the firm results in a 100% or greater change in the firm's projected fixed overheads.

Article 34c-

Calculation of projected fixed overheads in the case of an investment firm that has not completed business for one year according to Article 97(3) of Regulation (EU) No 575/2013

Where a firm has not completed business for one year from the day it starts trading, it shall use, for the calculation of items (a) to (h) of Article 34a, paragraph 1, the projected fixed overheads included in its budget for the first twelve months' trading, as submitted with its application for authorisation."

Article 2

Final provision

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.



Done at Brussels,

For the Commission The President

[For the Commission On behalf of the President

[Position]



4. Accompanying documents

4.1 Cost- Benefit Analysis / Impact Assessment

4.1.1 Introduction

- Under Article 10(1) of the EBA Regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council) any draft regulatory technical standards developed by the EBA – when submitted to the European Commission (EC) for adoption should be accompanied by an analysis of 'the potential related costs and benefits'. This should provide the reader with the problem definition, the options identified to deal with this problem and the potential impact thereof.
- 2. This note outlines the EBA's assessment of the impact of the requirements regarding the calculation of fixed overhead requirement used to calculate the total risk exposure of investment firms. The development of these RTS covering these matters stems from the requirement presented in Article 97(4) of Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms (CRR).

4.1.2 Problem definition

Issues addressed by the EC and the EBA regarding the calculation of fixed overhead requirement

- 3. Investment firms have to calculate their capital resources requirement taking into account the risk-weighted exposures the firm has to the markets and other firms and general overheads. Once calculated, the relevant parts of the capital resources calculations should exceed the relevant sections of the capital resources requirement in order for the firm to meet its prudential requirements.
- 4. Directive 2006/49/EC (CRD) requires investment firms to calculate a quarter of the firm's relevant fixed expenditure or total expenditure in the firm's most recent audited annual report and accounts, excluding certain expenses. The requirements regarding this calculation currently vary between Member States and this calculation is not uniformly conducted across the EU.
- 5. These RTS will supplement at a technical level the provisions of the CRR and clarify how an investment firm should calculate its overhead expenses for the purpose of estimating its capital resources. These clarifications will contribute to achieving some of the following specific objectives defined by the EC in its impact assessment of the CRR:
 - ▶ S4: enhance legal clarity
 - S5: enhance level playing field
 - ▶ S6: enhance supervisory cooperation and convergence.



4.1.3. Technical options considered

- 6. The EBA considered two alternatives regarding the content of the draft RTS relating to the definition of fixed overheads:
 - ▶ Option A: define fixed overheads as a positive list ('additive procedure'), which means listing all the cost items that would have to be included as fixed overheads; or
 - ▶ Option B: define fixed overheads as a negative list ('subtractive procedure'), which means deducting a more limited list of variable costs from total expenses.
- 7. Option A entails a definite list of fixed overheads to be added up and would ensure a high degree of comparability across countries. A complete list could be generated under IFRS, but, given that this RTS applies only to investment firms with limited authorisation to provide investment services, which are often non-IFRS firms, such a list would need to be adapted to take into account national generally accepted accounting principles (GAAPs) and would result in different lists for many countries. Another disadvantage of using option A would be that any subsequent changes to the accounting standard would not be incorporated.
- 8. Option B, a subtractive approach, is based on deducting certain variable cost items from the total expenses calculated according to the applicable accounting framework. This approach is more prudent, as changes to the accounting framework are automatically taken into account and cannot be arbitraged by changing the accounting categorisation. Furthermore, it requires fewer adjustments for those firms that do not use IFRS, which include most of the smaller or limited-authorisation investment firms affected by these RTS.
- 9. The EBA favours option B, the subtractive approach, as it is more prudent. Moreover, as many investment firms are likely to use national GAAPs rather than IFRS, this approach will be simpler to implement.

Tied agents

10. The EBA is proposing to include a provision for investment firms providing investment services through their tied agents. When an investment firm with tied agents is winding down, it is likely that some of its tied agents will also have to wind down their business. As calculating fixed overheads for tied agents in the same manner as for investment firms themselves would be challenging, the EBA suggests adding a fixed percentage of the costs per tied agent instead. This method addresses the fact that tied agents have some element of variability in some cases but cannot be considered a fully variable cost item.

Thresholds for the adjustment of capital requirements by competent authorities

11. Own funds requirements are generally set for one year. During that time, firms may face a material change in the level of projected overheads or in the activities allowed in the firm's authorisation (e.g. a firm withdraws some of the services it has provided or gets an authorisation to provide more services). As a result of a large change, a capital requirement



based on projected overheads may no longer be aligned with the actual level of capital needed by a firm. The EBA, therefore, introduces thresholds defining when a change in business activities is large enough that competent authorities should allow adjustment to the capital requirement. Introducing thresholds would enable harmonisation regarding what constitutes a 'material change' and would fulfil the mandate of the EBA and ESMA under Article 97(4)(b) of the CRR.

- 12. The EBA proposes to implement an absolute and a relative threshold. The absolute threshold would be introduced for larger investment firms in order to address changes in capital requirements considered material in an absolute sense, which would affect larger investment firms.
- 13. The proposal tries to strike the right balance regarding the level of the threshold. A low materiality threshold would increase the supervisory burden for national competent authorities, given that competent authorities would have to adjust the requirements even if small changes in the business of a firm were to take place; this would not be particularly useful or cost-efficient, particularly given the one-year horizon of this requirement.
- 14. On the other hand, a high materiality threshold could lead to situations in which investment firms might hold either insufficient capital, when a company is expanding, or an excessive amount, when the business of a firm is shrinking. In addition, while it could be argued that a low threshold falls within the mandate for establishing conditions for the exercise of the competent authorities' adjustment of capital requirements, a high threshold in the RTS would end up circumventing the CRR provision that provides the national supervisory authorities (NSAs) with the power to adjust capital requirements.

4.1.4. Impact of the proposals

Costs

- 15. For investment firms, the implementation of these RTS will generate two types of costs:
 - Direct compliance costs, as investment firms will have to check if the current calculation they make meets the requirements of these RTS. Because most investment firms should have already implemented the processes necessary to conduct the calculation of their overhead expenses, this assessment should not require significant resources.
 - ▶ If some of the calculations currently made by an investment firm do not meet the requirements, the institution may need to raise additional capital as a result. In Member States where less prescriptive requirements than those proposed by these RTS are in place, investment firms are more likely to have to raise additional capital.
- 16. The implementation of these RTS may have additional resource implications for NSAs, in terms of additional staff time for supervision. However, these additional resources should not be significant, as NSAs should already be monitoring the compliance of investment firms with the requirements on capital resources.



Benefits

17. By establishing harmonised practices for the calculation of fixed overhead requirements, the RTS will ensure that institutions in different Member States use the same practices when they estimate their capital resources requirement, ensuring legal clarity and a level playing field, as well as facilitating the calculation of this requirement for cross-border firms.



4.2 Feedback on the public consultation

The EBA publicly consulted on the draft proposal contained in this paper.

The consultation period lasted for three months and ended on 30 September 2013. Thirteen responses were received, of which nine were published on the EBA website.

This paper presents a summary of the key points and other comments arising from the consultation, the analysis and discussion triggered by these comments and the actions taken to address them if deemed necessary.

In many cases several industry bodies made similar comments or the same body repeated its comments in response to different questions. In such cases, the comments and EBA's analysis are included in the section of this paper where the EBA considers them most appropriate.

Changes have been incorporated into the draft RTS as a result of the responses received during the public consultation.

Summary of key issues and the EBA's response

The main points raised by the industry with regard to these draft RTS are the following:

- (1) Harmonisation of the approaches used in different Member States was considered necessary and the subtractive approach proposed by the EBA was considered appropriate. There were comments on the list of items to be included and some terms to be clarified.
- (2) The inclusion of tied agents was generally supported but the responses regarding how to calculate it varied.
- (3) The inclusion of three different thresholds was generally supported as was the general approach to take into account the differences in firms regarding their size, structure and complexity. There was some support for the introduction of a *de minimis* threshold for small investment firms.
- (4) No material impact was foreseen provided that the existing proposals are adopted.

These and the other issues are addressed in detail in the feedback table 'Summary of responses to the consultation and the EBA's analysis' below.



Summary of responses to the consultation and the EBA's analysis

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
General comment	ts		
Harmonisation	Harmonisation across Member States was strongly supported.		
Proportionality	The need to take into account the differences in firms regarding their size, structure and complexity was emphasized by many respondents and provisions relating to this need were welcomed.		
Responses to que	stions in Consultation Paper EBA/CP/2013/30		
Question 1	The subtractive approach proposed by the EBA was strongly supported by all but one respondent, who agreed with the proposed approach generally given the need to harmonise practices. Provisions taking into account the differences in firms regarding their size, structure and complexity were also welcomed.	The proposed approach seems to be used by most firms subject to these RTS and there is broad support for it. Most respondents agreed with the reasoning behind adopting this approach that it is more prudent than the alternative approach. It also enables firms to take into account different national accounting frameworks and helps to reduce regulatory arbitrage.	No changes.
Question 2	More than half of those who commented agreed with the list of items as was proposed. There were some comments on the list of variable cost items and requests for clarification of the	The CP did not give a definition of 'total expenses' but did make reference to the calculations being made according to the applicable accounting framework.	Clarification that distribution profits are outside the scope of total expenses.
	term 'total expenses'. The industry asked for clarification about whether or not distribution profits, contract-based profit transfers and taxes	Regarding distribution profits, they can be avoided and there is no legal basis which requires them to be paid; therefore this item should be treated as	No changes to the list of items but the



Comments

Summary of responses received

EBA analysis

Amendments to the proposals

on income would be outside the scope of total expenses.

There were suggestions to add (i) interest paid to counterparties and (ii) interest charges in respect of borrowings made to finance the acquisition of a fund's tradable investments because they are currently deductible under the subtractive approach in at least one jurisdiction.

The industry also suggested adding foreign exchange losses to the list because these losses arise from market risk and not from the underlying operating risk of the business and are also currently deductible in some jurisdictions where this approach is in use.

Finally, there were a few comments from the industry asking to change or at least clarify 'extraordinary non-recurrent expenses' to avoid the possibility that it would coincide with a narrower concept under local accounting principles. Moreover, extraordinary items are recognised in the US and UK but not under IFRS.

variable. This is also in accordance with the IFRS, and the EBA agrees to exclude them from total expenses.

Contract-based profit transfers, however, although they are variable and depend on the yearly profitability, are not avoidable on a legal basis because they are based on a contract between a parent company and a subsidiary (usually for tax purposes) and the subsidiary entity will have to fulfil the terms of the contract. Therefore they should be treated as fixed. Similarly to contract-based profit transfers, taxes on income, although they are variable and depend on the yearly profitability, are incurred in the normal course of business and they are unavoidable. On that basis, they should also be treated as fixed expenses.

Regarding the items 'interest paid to counterparties' and 'interest charges in respect of borrowings made to finance the acquisition of a fund's tradable investments', one could argue that an investment firm can cut down on these expenses, if the type of borrowing is short term and the investment firm reduces the amount of funds borrowed or agrees on more favourable terms (lower interest rate). Nevertheless, the EBA believes that these items are part of the normal course of business and are therefore fixed. In addition, there is a legal basis that makes these types of expenses unavoidable (i.e. contract with counterparty).

Foreign exchange losses can indeed be expected to be variable expenses, but, given the fact that investments of firms would usually be in several term 'extraordinary non-recurrent expenses' changes to 'non-recurring expenses from nonordinary activities'.



Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		currencies, the use of foreign currency (with the risk of foreign exchange losses) is part of the normal course of the business of an investment firm. Any foreign exchange loss would derive from the positions held by the investment firm, for which there is a legal basis (i.e., for all the positions that the investment firm has, there should be a contract with the terms and conditions). Foreign exchange loss would be one of the outcomes of the contract, and as a result it, cannot be avoided.	
		The EBA finds that 'all other variable expenses' is a very broad term and contradicts the aim of the subtractive approach. Therefore, the EBA does not support this amendment but instead proposes to change the term to 'non-recurring expenses from non-ordinary activities'. This would also be more in line with the original proposal, given that most respondents agreed with the list as was proposed in the CP.	
Question 3	The additive approach was not considered appropriate and one respondent mentioned that it is not flexible enough to take national differences into account.	Given the broad support, the subtractive approach has been maintained.	No changes.
	One respondent preferred the additive approach because it is currently used in its jurisdiction.		
Questions 4–6	These questions were not commented on by many; those who commented generally agreed with the inclusion of tied agents. Two respondents supported the EBA's proposal to cover them with a	The EBA proposed a fixed percentage taking into account the practical issues with this calculation: it is less burdensome and more straightforward than other options. Given that the responses on how the	No changes.



Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	certain amount related to a tied agent; one suggested that the calculation be part of the capital planning process and agreed with supervisors; and one preferred that the calculations be made in the same manner as for investment firms.	tied agents should be addressed varied with no clear preference for any option, and taking into account the practical issues with the other methods of calculating it, the EBA decided not to change the RTS in this respect.	
	One respondent proposed that the percentage be raised to 40% and one proposed to design the calculation so that the actual expenses regarding particular business arrangements would be reflected.		
Question 7	The 20% threshold was supported by all but one respondent who commented on it. One respondent proposed 33% and suggested it be more flexible and proportionate.		No changes.
Question 8	The introduction of a <i>de minimis</i> threshold for small firms did not receive many comments and the views of those who commented were divided with some arguing that it would protect small firms, allowing them to expand, and others arguing that this threshold is not necessary. The amount of EUR 125 000 (which is also the initial capital required by the UCITS Directive) was proposed by two respondents. One respondent said that it should be a percentage of fixed overheads requirements (however, no specific percentage was proposed).	The EBA did not propose an amount because the sizes of investment firms vary significantly. A <i>de minimis</i> amount of EUR 125 000 means that changes to the capital requirements based on fixed overheads would be considered by the competent authorities only for firms with at least EUR 500 000 of annual fixed costs. Therefore, the EBA proposes to set a <i>de minimis</i> amount of EUR 125 000, which, in effect, would apply only to very small firms. However, in order to ensure that a backstop exists for small investment firms whose capital requirements based on fixed overheads are less than EUR 125 000, it is suggested that the change in fixed overheads should be 100%.	Introduce a <i>de minimis</i> amount of EUR 125 000 of the capital requirements based on fixed overheads.



Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Question 9	Three respondents agreed with the EUR 2 million absolute threshold, two were against it and one did not consider it applicable given the current sizes of firms in its jurisdiction.	Introduction of a EUR 2 million absolute threshold No ch seems appropriate.	No changes.
Question 9	Out of those who were against this threshold, one did not consider any threshold necessary and the other questioned the absolute value of it and how it was derived.		NO Changes.
Questions 10–11	No material impact was foreseen, provided that the subtractive approach is introduced. There were no comments on the impact analysis, except from one respondent who agreed with it.		No changes.