EBA consultation on draft Regulatory Technical Standards (‘RTS’) on the reclassification of investment firms as credit institutions in accordance with Article 8a (6)(b) of Directive 2013/36/EU

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Jefferies welcomes the opportunity to respond to the EBA’s second consultation on draft RTS on the calculation for the threshold for investment firms.

Summary

Jefferies notes and is concerned by the EBA’s intention to include the assets of all undertakings conducting relevant business in an investment firm’s group, irrespective of where the group is domiciled, in the calculation for the investment firm’s group threshold test.

The proposed approach to include worldwide assets does not appear consistent with and goes beyond the intentions of the Level 1 text.

The proposed approach is also not justifiable from either an economic or risk perspective, resulting in an unduly burdensome approach, with significant practical difficulties for investment firms, without a proper impact assessment and cost/benefit analysis.

Question 1. *Is there any further element (including any potential simplification) concerning the accounting standards to be used for the purposes of these draft RTS that should be considered in this article?*

<u>In summary, the proposed approach not to allow for third-country GAAPs results in an unduly burdensome approach that would result in significant practical implications and costs.</u>

Question 2. *This article is introduced to cover all possible cases envisaged in the definition of credit institution in point (1)(b) of paragraph 4(1) of the CRR (as amended by Article 62 of the IFR). Is there any other case that should be considered in clarifying the calculation methodology?*

<u>In summary, the calculation should not include the assets of non-EU subsidiaries of non-EU entities as there is no economical or risk rationale to do so.</u>

Question 3. *Based on the provisions included in Articles 5, 6 and 7 of the draft RTS, do you anticipate any operational issues concerning the calculation of consolidated or combined assets? Please provide concrete examples.*

<u>In summary, the proposed approach results in an unduly burdensome approach that would result in significant practical implications and costs.</u>

Risk, proportionality and efficient markets

The new prudential regime for investment firm was intended to be a more appropriate and proportionate regime. The new proposed calculation of the €30bn threshold in this RTS would result in investment firms, which are part of larger third-country groups, with very small EU operations, to be required to become credit institutions, simply because of the balance sheet size of non-EU subsidiaries of non-EU entities, which have no activity in and pose no risk to the EU markets and EU market participants.

Activities conducted outside the EU do not pose a direct risk to EU markets, consumers or market participants. While the group threshold text provides an appropriate 'anti-avoidance' measure to prevent EU or third-country groups from dividing their EU activities to keep them individually below the threshold, this should not require the inclusion of non-EU activities as these pose no risk to EU markets or market participants.

Treating these small and non-systemic investment firms as systemic investment firms would result in an inappropriate and disproportionate prudential regime applying to them, creating a barrier to entry for third-country groups. This places the EU at a competitive disadvantage internationally and makes other countries a more attractive option for the establishment and centralisation of operations. This outcome is not aligned with the objective of promoting the effective and efficient functioning of the EU's capital markets.

Scope of Level 1 vs Level 2

Article 62 of the IFR, which amends Article 4 of the CRR, modifies the definition of a 'credit institution'. This now includes investment firms carrying out relevant activities, where the total value of individual or consolidated assets, based on different calculations, is equal to or exceeds €30 billion.

We note that the Level 1 text does not take into account the parts of a third-country group, other than the part of the group consolidated in the EU, composed of individual undertakings of more than €30bn. This indicates that the Level 1 text is only considering undertakings in the EU, or included in EU domiciled groups, indicating there is no intention to apply a worldwide approach to third-country groups.

We believe that extending the €30bn threshold calculation to include non-EU based undertakings within a group that carry out relevant activities regardless of geographical location is not in line with the intention of the establishment of the IFR nor is it proportionate regulation.

Firms should only be included in the group calculation if they pose a risk to the EU. As noted above, a non-EU subsidiary of a non-EU entity, that does not operate in the EU and is not a subsidiary of an EU entity, does not create any such risk and as such should not be included in the group calculation to determine the appropriate prudential regime to apply to the EU based entity. To treat non-EU subsidiaries as if they do pose such a risk is to completely ignore corporate structures, which are often intentionally designed to limit risk sharing or contagion between subsidiaries of the same parent.

By including non-EU entities in the calculation of group assets, the EBA is going beyond the scope of the original regulatory Level 1 text set out in the IFR. It is also taking an approach that no other major regulator globally takes.

Practical implications and impact assessment

A large number of third-country groups have been preparing, for the last two years, for their EU subsidiaries to move into and have now moved to the new prudential regime. Under the current proposal these groups are now facing uncertainty that can result in implementing a complex calculation, at this late stage, which can lead to an additional complex implementation of the new CRR framework. This very late change, which as mentioned appears to have little justification, would prove very disruptive and costly. It is already creating uncertainty and is contrary to the stated aim of a non-disruptive transition.

The amended approach will be impractical and an unduly burdensome process to implement as it requires firms to assess:

- the activities performed by a very large numbers of entities across the globe and compare these against EU definitions of activities, which are also implanted differently across EU member states.
- Adjust the accounting treatment performed by third-country entities and performed for the purpose of consolidation, so that it becomes IFRS equivalent.
- Perform a sub-consolidation at different levels, due to nature of the activities performed by different undertakings within the group.
- This would then need to be performed on a regular basis, for compliance, and in order to submit the necessary information to the relevant competent authorities.

This proposal would result in a deviation from other group entities based on other jurisdictional implementations. This creates the risk of that a very small entity in Europe being a credit institution, while a parent and all other group entities in other jurisdictions are not defined as such. This would result in a failure in the cost/benefit test and would also not be reflective of the way prudential consolidation and supervision takes place at group levels.

Additionally, such approach would result in very different monitoring metrics being appliable for different group entities. This would further make indicator monitoring more difficult and deviate resources from the focus on the actual risks that a firm is running.

The identification of the number of firms in the EU, which are part of third-country group, affected by this new proposal, and the one-off and on-going costs associated in this implementation, may not have been considered in its entirety as part of the EBA consultation.