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Optiver[1] welcomes the opportunity to provide input to this consultation on the EBA Guidelines for application of the Group Capital Test (GCT) under the IFR/IFD framework.

We note that the EBA has emphasised the relatively small number of Union parent investment holding companies of investment firms who have chosen to apply for the GCT. In our view this is due to the fact that within the large category of investment firms, the subset of firms who are both headquartered in the EU and have meaningful global operations is small despite representing a critical mass that supports the functioning, efficiency, and liquidity of EU capital markets.

We want to take this opportunity to emphasise the importance of having a mechanism like the GCT available to Union parent investment holding companies of investment firms in the EU to maintain the competitiveness of EU headquartered firms on a global scale. In the absence of the GCT, the current IFR-IFD framework would have extensive extraterritorial application for investment firm groups that are consolidated in the EU. In particular the extension of the IFR-IFD requirements on governance and remuneration to operations outside of the EU in the absence of the GCT would significantly undercut the competitive nature of EU headquartered investment firms. Global application of these requirements would undermine the ability of EU firms to compete on an even footing with their peers in non-EU markets in particular as far as access to talent pools is concerned. It would, however, also diminish their ability to innovate in the EU and contribute to making EU markets more competitive as there will be significantly less skill and experience transfer from non-EU jurisdictions into EU markets.

Having the GCT available to EU headquarters investment firm groups allows them to compete on a level playing field with their peers headquartered in other non-EU jurisdictions by allowing them to forego the requirements and application of IFD governance and remuneration requirements to their non-EU subsidiaries. This is particularly important as the EU is the only major global financial services jurisdiction that has chosen to apply governance, remuneration, and capital requirements derived from the Basel Framework, being the primary global standard for prudential regulation of banks, to investment firms.

The absence of the GCT would create significant complexity for investment firm groups that have their headquarters in the EU, but operate globally, as other major jurisdictions – for example the United States – have chosen to apply specific local prudential and organisational requirements to their local investment firms only. As there is no internationally agreed set of prudential standards for (EU headquartered) investment firm groups, the GCT is an essential mechanism for allowing such investment firm groups to meet their specific local prudential and organisational requirements in the jurisdictions that they are active in, without having to apply a second layer of consolidated requirements in parallel to their local prudential and organisational requirements. This reduces complexity for EU headquartered investment firm groups and at the same time allows them to compete on an even playing field in their non-EU jurisdictions.

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Finally, we would also emphasise that today firms who have been granted use of the GCT derive no benefit in terms of the overall level of capital requirements from this and effectively apply IFR/IFD capital calculations to their non-EU subsidiaries. On the one hand this is contrary to the predecessor regime of the IFR-IFD and the equivalent of the GCT within that (Article 15 CRR), on the other hand it means that the primary driver for investment firm groups obtaining the GCT is to not apply EU governance and remuneration requirements to their non-EU subsidiaries as a second layer on top of local governance and remuneration requirements in those jurisdictions.
With this in mind, we would urge that the guidelines for the GCT are designed and the GCT itself is applied in such a way so as to – at the very least – enable EU headquartered investment firm groups to reduce their operational complexity by not having to apply IFD governance and remuneration requirements to their non-EU subsidiaries in parallel to the local requirements these subsidiaries are subject to. This intention seems to be set out within the introduction of the guidelines (paragraph 20, section 3.2), however we feel the guidelines do not fully allow for the mechanism detailed within that paragraph, see response to question 9 for further details.

Q2. Do you consider the above criteria to be relevant for the assessment of the simplicity of the group structure of an investment firm group? If not, please provide a rationale.

We would consider the criterion listed in paragraph 16e/g with respect to contracts or arrangements in place to transfer activities within the investment firm group not a relevant metric for assessing the simplicity of an investment firm's group structure. Contracts or arrangements to transfer activities may be in place for various risk management or market specific reasons and should not constitute a relevant criterion for assessing structural simplicity so long as adequate governance and risk controls are applied. Firms are likely to transfer activities for reasons other than to optimise their capital requirements, as there are no reductions in regulatory capital requirements for firms who are granted permission to use the GCT versus application of full consolidation. More broadly, Investment firm groups may transfer positions between entities for various reasons as there could be market specifics in the jurisdictions that the group is active in that necessitate the need to transfer positions between entities. For example, the need for two subsidiaries located in the same jurisdiction to transfer positions between each other would not materially differ to the risk profile in which positions are maintained in a single 'consolidated' entity, provided that the governance is identical in both arrangements.

We do not believe that setting a threshold above which any position transfers result in the investment firm group not being deemed sufficiently simple would enable the consolidating supervisor to make an assessment as to whether or not a position transfer has materially increased the risk profile of an EU investment firm. It should be left to the individual national competent authorities (NCAs) to determine based on the nature, scale, and risk management rationale whether any position transfers between group entities alter the complexity of the investment firm group structure materially. Moreover, such an assessment should only focus on position transfers out of the EU where the NCA deems it of material relevance to financial stability in the Member State in which the firm is active or to the financial stability of the EU as a whole.

Q4. Do you consider the above criteria to be relevant for the assessment of the significance of the risk to clients or to market? If not, please provide a rationale.

Optiver does not agree that the outcome of the Group Capital Test, by way of the introduction of hard ratios, should be used as a hard criterium used in the granting of the Group Capital Test. Instead, any relief afforded by the granting of the Group Capital Test should be assessed as part of the ongoing SREP process and any related add-on introduced based on any risk that is no longer captured as a result of the Group Capital Test.

Q7. Do you consider the above criteria to be relevant for granting the derogation pursuant to Art. 8(4) the IFR? If not, please provide a rationale.

In addition to the general comment around the introduction of capital ratios noted in response to questions 4, we do not consider the thresholds detailed in paragraph 24 to be appropriate as a result of the prescribed methodologies within this consultation paper and the RTS on the scope and methods of the prudential consolidation of an investment firm group under Article 7(5).

Due to the differences in the calculation methodologies, there are scenarios in which the sum of IFR on an individual basis will be lower than under the full consolidation (Article 7 IFR); however this is not a signal of an increase in risk to the market or to clients (if applicable):

Taking K-NPR as an example:

- In accordance with the RTS on consolidation, K-NPR is applied on a consolidated basis. However , as set out in the general provisions for the calculation of own fund requirements for Market Risk; positions across entities can only be netted if there is a guarantee of mutual support within the investment firm group. In the case of a 'simple' structure, as required for the application of Article 8 IFR, it is unlikely that such guarantees are in place.
- As a result of the above, the K-NPR under Article 7 IFR is the sum of individual K-NPR, applying a base currency of EUR.
- This differs slightly from the methodology of the calculation under Article 8(4) IFR as set out in the consultation paper. Whereby the K-NPR on a consolidated basis is the sum of the individual K-NPR, applying local currency (USD).

This difference in base currency can lead to the total K-NPR under Article 8(4) IFR being lower than that calculated under Article 7 IFR. A simple example is an investment firm group with a US subsidiary. The subsidiary is funded in USD, and has a reporting (base) currency of USD. In EUR terms the total value (equity value) of the firm is EUR 100M.

For simplicity, one can assume the entity has zero trading positions, and as such the only K-NPR requirement relates to any 'open' FX exposure.

- In the case of the application of Article 8(4) IFR; the K-NPR = zero, as there is no FX exposure vs. the base currency (USD).
- In contrast, under Article 7 IFR the K-NPR is 4M. Whereby the 4% requirement for closely correlated currency exposure applies (USD vs. EUR).

As a result of the above, we do not feel that applying a restriction on the ratio between Article 7 IFR and Article 8(4) IFR is appropriate.

Q9. Do you agree with the provided elaborations on the definitions of "notional own funds" and "satisfactory level of prudence"? If not, please provide a rationale.

As we have detailed previously, the primary benefit of obtaining the GCT for investment firm groups is not related to capital relief, but is instead from the relief afforded by not applying items such as governance and remuneration requirements on a consolidated basis. The EBA has recognised this in paragraph 20 of section 3 (Background & Rationale):

"Competent authorities should require that an investment firm group applies Article 7 of the IFR only for the calculation of the consolidated capital requirements, without performing the prudential consolidation for any other aspects included in that article."

In light of this, we feel that as an alternative to the methodology proposed under paragraph 22, a firm should at the very least be able to apply full consolidation for capital purposes under Article 7 IFR, but forego application of the governance and remuneration requirements.

That said, we would highlight that there should be broader recognition for the adequacy of the own funds requirements a firm's non-EU subsidiaries comply with in sophisticated jurisdictions (from a prudential policy perspective) such as the United States, Australia, Singapore, the United Kingdom etc. Therefore NCAs should be able to determine the adequacy of the prudential standards in the non-EU jurisdictions that the firm's subsidiaries are active in not on the basis of whether those standards result in exactly the same absolute level of requirements as expected under the IFR in the EU, but on the basis of whether the prudential rules in that non-EU jurisdiction achieve a similar outcome. We would also highlight that in any event NCAs are able to assess the risk posed by foreign entities through the ongoing Supervisory Review and Evaluation Process (SREP).