Consolidated response by the
FIA European Principal Traders Association (FIA EPTA) to the EBA consultations on IFR/IFD Level 2

4 September 2020

EBA/CP/2020/06
EBA/CP/2020/07
EBA/CP/2020/08
EBA/CP/2020/09

FIA EPTA
EUROPEAN PRINCIPAL TRADERS ASSOCIATION

Contents

1. Executive summary

1.1. FIA European Principal Traders Association (FIA EPTA) appreciates the opportunity to provide feedback to the European Banking Authority (EBA) on the implementation of the new regulatory framework for investments firms (IFR/IFD).

1.2. FIA EPTA represents 29 independent European Principal Trading Firms (PTFs) which deal on own account, using their own money for their own risk, to provide liquidity and immediate risk-transfer in exchange-traded and centrally-cleared markets for a wide range of financial instruments, including shares, options, futures, bonds and ETFs.

1.3. Our members are independent market makers and providers of liquidity and risk transfer for exchanges and end-investors across Europe. Market making and liquidity provision (also referred to as principal trading or dealing on own account) is a distinct activity that is undertaken by non-systemic investment firms rather than banks, in a highly dispersed and varied ecosystem of independent Principal Trading Firms. These firms operate in an innovative and competitive fashion leading to a vibrant, dynamic and diverse ecosystem which massively reduces interconnectedness and increases substitutability. This fundamentally reduces systemic risk whilst improving market quality and lowering costs for retail and institutional investors alike.

1.4. As such, we have consistently welcomed the new prudential regime for investment firms contained in the Investment Firm Regulation and Directive (IFR/IFD), which is aimed at creating a tailored and proportionate prudential framework for firms such as those we represent. In line with this, we have consistently argued for a robust, fair and proportionate prudential regime to be applied to our members.

1.5. This document constitutes FIA EPTA's consolidated response to the EBA's IFR/IFD Level 2 consultations. In our response we focus on a number of key areas where we believe the EBA should consider amending the draft RTS/ITS to enable a proportionate, effective and practicable prudential regime for investment firms, in line with the original intent of the Investment Firm Review. For ease of reference we have summarised these points below. Further data and evidence are provided in our extended response.

1.6. FIA EPTA members appreciate the EBA's consideration of our comments and suggested solutions and stand ready to provide any further input as required.

K-CMG

- We believe the scope of K-CMG should be expanded to also allow direct and indirect clearing and the use of non-EU clearing members and CCPs.
- We support the EBA's proposal for the alignment between portfolios and trading desks.
- We argue that the definition of total margin required should be amended.

- In the case of multiple clearing members, we believe the use of 'third highest' should be based on the same day only.
- In relation to prevention of arbitrage, we argue that improvements could be made regarding the clarity of its structure and contents.

K-DTF

- We support the treatment of ETDs as 'cash trades' and the use of the premium for the calculation of DTF.
- However, we have concerns regarding the adjustment for 'exceptional circumstances' only. We therefore propose to expand this to 'stressed market conditions' and suggest two alternative approaches; a statistical method and one based on MiFID II Level 2 practice.

Classification

- We believe the impact of the 'group test' needs to be considered further as the current drafting does not seem to be aligned with the intention of the Level 1 text. We propose an alternative calculation for the 'group test' and a definition for the prudential definition of 'total assets' based on the Leverage Ratio calculation in CRR.

Consolidation

- We have concerns regarding the extra-territorial application of prudential consolidation and suggest that consolidated own funds requirements should follow a general consolidation approach, rather than aggregation for some K-factors.

Fixed Overheads Requirement (FOR)

- We believe several clarifications and amendments would need to be done in order to make the rules workable in practice. Specifically, we urge the EBA to consider making changes to enable:
    - Clarity regarding the basis of calculation;
    - Inclusion of a full list of deductions in the delegated regulation;
    - Ability to deduct staff bonuses to be linked to 'net profits';
    - Ability to deduct fees only where they are passed on and charged to customers;
    - That expenses related to items already deducted from own funds to be deducted from total expenses.
- Finally, we have concerns regarding the fixed amount threshold to determine a material change in an investment firm's business activity.

Cont'd

Remuneration

- Instead of implementing the new remuneration rules mid-way through the year we suggest aligning the implementation with an investment firm's year-end.
- We have concerns regarding the conditions for the issuance of financial instruments, especially the points related to credit quality of the investment firm.
- We believe there should be alignment of Tier 1 and Tier 2 instruments' redemption as well as the deferral period for variable remuneration.

Supervisory reporting

- We have concerns regarding the proposal to submit COREP templates for K-NPR. Instead, we propose a proportionality threshold to be applied.
- We would urge the EBA to reconsider the inexistence of a materiality threshold for re-submissions.

2. K-CMG

Draft RTS to specify the calculation of the amount of the total margin for the calculation of K-CMG (Article 23(3) of the IFR) –
EBA/CP/2020/06

Scope of K-CMG

2.1. While being conscious of the IFR Level 1 text, FIA EPTA members would like to bring to the EBA's attention, in the context of this consultation response, that the combination of the definition of 'clearing member' in Article 4(1)(3) of the IFR and Article 23 of the IFR limits the use of K-CMG to investment firms where they are direct clients of an EU clearing member. However, it should be noted that alternatively, investment firms can also be clients of direct clients of EU and non-EU clearing members (i.e. *indirect clients*), or even direct members of the CCP (i.e. *clearing members*). All these cannot benefit from the use of K-CMG, even if the models used to set margin requirements are set at an appropriate level of prudence and meet all conditions in paragraph 1 of Article 23 of the IFR.

2.2. FIA EPTA members are of the view that this limited scope, where the ability to use the total margin requirement as a methodology to set capital requirements to Risk to Markets should focus on the quality of the margin model, may have an undesired and 'cooling' effect on competition, as the requirement discriminates against non-EU clearing members and CCPs, which may lead to further concentration of client clearing activity in a limited number of clearing members or CCPs, without the underlying economic rationale. We would argue that K-CMG should be available to investment firms, irrespective of the location of the clearing member that they use, and if they are direct or indirect clients of a clearing member, or even direct members of the CCP.

Portfolios and trading desks – (Article 1 of the Draft RTS)

2.3. FIA EPTA members support both the alignment of portfolios with trading desks and the definition of 'trading desk' itself as proposed by the EBA in the draft RTS. The concept of trading desks in the draft RTS is aligned with how firms operate in practice and is consistent with other regulations, among other with the CRR2 amendments. In this regard, FIA EPTA members note that this would allow investment firms to define trading desks depending on their business models and would cover the diversity of their trading strategies. As such, and to ensure uniform interpretation across the Union, FIA EPTA members would encourage the EBA to clarify the concept of trading desk further in a Recital to the RTS, along the lines set out below in paragraph 2.4.

2.4. A trading strategy is characterised by a multiple of factors, each equally important, which include the trading objectives, the type of products traded, the maturity of the products and the market traded. It is therefore important that an investment firm is able to treat relevant variation of one of these factors as a different trading strategy, and therefore a different trading desk, as it would give rise to different underlying risks, different risk management techniques and different margin requirements at one or more clearing members.

Calculation of the amount of the total margin required – (Article 2 of the Draft RTS)

2.5. FIA EPTA members note that Article 2(1) of the draft delegated regulation proposes that the amount of the total margin required to be calculated as follows:

"The amount of the total margin referred to in Article 23(2) of Regulation (EU) 2019/2033 shall be the required amount of collateral in the collateral account comprising the initial margin, variation margins and other financial collateral, as required by the clearing member's margin model from the investment firm."

2.6. FIA EPTA members support the objective to define total margin required. However, we would caution that the proposed definition is not aligned with the operational model of clearing members and would , in its current wording, limit the ability for simultaneous use of K-CMG and K-NPR by different trading desks within the same investment firm, which would be at odds with the intention of the Level 1 text. There are several points in the proposed definition that lead to this potential limitation, as follows:

a. *Reference to initial and variation margin* – the suggested language in the draft RTS appears to be borrowed from CCP requirements in EMIR. However, it should be noted that clearing members apply a variety of proprietary margin models which do not use the CCP terminology. In addition, if the definition already refers to the amount of collateral required to cover for the risks, specific reference to individual components is superfluous as they are understood to be included. We would therefore suggest focussing on an outcome-based approach and to remove the reference to initial margin and variation margin but to include the exposures that must be covered.

b. *Reference to collateral account* – it should be noted that firms may have more than one collateral account, which may include financial and non-financial collateral. Given that, as currently proposed, the draft definition is not aligned with common market practice, we would therefore suggest removing the reference to 'the collateral account' and to 'financial collateral'.

c. *Specific reference to portfolios* – the use of K-CMG on a trading desk basis is allowed under IFR and the proposed delegated regulation. However, the proposed calculation of the total margin required does not specify that the amount of collateral is specific for the trading desks subject to K-CMG. For the purpose of clarifying the calculation, and to allow for the simultaneous use of K-NPR and K-CMG methodologies on a trading desk basis, we suggest that the calculation of the total margin required make specific reference that it will apply 'for the trading desks subject to K-CMG'.

d. *K-NPR and K-CMG as a proxy for 'market risk'* – it is understood that K-NPR and K-CMG are designed to capture what is, in the current prudential framework, the 'market risk', which in summary captures the risk of loss resulting from fluctuation in the market value of net positions. Based on this, and the fact that K-NPR is proposed to use CRR methodologies, we propose that the calculation of total margin required include a reference to 'exposures resulting from change in the market value of net positions'.

2.7. Based on the above comments, we would suggest the calculation of the total margin required included Article 2(1) of the proposed delegated regulation to be amended as follows:

*"The amount of the total margin referred to in Article 23(2) of Regulation (EU) 2019/2033 shall be the ~~required~~ amount of collateral ~~in the collateral account comprising the initial margin, variation margins and other financial collateral, as~~ required by the clearing member's margin model ~~from the investment firm,~~ **to cover for current and potential future exposures resulting from change in market price of net positions, for the trading desks subject to CMG**."*

Method of calculation of K-CMG in case of multiple clearing members – (Article 3 of the Draft RTS)

2.8. FIA EPTA members note that Article 3 of the draft delegated regulation proposes that:

"For the purposes of calculating the K-CMG as referred to in Article 23(2) of Regulation (EU) 2019/2033, where an investment firm makes use of the services of more than one clearing member, the investment firm shall calculate the K-CMG by first determining the third highest amount of total margins required on a daily basis by each clearing member separately over the preceding three months, then adding those amounts and multiplying the outcome by 1.3"

2.9. FIA EPTA members do not support the proposed approach of first determining the third highest amount by each clearing member separately and then adding those amounts. It is our view that the proposed approach does not reflect how the underlying risk is managed in practice by firms and is therefore overly conservative. In addition, the proposed calculation of K-CMG, before adding this additional component where there are several clearing members, already includes a high degree of prudence that does not need to be further increased. In this regard, we suggest the following for consideration by the EBA:

a. *Risk management* – investment firms manage risks based on the positions they have on a specific day and do not operate a risk management framework based on risks being added up across different days.

b. *Third highest margin requirement* – it is understood that the use of the third highest total margin required is to embed a degree of prudence; in combination with other components in the calculation (as set out below) this should be sufficient to ensure an appropriate level of prudential confidence. It is worth noting that the internal models approach in CRR uses an averaging of outcomes over a period. The use of the third highest margin requirement, which is based on the margining model of the clearing member for the same type of risks, is already a more conservative approach.

c. *Multiplying factor* – The K-CMG calculation includes a 1.3 multiplying factor which provides for an additional degree of prudence. Our members have assessed that the use of the third highest per clearing member in the manner currently proposed by the draft RTS would further increase capital requirements by an additional 10% to 20%, at the very minimum, depending on the number of clearing members which the firm uses. This would seem disproportionate given all other prudential safeguards in place.

d. *Double counting* – in cases where an investment firm switches a trading desk between clearing members or methodologies (K-NPR and K-CMG), this may lead to a double counting of certain requirements due to the way margin requirements are proposed to be aggregated. Using the aggregation based on days-only would mitigate such effect.

e. *Inconsistent outcomes* – the proposed approach may lead to inconsistent outcomes between different investment firms where firm A uses one clearing member and firm B uses more than one clearing member. For example, even in the case that risks are the same in two investment firms, an investment firm that uses only one clearing member will have lower capital requirements than the one that uses more than one clearing member, for no other reason other than the way margin requirements are added up across multiple clearing members.

f. *Concentration risk* – the proposed approach would incentivise investment firms to use only one clearing firm, which may lead to further concentration of client clearing activity in a more limited number clearing members or CCPs, without any underlying economic rationale. This in would increase the risk to the firm, in case of a clearing member's failure, and the risk to financial stability.

g. *Market liquidity and impact assessment* – the proposed calculation can lead to an impact on the level of liquidity that investment firms would be able to provide to the market. We would be interested in understanding if the EBA has undertaken any data analysis to assess the impact of the cumulative effect of these proposed rules, which include the third highest, multiplier and aggregation per clearing member. If not, we would urge the EBA to do so and share the outcome with firms.

2.10. Based on the above comments, <u>we suggest the calculation of K-CMG in case of multiple clearing members included in Article 3 of the proposed delegated regulation to be amended as follows</u>:

> *"For the purposes of calculating the K-CMG as referred to in Article 23(2) of Regulation (EU) 2019/2033, where an investment firm makes use of the services of more than one clearing member, the investment firm shall calculate the K-CMG by first* **adding up, across all clearing members used, the margins for each day,** *determining the third highest amount of total margins required on a daily basis ~~by each clearing member separately~~ over the preceding three months, then ~~adding those amounts and~~ multiplying the outcome by 1.3"*

<u>Prevention of arbitrage – (Article 4 of the Draft RTS)</u>

2.11. The EBA includes a specific question in this section. As follows:

"Question 4 – What would be appropriate thresholds or events that should trigger the comparison between the calculation under the K-CMG compared to the one under the K-NPR?"

2.12. FIA EPTA members fully support the prevention of regulatory arbitrage that can undermine the stability of the financial market. However, FIA EPTA members do not support the current wording of Article 4 of the proposed delegated regulation and would like to provide feedback on these points and recommend amendments to further improve the current text.

2.13. The current structure of Article 4, although covering the different points on the mandate that has been given to the EBA, is not entirely clear, which may lead to divergent implementation and supervisory practice across Member States. The conditions that need to be met for a competent authority to grant permission for the use of K-CMG are determined in the IFR. However, it is unclear at what point in time which conditions need to be met and what general non-arbitrage clauses apply. (For example, the requirement to keep consistent methodologies for a period of two years).

2.14. FIA EPTA members observe that the currently proposed drafting of Article 4 appears to mix different types of conditions together. Based on the objectives which Article 4 of the proposed delegated regulation is meant to achieve, <u>we would suggest that it would be more clear if Article 4 were to capture separately the different types of conditions that are captured in Article 23(1)(e) IFR</u>. Consequently, the structure of Article 4 of the Draft RTS should in our view reflect the following three types of conditions (a-c below):

a. ***Conditions at point of granting permission*** – this is understood to be the conditions that are set in paragraph 1 of Article 4 of the proposed delegated regulation. In general, FIA EPTA members support the text in points (a) to (d) of this paragraph.

However, regarding point (e) of this paragraph (comparison of K-CMG with K-NPR), and the factors described in paragraph 3 of Article 4, FIA EPTA members have a number of concerns, as follows:

i. The text should reflect that certain trading strategies are expected to give rise to an inherently large difference between K-NPR and K-CMG, due to the nature of how standardised approaches to market risk in CRR interact with the structural characteristics of certain financial instruments, for example, the enhanced maturity ladder for general interest rate risk in the case of short term interest rates (e.g., for STIR exchange traded derivatives (ETDs). However, such a difference should in itself not prevent the use of K-CMG as a more appropriate methodology to capture risk to market.

The more so, as the margin models of clearing members are regarded as prudentially sound. These have undergone extensive testing to ensure their efficacy and accuracy and they are subject to stringent governance criteria.

<u>Therefore, the following amendment is proposed, by adding a point to paragraph 3 of Article 4</u>:

***"(f) some trading strategies are expected to give rise to a large difference between K-NPR and K-CMG.* A difference between K-NPR and CMG, even if large, should not be sufficient to prevent the use of K-CMG provided that K-CMG meets Article 23 *of Regulation (EU) 2019/2033* and is assessed by competent authority as prudentially sound"**

ii. Two of the points included in paragraph 3 of Article 4 have no relationship with any potential justification of a difference between K-NPR and K-CMG as they are completely independent of any of these.

For example, a calculation of capital requirements based on FOR or other K-factors is not relevant for the purpose of justifying the correct approach to calculate capital requirements for Risk to Market.

Similarly, the level of own funds and the excess over capital requirements is not relevant for this justification. To note that it is ultimately an investment firm's responsibility to decide the best use for the excess capital it holds, and it should retain the ability to retain control over the use of its excess capital. As such, FIA EPTA members propose the deletion of points (c) and (e) of paragraph 3 of Article 4 of the Draft RTS.

b. ***General no arbitrage conditions*** – FIA EPTA members understand this is provided in point (a) of paragraph 2 of Article 4 of the proposed delegated regulation. Investment firms will have to conduct an annual assessment of their capital adequacy and risks. We believe that an approach to these general no-arbitrage criteria would be more appropriate if aligned with this risk assessment requirement. As such, we propose that the period of 'at least 24 months' is replaced by a period of 'at least 12 months'.

In addition, point (6) in the Recital references that an investment firm will have to make continuous use of the K-CMG method for a trading desk. It also refers to exceptional circumstances where an investment firms may switch methods. However, the Articles in the delegated regulation do not cover these exceptional circumstances. Therefore, FIA EPTA members would suggest to the EBA to cover these exceptional circumstances and provide more detail regarding such conditions.

c. ***Regular assessment of conditions*** – FIA EPTA members understand this is provided in point (b) of paragraph 2 of Article 4 of the proposed delegated regulation. In answering to Question 4, regarding appropriate thresholds or events that should trigger the comparison between the calculation under the K-CMG compared to the one under the K-NPR, FIA EPTA members do not support the proposed approach. As presented, it is unclear what are the key criteria that trigger the requirement to compare K-CMG and K-NPR, and whether this encompasses qualitative or quantitative criteria.

In addition, the proposed approach appears to be an automatic trigger. In FIA EPTA members' view, these triggers should be used as indicators for competent authorities then to make a subsequent judgement whether or not to require a comparison between K-CMG and K-NPR.

FIA EPTA members would support an approach which aligns these triggers with the regular assessments that have to be conducted by competent authorities and would urge to the EBA to clarify this in the final RTS, in line with the suggested approach outlined below, in which:

i. Competent authorities should assess the qualitative criteria proposed, including material change in the margin model or in trading strategies, and whether these lead to material changes in relation to K-CMG.

ii. Based on the assessment under point i. above, competent authorities should then determine if there are any reasons to require a comparison between K-NPR and K-CMG capital requirements.

iii. Based on the outcome of the comparison under point ii. above, determine whether the firm's permission to use K-CMG is kept or revoked.

Double counting

2.15. The EBA includes a specific question in this section, as follows:

"Question 5 – Which other conditions should be considered to avoid double counting or to prevent regulatory arbitrage in the use of the K-CMG approach?"

2.16. FIA EPTA members welcome the objective to understand and avoid cases of double counting and as noted above, we also support the objective to avoid regulatory arbitrage. Double counting may arise in some situations where for example a trading desk is moved from one clearing member to another, or when a firm changes from K-CMG to K-NPR for a trading desk (for example, it has assessed that the other methodology was more appropriate to reflect the underlying risk of the portfolio).

2.17. FIA EPTA members would suggest that the amendments proposed in paragraphs 2.7 and 2.10 above offer an effective solution to mitigate the occurrence of double-counting.

3. K-DTF

Draft RTS to specify adjustments to the K-DTF coefficients (Article 15(5) point c) of the IFR)

Draft RTS specifying the methods for measuring the K-factors (Article 15(5), point a) of the IFR) –

EBA/CP/2020/06

Exchange traded options – (Article 1 of the Draft RTS)

3.1. FIA EPTA members agree with the EBA that the trading and settlement of exchange-listed options is akin to other "cash trades" such as for stocks and should be treated as such for purpose of the K-DTF calculation.

3.2. We support, therefore, the proposal in the draft RTS specifying that exchange-traded options are to be treated as 'cash trades' and the premium paid or collected – rather than the notional value of the contract – will be used when measuring DTF.

Stressed market conditions – (Article 2 of the Draft RTS)

3.3. The EBA includes a specific question in this section. As follows:

"Question 3 – Is there any example of situations of market stress which would not been taken into account applying the proposed approach but would be relevant for the measurement of the K-DTF?"

3.4. FIA EPTA members consider that there are several examples of situations of market stress which are not covered by the current proposal in the draft RTS. FIA EPTA members are concerned that, as currently proposed, the draft RTS will not be effective in delivering on the objectives as set out in the IFR Level 1 text. We would strongly urge the EBA, therefore, to reconsider its proposed approach. To this end we suggest the proposed solutions which are described in the following paragraphs.

3.5. The current proposal to allow a coefficient adjustment only when there are "exceptional circumstances" pursuant to point (a) of Article 3 of Commission Delegated Regulation (EU) 2017/578 (MiFID II "RTS 8") would have a very limited or no impact at all. Empirical feedback from trading venues confirms that exceptional circumstances almost never occur, or only very rarely for extremely limited periods of time, maybe just a few minutes. It should be noted that even the extreme market volatility during the depth of the COVID-19 crisis in March 2020 did not change this picture. In addition, when exceptional circumstances are called under MiFID II, this is specifically designed to relieve investment firms of their obligation to provide liquidity on a regular and predictable basis (i.e., not trade), which means the current proposal does not achieve the objective of incentivising liquidity in the markets as set out in recital 1 of the Draft RTS.

3.6. FIA EPTA members also note that pursuant paragraph 5 of Article 15 of IFR, the EBA was tasked with developing the draft RTS to specify when the K-DTF coefficient should be adjusted in the event of 'situations of market stress'. We note that the current proposal referencing 'exceptional circumstances' constitutes a more narrow concept and we consider, therefore, that expanding to a broader concept of situations of market stress would be more aligned with the mandate given to the EBA, and would better achieve the stated objectives.

3.7. FIA EPTA members would strongly recommend, therefore, to the EBA to substitute the approach based on the concept of 'exceptional circumstances' for one based on 'stressed market conditions'.

3.8. In that regard, we would further suggest that an approach based on an objective statistical methodology will most effectively deliver on the targeted objective.

3.9. Below, we propose two alternative statistical solutions which would allow for an objective assessment of the existence of 'stressed' vs. 'normal' market conditions, based on the comparison of short-term market behaviour vs. longer term historical norms. Either of these would efficiently deliver on the need to determine whether stressed market conditions are of a type that should result in a coefficient adjustment for the purposes of K-DTF.

3.10. Further, by way of an additional (although in our view less effective) solution we also suggest an alternative approach defining 'stressed market conditions' as per MiFID II RTS 8.

3.11. Our suggested solutions are as follows:

Statistical method

3.12. FIA EPTA members believe that, rather than relying on trading venues, a simpler and more objective approach is to take a statistical view of stressed market conditions. This method removes volumes of transactions that are associated with statistically high volatility, high volume and observation days. The great advantage of this method is that it is very simple, using generally available external market data and that the method can be used for every product on every exchange.

3.13. This approach is justified because during heightened volatility, end users of securities or derivatives increase their demands for liquidity. These periods tend to coincide with higher than average volume. The current drafting implies that following a period of heightened volatility, investment firms would be required to account for higher K-DTF. This creates a disincentive to provide liquidity at a point in time when end users most need it.

3.14. To ensure that liquidity providers are not disincentivised through higher K-DTF readings during this time, firms should be allowed to remove volume from the calculation which coincides with higher than average volume. Specifically, a threshold which defines higher than average volume is required in order to base this calculation.

3.15. The use of price volatility to statistically define 'stressed markets' is widely accepted practice. Delegated Regulation (EU) No. 2017/578 places this exact requirement onto trading venues who must set out parameters to identify stressed market conditions in terms of significant short-term changes of price and volume. Trading venues must then consider the resumption of trading after volatility interruptions as stressed market conditions.

3.16. The use of the same approach to identify stressed market conditions for the purposes of adjusting K-DTF seems entirely appropriate and aligns purposefully with the approach taken by exchanges, while ensuring an objective and consistent methodology across exchanges and financial instruments.

3.17. A percentile approach offers an elegant and scalable approach that should be simple to calculate. A percentile can be defined as the Nth percentile derived from a list of observations sorted from greatest to least. This can be determined as follows:

*Cadj = C * (DTFexcl / DTFincl)*

Where:

*DTFexcl =the daily trading flow (DTF) of derivatives measured in accordance with Article 33 of Regulation (EU) 2019/2033, excluding the value of any trade that occurred during periods of ~~extreme volatility~~ **stressed market conditions** as set out in Article 2**a**; and*

*DTFincl =the DTF of derivatives measured in accordance with Article 33 of Regulation (EU) 2019/2033, including the value of any trade that occurs during periods of ~~extreme volatility~~ **stressed market conditions** as set out in Article 2**a**.*

3.18. Article 2 would be deleted and a new Article 2a included to define 'period of stressed market conditions'.

3.19. We propose two different options, set out below, to define 'stressed market conditions', one based on historical volatility and another based on historical volume.

3.20. To ensure consistent outcomes from the calculation, we propose for the statistical method a longer look-back period than 6 months. This is to make sure the measurements can indeed empirically be assessed as substantive outliers over a longer time horizon; based on FIA EPTA members' quantitative analysis of market behaviour, we suggest to use a 3 year lookback period for this purpose.

3.21. <u>Option 1 – historical volatility:</u>

"Article 2a

Period of stressed market conditions

For the purposes of Article 1, periods of stressed market conditions shall be determined as the trading days where historic volatility is in the highest 10% of the last 3 years for a given market and product."

3.22. Historical volatility is measured by the difference between the high and low price of a product on a certain day. For derivatives, the price of the underlying product is used for the measurement. FIA EPTA members have analysed the proposed adjusted calculation, using this statistical method, based on Eurostoxx futures data. In doing so, we have used the year 2019 as the base data. When compared to this the calculated value for K-DTF, once March's volume begins to be included, increases by up to 51% compared to the same period for 2019.

3.23. Using this proposed statistical method, the increase in capital requirements would show an increase of only 5%, rather than the 51% increase. Without this statistical method the year on year changes for K-DTF range from -11% to 51%. With this statistical method the K-DTF value stabilises with the range tightening from -3% to 10% across 2019 and 2020. This achieves the desired effect of not disincentivising investment firms from providing liquidity during periods of market stress.

3.24. Option 2 – historical volume:

"Article 2a

Period of stressed market conditions

For the purposes of Article 1, periods of stressed market conditions shall be determined as the trading days where market volume for that day was in the highest 10% of the last 3 years for a given market and product."

3.25. FIA EPTA members have analysed the proposed adjusted calculation, using this statistical method, based on Eurostoxx futures data. In doing so, we have used the first 6 months of 2019 as the base data and set this at 100. When compared to this, the volume of transactions in the first 6 months of 2020 increased by almost 50%.

3.26. Using this proposed statistical method, the increase in capital requirements would show an increase of only 2%, rather than the 50% increase. For 2019, this statistical method would show a decrease of only 5%. This demonstrates that there is a normalisation of capital requirement, with large increase in trading volumes, without the negative impact on normal times.

MiFID II definition

3.27. 'Stressed market circumstances' is a concept used in MiFID II RTS 8 and mandated by Article 6 of those RTS to be used by all EU exchanges in their market making schemes. This definition may even allow for it to be applicable more generally rather than only EU trading venues.

3.28. When compared to the statistical method, this approach may be more difficult to implement by investment firms. Exchanges publish when stressed market circumstances do occur per product. However, this data is not always available in an easy format to use in K-DTF calculation by investment firms, which may make the calculation quite burdensome from an operational perspective. In addition, the trigger of stressed market conditions is not generic and can differ per exchange and/or product, and while being quite common in equity markets but less common in commodities and interest rates. Consequently, FIA EPTA members would deem this approach, while an improvement on the 'exceptional circumstances' approach to be less effective than the statistical approach outline above.

3.29. This approach can be implemented as follows:

*Cadj = C * (DTFexcl / DTFincl)*

Where:

*DTFexcl =the daily trading flow (DTF) of derivatives measured in accordance with Article 33 of Regulation (EU) 2019/2033, excluding the value of any trade that occurred during periods of ~~extreme volatility~~ **stressed market conditions** as set out in Article 2**a**; and*

*DTFincl =the DTF of derivatives measured in accordance with Article 33 of Regulation (EU) 2019/2033, including the value of any cash trade that occurs during periods of ~~**extreme volatility**~~ **stressed market conditions** as set out in Article 2**a**.*

3.30. Article 2 would be deleted and a new Article 2a is included to define 'period of stressed market conditions'. As follows:

"Article 2a

Period of stressed market conditions

For the purposes of Article 1, periods of stressed market conditions shall be those situations referred to in of point (b) of paragraph 1 Article 6 of Commission Delegated Regulation (EU) 2017/578. Their start and end times shall reflect precisely the times when the trading venue communicated the occurrence of such stressed market conditions under paragraph 6 of Article 7 of Commission Delegated Regulation (EU) 2017/578."

Additional prudence

3.31. Although stressed market conditions are quite unique, there could conceivably be a concern that such adjustments may lead to a reduction of K-DTF which is deemed too large. It could be an alternative to provide an additional floor to the calculation in such a way that the reduction is not greater than 50%. As follows:

Cadj = **Max [0.50 * C** ; C * (DTFexcl / DTFincl)]

Draft RTS specifying the methods for measuring the K-factors referred to in Article 15 of the IFR - EBA/CP/2020/06

Question 1 – Is the proposed articulation of the K-factors calculation methods, in particular between AUM and CMH and ASA, exhaustive or should any other element be considered?

Treatment of cash trades in bonds

3.30 FIA EPTA members would like to note that there is a discrepancy in the treatment of cash trades in bonds, when compared to bond futures. This is because the bond futures would have their notional amount adjusted for the time to maturity of those contracts, in line with Article 33(2)(b), while the cash bonds would be included in the calculation of K-DTF by the amount paid or received. In addition, we would reiterate that market makers and liquidity providers, who as firms dealing on own account will be subject to K-DTF, play an important role in improving market quality and lowering execution and risk management costs for retail and institutional end-investors in government bonds, which also benefit the liquidity of EU Member States' sovereign debt issuance.

3.31 FIA EPTA members also note that the duration adjustment in Article 33(2)(b) of the IFR is only applicable to interest rate derivatives, while the duration adjustment in Article 29(4) of the IFR is applicable to interest rate and credit derivatives. We understand this is because of the additional underlying risk that applies to credit derivatives. However, we note further that high-quality and EU Member States bonds are subject to a 0% specific risk charge own funds requirement, as per Article 336 of the CRR. Therefore, only the general market risk related to the interest rate applies to these bonds.

3.32 Therefore, FIA EPTA members would ask the EBA to include an additional article in the final RTS specifying that the amount paid or received for trades in government bonds, which are subject to a 0% specific risk own funds requirement according to Article 336 of the CRR, is also adjusted for the time to maturity (in years) of the bond, specified in Article 33(2)(b) of the IFR.

4. Classification

Draft RTS on the information to be provided for the authorisation of investment firms as credit institutions (Article 8a (6) point a) of the CRD)

Draft RTS on the calculation of the threshold referred to in Article 4(1)(1b) CRR (Article 8a(6) point b) of the CRD) –

EBA/CP/2020/06

Overview

4.1. FIA EPTA members would like to raise a concern regarding the potential consequences of the implementation of the proposed delegated regulation in its current form and as currently drafted. As it stands, we are concerned that the currently considered approach will effectively put a disproportionate hard-cap on the size of European investment firms, making it very difficult for them to compete with banks that are not so encumbered. We believe that an alternative approach should be considered which would be more in line with the Level 1 text while enabling larger EU investment firms to compete on a level playing field, aligned with the underlying objectives of the Capital Markets Union (CMU) project of which IFR/IFD is a part. We would strongly urge the EBA to consider such an alternative approach.

4.2. In the following paragraphs, FIA EPTA members propose an approach which looks to clarify more clearly the calculation of the threshold values, and closer to align the methodology to the intention of the IFR Level 1 text.

4.3. Firstly, is FIA EPTA members' view that the Draft Regulatory Technical Standard on the calculation of the threshold referred to in Article 4(1)(1b) CRR (Article 8a(6) point b) of the CRD) as currently proposed by the EBA is inconsistent with the intention of the European Commission proposal for the IFR and the subsequent discussions held by the co-legislators in finalising such legislation.

4.4. The proposed delegated regulation could lead to an unintentional classification and subsequent authorisation of certain European investment firms as Credit Institutions under CRD/CRR and subsequent direct supervision by the Single Supervisory Mechanism (SSM).

4.5. Secondly, FIA EPTA members seek clarification from the EBA as to the intended methodology to be used in the calculation of total assets as detailed in Article 3, sub-paragraph 2 of the draft RTS. FIA EPTA members' interpretation of the intended calculation methodology is detailed in sub-section 'Total value of assets'.

1. IFD/IFR rules on classification of large investment firms

4.6. We note that the IFD/IFR introduces a number of amendments to CRD and CRR including:

- Extending the definition of 'credit institution' in CRR so as to include certain entities carrying out the activities of dealing on own account or underwriting or placing on a firm commitment basis ('specified activities') if their total assets reach or exceed a EUR 30 billion threshold (new point (1)(b) of Article 4(1) CRR).

- Adding new provisions to the CRD requiring EU entities that fall within the extended definition to submit an application for authorisation as a credit institution when their assets reach or exceed a similar (but not identically defined) EUR 30 billion threshold calculated *on an average basis over a 12 month period* (new Article 8a(1) of CRD).

4.7. FIA EPTA members support the threshold in place, to ensure that investment firms of sufficient size and European importance are proportionately regulated within the European Union, and welcomes the standalone 'solo test'. However, FIA EPTA members have concerns regarding the calculation of the 'group test' threshold in article 8a(1)(b) CRD (and thus article 4(1)(1)(b)(ii) and (iii) CRR) as set out in the proposed delegated regulation and its alignment with the intentions of the IFR/IFD level 1 text.

4.8. Within the proposed delegated regulation, there is a distinction between an investment firm headed by an 'EU parent undertaking' and an investment firm headed by a 'non-EU parent undertaking'. This distinction seems to be an incorrect interpretation of the intent of the Level 1 Legislation.

4.9. According to articles 8 and 9 of the proposed delegated regulation, the investment firm must calculate 'total assets' for the purposes of the 'group test' in point 8a(1)(b) CRD as follows:

a. *"the aggregation of the assets of both EU and non-EU entities carrying out specified activities where they are part of a group headed by an EU parent undertaking (an EU group) - but only the assets of EU entities (so carrying on specified activities where they are part of a group headed by a non-EU parent undertaking (a third-country group); and*

b. *that aggregation to use the individual (i.e., unconsolidated) balance sheets of those group companies (with some adjustments for intercompany items)."*

Legal background

4.10. Originally the proposed text of the 'group test' required only the aggregation of the total assets shown on individual balance sheets of EU entities which were part of the group, regardless of the location of the parent entity. The group test in the original proposal made no distinction between EU groups and third-country groups and it would have been clearly disproportionate to treat smaller EU firms which are subsidiaries of third country groups as credit institutions simply because the third-country group also includes large non-EU entities that carry on specified activities outside the EU.

4.11. Subsequent changes by the co-legislators were made as a response of the opinion of the ECB of 22 August 2018. In that opinion the ECB recommended the following:

"the proposed regulation should provide clarification as to how the assets are to be calculated, i.e. including the assets of Union branches of third country groups and third country

subsidiaries of undertakings in the Union arising from their consolidated balance sheet." (emphasis added)"

4.12. The response to the ECB's remarks resulted in the following proposed rewording of the original legislative document:

a. a provision to widen the scope of 'individual assets' to include branches of non-EU entities within third country groups; and

b. a provision to focus on the (sub-)consolidated assets of the entities already encompassed by point (1)(b) of article 4(1) CRR and 8a(1) CRD. (i.e. EU entities that carry out specified activities).

4.13. A key principle of the IFR, and wider European banking regulation, is to prevent the ability for regulated entities to take advantage of regulatory arbitrage across the Union, and prevent the risk of circumvention of the requirement for entities to be authorised as credit institutions by structuring their EU activities in such a way that allows EU activities to be excluded from the calculation of 'total assets'. As such, the 'group test' should be focused on EU activities, as opposed to activities conducted outside of the EU.

Other thresholds in IFD/IFR apply only to EU assets

4.14. During the legislative process, the co-legislators added a provision to IFR that was not included in the legislative proposal and that was designed to ensure that larger investment firms not treated as credit institutions would still be subject to supervision under CRR/CRD (Article 1(2) IFR). This provision includes a solo and group test structured in a similar way to the solo and group tests under CRR/CRD, but with a size threshold of EUR 15 billion and subject to wording excluding from the calculations of the threshold *"the individual assets of any subsidiaries established outside the Union that carry on any of the [specified activities]"* (see points (a) and (b) of Article 1(2) IFR).

4.15. However, the starting point for the solo and group test under this provision should be understood as being consistent with the correct methodology discussed above. Article 1(2)(a) and (b) of the IFR should be understood as focusing on the consolidated assets of EU entities that carry on specified activities, but then excluding the assets of non-EU subsidiaries of those EU entities when calculating the consolidated assets of those EU entities if those non-EU subsidiaries carry on specified activities. Thus, the intention appears to have been to apply an approach closer to the originally proposed text of point (1)(b) of Article 4(1)(1) CRR and Article 8a(1) CRD.

Proposed solution to the 'group test'

4.16. FIA EPTA asks the EBA to amend its proposed delegated regulation so that it aligns the method for applying the thresholds in Article 8a(1) CRD with an approach which is consistent with an understanding of point (1)(b) of Article 4(1) CRR, based on its legislative history and the apparent reading of the ECB on this issue.

4.17. FIA EPTA proposes a calculation of the 'group test', which is believed to meet the original intent of the Level 1 co-legislators as well as providing a level playing field for European investment firms who have managed to create large businesses outside of the EU, while ensuring that once the assets held by that investment firm reach certain thresholds within the EU, they are subject to the appropriate regulatory regime. The calculation should contain the following:

a. A provision making clear that the threshold in point (a) of Article 8a(1) CRD is determined by reference to the total value of the consolidated assets of an EU entity that carries on specified activities; and

b. A provision making clear that the threshold in point (b) of Article 8a(1) CRD is determined by:

    i. identifying all the EU entities in a group that carry out specified activities (step 1);

    ii. eliminating those EU entities identified at step 1 which are subsidiaries of another entity identified at step 1 (to prevent double counting);

    iii. calculating the consolidated assets of each of the remaining entities identified at step 1 (including the assets of their EU and non-EU subsidiaries);

    iv. eliminating those EU entities identified at step 1 whose consolidated assets are equal to or greater than EUR 30bn (consistently with the requirements of point (1)(b)(ii) of Article 4(1) CRR and point (b) of Article 8a(1) CRD);

    v. summing the total consolidated assets of the remaining entities identified at step 1;

    vi. for third-country groups, adding to that sum the assets of EU branches of non-EU entities (for consistency with the requirements of point (1)(b)(ii) of Article 4(1) CRR).

2. **<u>Total value of assets</u>**

4.18. Article 3 of the regulatory technical standards for the calculation of the threshold referred to in Article 8a(6)(b) of the CRD describes how to calculate the total value of assets for relevant institutions. Three possibilities are provided, firstly a prudential approach, secondly the use of IFRS and finally the use of an applicable national accounting law.

4.19. FIA EPTA members consider the EUR 30 billion threshold aims to capture whether or not an investment firm is running a large or similar risk profile as a significant credit institution. It is FIA EPTA members' opinion that total asset value from an accounting standards perspective is a poor metric for determining the risk profile of an investment firm, and it welcomes the introduction of the ability to use a prudential approach in measuring total assets, as a fairer representation of total assets for investment firms. This is mainly due to the strict netting pre-requisites under (IFRS) accounting standards, which particularly penalises investment firms with active trading portfolios.

4.20. In Part7 of CRR – 'Leverage', the regulator prescribes an exposure measure methodology for the use of calculating the total exposure of the institution for the purpose of measuring the total leverage used by the institution. The methodology used to calculate the 'total exposure measure' is the sum of the following:

- Total Assets as reported in the financial statement and securities financing transactions; excluding derivatives.
- Total Derivatives Exposure using the SA-CCR methodology
- Add-ons for Securities Financing Transactions
- Off-Balance Sheet Items
- Certain Outstanding settlements

4.21. FIA EPTA members support the use of the prudential measures, as prescribed within the Leverage Ratio calculations, to determine total assets and would strongly urge the EBA to clarify in the final RTS that such can indeed be applied in this manner. They will meet the methodology prescribed within Article 3, sub-paragraph 2 of the proposed delegated regulation on the calculation of total assets. Using the approach taken in the calculation of the 'total exposure measure' and applying it to calculate the 'total assets', the investment firm would exclude the off-balance sheet, SFTs, add-ons and outstanding settlements. The calculation of 'total assets' would be the sum of the following:

- Total Assets as reported in the financial statement; excluding derivatives.
- Total Derivatives Exposure using the SA-CCR methodology.

4.22. Finally, FIA EPTA members take from the wording of paragraphs 3 and 4 of Article 3 of the RTS that there is a hierarchy in the three different methods in subsections (2), (3) and (4). FIA EPTA members understand that there is a hierarchy proposed between (3) and (4) so that IFRS is to be preferred over other national accounting standards, but we fail to see the logic for a hierarchical order between subsection (2) on the one hand and (3) and (4) on the other. Therefore, we would suggest to the EBA to provide firms with optionality between using (2) *prudential individual reporting*, and (3) *IFRS*, and only allow (4) *other national accounting laws*, if (2) and (3) cannot be determined.

5. Consolidation

Draft RTS on prudential consolidation of investment firms groups (Article 7(5) of the IFR) – EBA/CP/2020/06

5.1. FIA EPTA members are of the view that the draft RTS is unnecessarily complex, mainly because of a number of cross-references. We would suggest to the EBA that it would be helpful if the text could be clarified and simplified. We note that Class 2 investment firms, including principal trading firms, are relatively simple and straight-forward and the current drafting of the RTS does not seem to take into account this type of uncomplicated structures.

5.2. FIA EPTA members note that the extraterritorial application and aggregation of the K-factors is troublesome for three reasons:

i. Third-country regimes applicable to investment firms do not have such extraterritorial application, which creates an unlevel playing field;

ii. The K-factors are explicitly not calibrated for market circumstances in third countries, which if applied would cause disproportionately high capital requirements for third-country operations, likewise resulting in an unlevel playing field; and

iii. The wide scope of consolidation may lead to a consolidated capital requirement where the sum is larger than the individual parts. We believe that applying the consolidation provisions to third-country subsidiaries is unnecessary as these are subject to their own capital requirements, consistent with their local environment and market structure. This would also level the playing field, leading to an increased attractiveness and competitiveness of principal trading firms with substantial operations or structures in the Union.

Question 9 – The methods for calculating the K-factors in a consolidated situation may allow for further specifications. Is there any K-factor for which the calculation in the context of the consolidated basis would require further specifications? What aspects should be considered?

5.3. Additionally, in response to Question 9, FIA EPTA members would welcome a confirmation in the final RTS that, for the purpose of consolidated K-factor own-funds requirements, activities or exposures would be disregarded as a matter of principle, for all K-factors, in line with a consolidation approach. This would be in line with the language in Article 11 (3)(b). This is clear in Article 11(3) for K-NPR, K-TCD and K-DTF but should be clarified in the RTS for all other K-factors that may be affected by intragroup positions and transactions.

6. Fixed Overheads Requirement (FOR)

Draft RTS to specify the calculation of the fixed overheads requirement and to define the notion of a material change (Article 13(4) of the IFR) –

EBA/CP/2020/06

6.1. FIA EPTA members note that the FOR now applies to all investment firms. This is set as one quarter of the fixed overheads of the previous financial year, and the competent authority can adjust this amount if the investment firm materially changes its business during the year. This adjustment could be an increase or a decrease, depending on the business change. FIA EPTA members also note that the FOR calculation is also used for setting liquidity requirements as one-third of FOR.

6.2. The EBA in its consultation clarifies several points regarding the calculation of FOR, some of which are ambiguous in the current CRD III/CRD IV calculation and adding deductions that are not included in current FOR calculations and in the IFR. FIA EPTA members' views in the regard are described in the below.

Basis of calculation

6.3. The EBA clarifies that FOR calculations are based on the most recent audited annual financial statements or just annual financial statements, if audited financial statements are not available. Currently, the draft delegated regulation refers to annual financial statements validated by the competent authority. This means that according to the current proposed text, the timing of application of the most recent annual accounts would be unclear.

6.4. FIA EPTA members would ask the EBA to clarify that 'annual financial statements' are regarded as being annual financial statements approved by the directors or other competent body of the investment firm.

Full list of deductions

6.5. FIA EPTA members note that the full list of deductions is not included in either the Level 1 or Level 2 texts (i.e., regulation and delegated regulation). In the delegated regulation, the additional items to deduct are referenced as being added to the items already included in the regulation. This means that although the reference to 'net profits' for bonuses is included in the regulation, all the items in the regulation have been stated as items to be considered. This means that they can be changed if a complete list is included in the delegated regulation, making it even more important to have a full list of deductions, with potential amendments to the text in IFR, in the delegated regulation.

6.6. FIA EPTA would ask the EBA to include in the delegated regulation a full list of items, to be deducted from total expenses. We would urge that this should also cover the reference to 'fully discretionary' staff bonuses be included, rather than the reference to 'net profits'.

Staff bonuses

6.7. Currently for the purpose of CRR, and in line with delegated regulation (EU) 2015/488, 'fully discretionary staff bonuses' are deducted from total expenses for the calculation of the FOR. However, we note that point (a) of paragraph 4 of Article 13 of the IFR instead refers to 'staff bonuses and other remuneration, to the extent that they depend on the net profit of the investment firm in the respective year'. It is unclear to us why this change has been made, and why there is a need to refer to profits, when in most cases an investment firm has the discretion not to pay any bonuses to staff, even if it is making a profit.

6.8. We note further that the EBA proposes that staff bonuses and other remuneration is dependent on net profits of the investment firm if it has been paid to employees in the preceding year of payment, or the payment will have no impact on the firm's capital position in the year of payment. However, FIA EPTA members observe that the meaning of 'bonus paid before the year of payment', is unclear. One possible interpretation could be where the payment has occurred in a year preceding the current year, or year the FOR is being calculated. Consequently, FIA EPTA members would ask for the EBA to delete any link between the ability to deduct staff bonuses, from total expenses, and net profits. Alternatively, we would urge the EBA to consider clarifying the meaning of bonus paid in the preceding year of payment.

6.9. In addition, with respect to current year and future years, the ability to deduct staff bonuses from total expenses, appears to only be possible where the firm is not obliged to pay unless it makes a net profit in that year. It is important to note that the FOR is normally calculated based on previous years expenses, and what is being proposed, for current and future years, can have a knock-on impact for the calculations of material changes in FOR. As mentioned before, an investment firm may decide not to pay bonuses even it is making a profit, as bonuses are normally dependent on employees meeting targets, which might not be met, and are normally discretionary.

6.10. Based on the current drafting, the normal calculation of FOR would, in most cases, include a deduction of bonuses. However, the calculation of current and future years FOR would not, if a firm projects to make a profit. This means that the calculation of previous years and current year are technically different. Because of this, investment firms may breach the thresholds in Article 3 of the proposed delegated regulation and may be required by the competent authority to calculate a FOR based on these projected figures, without the ability to deduct staff bonuses from total expenses.

6.11. FIA EPTA would ask the EBA, therefore, to remove this reference to 'net profits' and suggest to revert to 'fully discretionary staff bonuses', where it can be added that the link to net profits can be used as an example where discretion exist, but not as the mandatory condition to meet.

6.12. Finally, we note that this linkage between the deduction of staff bonuses and 'net profits' is likely not to have been considered in the EBA impact assessment of the proposed new regime, as this is likely to have considered investment firms' responses aligned with the current CRR regime that only refers to 'fully discretionary' bonuses. We consider that this change can have a material impact that should not be underestimated and, if kept, we urge that it should be reflected in a new impact assessment conducted by the EBA where the CRD III/CRD IV FOR is compared to the IFR FOR.

Deduction of fees only where they are passed on and charged to customers

6.13. FIA EPTA members note that the deduction for trading fees has been restricted to cases where such fees are passed on and charged to customers. We do not support this wording and would have the following comments:

- It is not clear what is the intention of this restriction;
- Fees incurred for the purposes of executing, registering or clearing transactions are mostly variable in nature;
- The restrictions create an unlevel playing field between firms subject to CRR and those subject to IFR and also among firms subject to IFR (those with or without clients) without an objective justification.

6.14. Furthermore, we consider that it should not matter whether an item is included under total expenses provided that they are accounted for in line with the relevant accounting standards. Some expenses would reduce trading income or be accounted for in a separate expenses line in line with accounting standards. In order to make this clear, we consider that the text should read 'where they are accounted as an expense in accordance with the relevant accounting standard'.

Additional items to deduction from total expenses

6.15. From the deductions listed in both the regulation and delegated regulation above, and the principles behind the ability to deduct items from total expenses, FIA EPTA members consider there is at least one type of deduction that is not included and should be added to the list. These relate to a *'deduction of expenses related to items that have already been deducted from own funds'*. The reason behind this additional deduction is that items such as intangible assets, for example, are deducted from own funds and, as such, any expense recorded related to these, such as impairment or amortisation (acceptable in certain local GAAPs), would have no impact on own funds.

Material change in activities on an investment firm

6.16. FIA EPTA members note that the EBA consultation also proposes a definition of what is considered a material change in the activities of an investment firm. As proposed, material change is considered to have occurred if there is a change in projected fixed overheads of the current year, equal to or greater than:

- 30% of the FOR: or
- EUR 2 million.

6.17. FIA EPTA members note further that the EBA decided to increase the percentual change but kept the same EUR 2 million threshold. It is our view that the EUR 2 million threshold for investment firms with a large FOR is inappropriate. For example, for an investment firm with a FOR of EUR 100 million, a EUR 2 million change in FOR represents only a 2% change in fixed overheads and is not likely to be related to a material change in an investment firm's activities. Requiring such investment firm to restate its FOR is an unnecessary burden. We would ask the EBA to consider two alternative options:

i. Remove the EUR 2 million condition to determine a material change; or

ii. Include an additional statement clarifying that this condition should be considered in a proportionate manner and not as an automatic approach.

FIA EPTA
EUROPEAN PRINCIPAL
TRADERS ASSOCIATION

7. Remuneration

<u>Draft RTS on classes of instruments that adequately reflect the credit quality of the investment firm as a going concern and possible alternative arrangements that are appropriate for the purposes of variable remuneration –</u>

<u>EBA/CP/2020/08</u>

<u>Implementation period</u>

7.1. FIA EPTA members note that the 'EBA next steps' section (page 5) of the consultation paper, states that it is assumed that institutions will have to comply with the RTS with regard to the remuneration awarded for the performance year 2021.

7.2. There is an implied assumption that the application of the RTS on remuneration applies mid-way through a performance year for firms that have a calendar year end. We would strongly caution the EBA that such an asymmetrical approach can be expected to cause a significant administrative burden for a number of firms that will have to pro-rate variable remuneration awards to take into account different remuneration rules.

7.3. To mitigate for such an undue administrative burden, we would suggest that it would be better to <u>provide an option for firms to apply this from the start of the accounting period/year-end, following the date of adoption of IFR/IFD</u>.

<u>Question 1 – Are the provisions within Article 1 -15 sufficiently clear?</u>

7.4. We note that point (e) of paragraph 2 of Article 1 states that instruments shall be priced at their value at the time the instrument is awarded, and the valuation shall be subject to independent review. FIA EPTA members consider that it would be important to clarify if this regular independent review needs to be performed every year, as part of an annual variable remuneration being awarded. FIA EPTA members do not support such an approach as a regular independent valuation would constitute a disproportionate cost-burden to smaller investment firms. It should be noted that investment firms with total assets of EUR 100 million or less are still of relatively small size and it is important to consider the large reduction of the threshold amount, when compared to the current prudential regime and to what is being applied to credit institutions.

7.5. FIA EPTA members would ask the EBA <u>to create a threshold of total assets at a higher level for the application of the condition in Article 1(2)(e).</u>

7.6. In addition, FIA EPTA members would like to make the point that the requirements referred to in point (a) of paragraph 2 of Article 4 of the proposed delegated regulation would be unduly costly and burdensome for unlisted firms with total assets above EUR 100 million. Specifically:

   a. A credit rating for the underlying firms issuing the instruments and a requirement for them to be independently assessed;

b. Triggering event provisions (paragraph 2 of Article 4; and

c. Periodic independent review required under point (e) of paragraph 2 of Article 1.

7.7. FIA EPTA members would ask the EBA to create a threshold of total assets at a higher level for the application of these conditions, so that the conditions apply in a proportionate ate manner.

7.8. FIA EPTA also notes that a significant number of investment firms currently do not have and do not need, other than for the purposes of this regulation, a credit rating. We therefore also query the cost benefit analysis of such requirements.

Question 2 – Is it appropriate to continue to require the same conditions for the use of AT1, Tier 2 and Other Instruments as under the current legislative framework?

7.9. We note that Article 52 and 63 of CRR indicate that one of the conditions that need to be met for instruments to be regarded as good capital from a Tier 1 or Tier 2 perspective is redemption of no earlier than 5 years. Allowing small investment firms a 3-year deferral of variable remuneration, for instruments held, would breach such a condition unless the deferral is extended to 5 years. FIA EPTA members would ask the EBA to consider avoiding such a mismatch so that a 3-year redemption is applied.

Question 3 – Are the provisions in Article 6 appropriate and sufficiently clear?

7.10. We note that Article 6(g)(i) states that where the alternative arrangement allows for predetermined changes of the value received as variable remuneration during deferral and retention periods, based on the performance of the investment firm or the managed assets, one of the conditions that has to be met is that the change of the value is based on predefined performance indicators that are based on the credit quality of the institution or the performance of the managed assets.

7.11. FIA EPTA members are of the view that, as also noted with regard to other articles of the RTS, requiring a linkage to the credit quality of the investment firm itself would be a problematic criteria for changes in the value of alternative instruments. Requiring this link also fails to take into consideration the fact that some investment firms may use group alternative instruments that meet all of the other criteria of Article 6, but are not directly tied to the credit quality of the EU regulated investment firm. FIA EPTA members would ask the EBA to consider deleting the condition in Article 6(g)(i).

Draft RTS on criteria to identify categories of staff whose professional activities have a material impact on an investment firm's risk profile or assets it manages under Directive (IFD) 2019/2034 of the European Parliament and of the Council on the prudential supervision of investment firms - EBA/CP/2020/09

Question 4: Are the qualitative criteria within Article 5 appropriate and sufficiently clear?

7.12. FIA EPTA members note that Article 5 refers to members of staff deemed to have a material impact on an investment firm's risk profile. The article includes staff members, of the management body, in its management function and supervisory function. We would ask the EBA

FIA EPTA
EUROPEAN PRINCIPAL
TRADERS ASSOCIATION

to provide clarity on whether or not this includes non-executive directors on a management body. Non-executive directors do not have a day-to-day management role but are involved in high level decision making. FIA EPTA members would not expect directors, non-executive in nature, to be in scope, especially as there is a deemed conflict of interest given any remuneration committee, that needs to be set up in accordance with Article 33 of the IFD, has to wholly include non-executive directors who will be the decision makers around how staff under the scope of Article 32 are being paid.

8. Supervisory reporting

Draft ITS on reporting requirements for investment firms under Article 54(3) and on disclosures requirements under Article 49(2) of Regulation (EU) 2019/2033 – EBA/CP/2020/07

COREP templates for K- NPR (IF 06.09 – K-Net position risk - K-NPR additional detail)

8.1. FIA EPTA members note the EBA's proposal that all firms subject to K-NPR will need to submit the COREP templates for 'market risk'. We are of the view that this approach does not appear to be in line with the principle of proportionality that is intended to apply for the new prudential regime for investment firms.

8.2. In order to ensure greater proportionality in reporting, FIA EPTA members would ask the EBA to consider, to apply an approach where only firms for whom K-NPR is a material risk to have to submit the detailed COREP templates, while other firms would only need to submit a simplified K-NPR report. We suggest that this could be achieved, for example, by requiring the detailed COREP templates for firms where the K-NPR is larger than 20% of the investment firm's own funds.

No materiality for resubmission (Article 3(4) – supervisory reporting and disclosures RTS

8.3. According to the proposed delegated regulation, investment firms may submit unaudited figures. However, where audited figures deviate from submitted unaudited figures, the revised, audited figures shall be submitted without undue delay.

8.4. We note there is no concept of materiality for resubmission of regulatory returns, which can lead to a large number of resubmissions, implying an additional burden for firms and national competent authorities. FIA EPTA would suggest to the EBA that a more proportionate and appropriate approach would be to introduce a concept of materiality for resubmission of an investment firm's regulatory returns.