ASSOCIATION OF PROPRIETARY TRADERS RESPONSE TO EBA-ESMA DISCUSSION PAPER ON THE COMMISSION CALL FOR ADVICE ON THE INVESTMENT FIRMS PRUDENTIAL FRAMEWORK

APT is grateful for the opportunity to provide input to the EBA on its technical advice to the European Commission on a review of the Investment Firm Regulation/Investment Firm Directive framework.

Q1: What would be the operational constraints of potentially removing the threshold?

- We understand that EBA would like to have a better overview of which investment firms are approaching the EUR 5bn threshold. Relevant NCAs already have this information at their disposal (cf. ICARAP data and quarterly FINREP reporting). To prevent unnecessary intensified reporting, we would suggest that the required information be requested by EBA directly from the relevant NCAs. If the information will be requested by EBA directly to investment firms, a *de minimis* could be considered to avoid additional reporting for smaller/mid-sized investment firms, by means of excluding firms below the EUR 100mio or EUR 250mio balance sheet (SREP category 1) thresholds.
- Whilst the IFR/IFD has only been applicable to investment firms for a few years, several challenges have become apparent, namely in relation to the classification methodology, the extraterritorial application of the IFR/D regime, as well as the disproportionate application of governance and remuneration requirements across investment firms of varied sizes. Moreover, the current governance and remuneration requirements are largely identical under IFR/IFD to those applicable to credit institutions under CRR/CRD, although investment firms have a completely different risk profile compared to banks. Investment firms who deal on own account in general have no clients nor do they provide client services, they do not take deposits, nor do they extend loans of any type. These non-bank proprietary traders play an important role in providing liquidity and staying in the markets, especially when volatility hits. But treating investment firms dealing on own account like they are banks mischaracterizes their activity, hedged nature of their trading book, and undermines the ability of these firms to provide liquidity. It is therefore not in line with the original objective of creating a bespoke (lighter) prudential regime for investment firms to simply apply largely identical governance and remuneration requirements to investment firms as for banks - e.g. requirements and methodology for identified staff, restrictions on variable compensation, high earners disclosures.
- We understand the rationale for policymakers for seeking a method for classifying investment firms, however the current classification methodology fails to adequately assess genuine systemic risk. There are several reasons for this:
    1. Nominal balance sheet size for investment firms that do not participate in maturity transformation is a entirely inadequate metric for determining the risk profile of an investment firm. It may give an indication as to the size of an investment firm's trading book, but it does not allow for any conclusions as to the systemic nature (or absence thereof) of an investment firm.
    2. The current balance sheet methodology (IFRS) does not allow firms who operate as market makers to - although this is risk reducing - recognise their hedging activity, which in practice means that proprietary trading firms calculate their gross nominal balance sheet.
    3. The current structure with three different balance sheet thresholds that move firms between entirely different regulatory regimes is unnecessarily complex. Moreover, given the classification methodology only leaves one category for investment firms dealing on own account that would not trigger application of rules intended for banks, the original objective of creating a bespoke regime for investment firms has not been achieved.
- We would suggest the following simplification of the classification methodology. In light of the possibility of applying full CRR/CRD, including the requirement to license as a credit institution above a balance sheet threshold of EUR 30bn and considering the discretion granted to NCAs attached to the EUR 5bn threshold to subject investment firms to more stringent prudential requirements based

on the current assessment indicators outlined in Article 1 of the EBA RTS for Article 5 IFD, in our view the Class 1-minus categorisation (for investment firms of which EU assets exceed EUR 15bn) adds needless complexity. Therefore, we welcome the investigation into the Class 1-minus category mentioned in paragraph 24 of the Call for Advice (CfA). Removing the EUR 15bn threshold and the automaticity of being moved into a higher classification category would allow investment firms greater flexibility in fulfilling their role as liquidity providers during volatile market conditions; where fixed balance sheet caps are in place may require investment firms stepping to step back in periods of increased volatility. To provide investment firms with legal certainty, the assessment related to the 5bn threshold would need to be valid for a period of at least 2 years (minimally aligning the term with the SREP/ICARAP).

- An alternative could be to maintain the EUR 15bn threshold but restrict application of prudential requirements to those of CRR and have such Class 1-minus firms continue to be subject to the governance and remuneration requirements of IFD. This would mean that (i) Clause 1(2) IFR would need to be adjusted such that the last sentence of this clause is deleted and (ii) Clause 2(1) IFD is updated to reflect that Class 1-minus firms are in scope of Titles IV and V of the IFD. In our view, the IFD governance and remuneration requirements are sufficiently robust as they are largely identical to those of CRD but are also more appropriate for proprietary trading firms in certain respects.
- 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 group capital test (GCT) – see chapter 8.3 of the CfA. In our view this is due to the fact that within the large category of investment firms, the subset of investment firms who are both headquartered in the EU and have meaningful global operations is small despite representing a critical mass of market makers that supports the functioning, efficiency, and liquidity of EU capital markets. However, maintaining a mechanism like the GCT for Union parent investment holding companies of investment firms in the EU is important for the competitiveness of EU headquartered investment firms on a global scale.
- This is because 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, unlike competing jurisdictions. 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 and the level playing field with similar firms that are not EU headquartered. Global application of these requirements would undermine the ability of EU investment 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 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 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 to investment firms. More specifically, in the US/APAC regions these firms compete with US/APAC headquartered firms to whom no IFR like governance and remuneration requirements are applicable. Such competition would become very difficult, from a labour market perspective, if such requirements would be applicable.
- Should the co-legislators intend to restrict the use of the GCT to small investment firms only, then other carveouts from prudential consolidation should be made available to EU headquartered investment firms to allow for the disapplication of - at the very least - the IFD/CRD governance and remuneration requirements to non-EU subsidiaries to enable EU headquartered investment firms to compete on a level playing field in the non-EU markets they are active in.
- We would suggest the EBA to consider if the main concern is to set a minimum amount of capital requirements, to disassociate the capital component from the governance and remuneration

requirements (i.e., by allowing investment firms to apply Article 7 for capital but Article 8(3) or 8(4) for any other purposes). This would mean a competent authority may require the application of Article 7 of IFR only for the purposes of the calculation of capital requirements, without performing prudential consolidation of other aspects, i.e. Governance and Remuneration.
In the absence of such a mechanism, we would only see an acceleration of the trend for investment firm groups to move their seat out of the EU to prevent extraterritorial application of the IFR regime outside of the EU. It is therefore of critical importance that a viable alternative to the GCT is fully developed and implemented before accessibility and application of the current GCT mechanism is restricted.

- Beyond this, we would underline that there should be broader recognition for the adequacy of the own funds requirements a firm's non-EU subsidiaries comply within 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 investment firm's subsidiaries are active in not based on 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).

Q4: Should the minimum level of the own funds requirements be different depending on the activities performed by investment firms or on firms' business model? If yes, which elements should be considered in setting such minimum?

- In our view, varying the FOR based on the activities or business models would make the FOR overly complex. More specifically for investment firms with no clients, such as proprietary trading firms, under IFR/D the FOR no longer primarily addresses operational risks as it did under CRR, but acts as a de facto capital floor if the K-Factor requirement is lower to ensure sufficient capital for an orderly wind-down. Thus, for our type of investment firms, an activities-based FOR would have to account solely for the wind-down scenario. Also, such approach would be a less granular substitute of a Pillar 2 assessment of an investment firm's wind-down capacity. The SREP Guidelines already address the adequacy of wind-down capital. An investment firm-specific assessment under Pillar 2 is more suitable than any non-granular regime under Pillar 1. As the K-Factor regime is already designed to cover investment firm-specific risks related to services and activities, introducing an activity-based variation in the FOR might duplicate the K-Factor regime and oversimplify Pillar 2 assessments.
- The average wind down period for trading firms that only/mainly deal in cleared trades through a clearing member and Central Counterparty clearing house (CCP) is short, regardless of their trading book size.

Q5: Is it necessary to differentiate the deductibles by activity or by business model for the purpose of calculating the FOR? If yes, which items should then be considered and for what reasons?

- Par. 53 of the Discussion Paper mentions the specific deduction for market making activities (cf. consideration (7) in relation to Article 1(6)(a) of Delegated Regulation (EU) 2022/1455). We feel this specific deductible should be kept, as it reflects the specific business models of market makers. During the drafting of the Delegated Regulation, we have provided extensive input in this regard to the European Commission.

Q7: Should the FOR be calculated distinguishing the costs related to non-MiFID activities, which criteria should be considered? What kind of advantages or disadvantages would this have in practice?

In our view, the FOR should not be linked to the type of activities conducted by the investment firm, as the FOR primarily serves as a capital floor to ensure an orderly wind-down of the investment firm, functioning as gone concern capital. As gone concern capital, it is irrelevant to differentiate between types of activities being wound down, as the entire legal entity must be wound down. Linking the FOR to specific activities could in our view complicate the FOR calculation process. Differentiating activities might not effectively address the practical realities of insolvency proceedings where all creditors, regardless of the type of activity, must be treated equally. Therefore, we recommend maintaining a unified approach to calculating the FOR, without distinguishing between costs related to MiFID and non-MiFID activities. This approach ensures simplicity, clarity, and fairness in managing the capital requirements for the orderly wind-down of investment firms.

Q10: Does the K-DTF provide a proper level of capital requirements for the provision of the services Trading on own account and execution of order on behalf of clients on account of the investment firm? If not, what elements of the calculation of the K-DTF present most challenges?
While an increase in daily traded flow does not necessarily increase operational risks pro rata, we believe it is a suitable baseline, when paired with an adequate Pillar 2 assessment of risks uncovered by K-DTF. We cannot come up with a more accurate ‘one size fits all’ metric because operational risk is highly idiosyncratic for investment firms. In our experience, the guidance provided for assessing operational risk for Pillar 2 additions and the NCA’s assessment in the SREP is accurate and adequate and does right to the large variety of investment firms, their businesses and inherent operational risk.

Q11: Would you have any examples where the calculation of the K-DTF based on comparable activities or portfolios results in very different or counterintuitive outcomes? If yes, how could the calculation of the K-DTF be improved?
See our answer at Q10

Q12: What are the elements of the current methodology for the calculation of the K-ASA that raise most concerns? Taking into account the need to avoid complexifying excessively the methodology, how could the calculation of the K-ASA be improved to assess those elements?
Whilst this does not relate to the K-ASA we would like to make a few remarks with regard to K-CMG discussed in paragraph 4.10:

- The CfA recommends an analysis regarding the “higher of” methodology between K-NPR and K-CMG, which was previously removed from proposals on IFR. We reiterate the European Commission’s conclusion during the IFR introduction that such construction would make K-CMG obsolete. No investment firm would apply for K-CMG if it only applies when ‘higher than K-NPR’. This would be an undesirable way forward, as K-CMG ensures risk-sensitive and granular capitalisation, fitting proprietary trading firms.
- It would be fair to lower the K-CMG 30% add-on because the GCM haircut contains, for conservative purposes, substantial mark-ups beyond CRR/SA-CCR requirements which are sufficiently prudent to cover the actual risks. Any required mark ups are already contained in the Clearing Margin Model, because GCM’s must comply with their own regulatory capital requirements and add substantial margins for risk.
- The use of the third highest total required margin over the preceding 3-month period for K-CMG (Article 23(2) IFR) does not reflect actual risk given the highly dynamic trading books that can expand and contract in very short periods. This high “water mark” leads to unintended consequences. It prevents investment firms that use K-CMG from effectively managing the risks in their books and their capital because reducing positions and thus risks does not result in freeing capital until much later. The resulting capital inefficiency hampers recovery in case of deteriorating financial positions and discourages participation in markets that are prone to volatility during market stress. As many of these firms are liquidity providers or market makers in these markets, this could even negatively influence market liquidity and might thus add to systemic financial risk. Any requirement should be assessed on a continuous basis to allow for effective capital management by the investment firm. As alternative for the high watermark in K-CMG we would propose the highest of a 5 day, 30 day and 90 day average. This would sufficiently capture sudden increases in margin, but still incentivise investment firms to reduce risk to the market when needed. In addition, it would guarantee

appropriate degree of conservatism, whilst being dynamic enough to incentivise participation in markets and risk management at the same time - both crucial particularly in times of market stress. It thus avoids the shortcoming of the current high watermark regime which penalises market participation as not to reach a high watermark and does not encourage to reduce the risk to the market, once a high watermark has nevertheless been reached.

- Because risks vary widely across investment firm business models and these firms just implemented their models, APT pleads to maintain the current options for K-NPR and K-CMG, adding FRTB as an additional option. Investment firms should pick one and stick to it for a few years to dissuade regulatory arbitrage.
- Of note, exposures on general clearing members (‘clearing banks’) should be left out of scope for K-CON and K-TCD by virtue of their special status. They are designed to be highly capitalized and resilient to settle/clear trades for their clients, e.g. through CCPs. All clients post margin with their clearing banks to cover failure of individual clients, which is resilient by design and has proven in practice time and time again, also in case of large failures of their clients. This is fundamentally different from having an exposure on a general bank or investment bank as a trading counterparty.
- Furthermore, it would be sensible to allow K-CMG for non-EU clearers. Investment firms trade on international markets and use clearing members with the best capabilities and market access, usually locally based. These clearing firms are themselves subject to supervision and Basel framework. Excluding non-EU clearing is not justified and leads to investment firms with identical portfolio being subject to different requirements. More specifically for the purpose of definition of Article 23(1)(b) IFR, the term clearing member of a QCCP should also apply to undertakings established in third countries, which, were they established in the Union, would fulfil the definitions of those terms.

Q14: Should crypto-assets be included into K-factor calculation, either as a new K-factor or as part of K-NPR?

- The lack of clear and explicit trading book treatment and computation is an obvious and we think easily remedied gap. A failure to address this in IFD/IFR would potentially leave as the only available guidance for MiFID firms, the BCBS Prudential Treatment of Crypto-assets proposals, which were not drafted with investment firms in mind. This would be an illogical and potentially unproductive outcome, given that the principle that different business types should have different prudential frameworks is now long established, the crypto framework for CASPs under MiCAR being the latest and most relevant example. Whenever the MICAR is going through a Review process, we suggest reopening this question of the consultation as MICAR would be the most optimal legislative package to build both a proportionate prudential regime for crypto assets as well as a level playing field between IFR investment firms and MiCAR CASPs.
- We would like to emphasize that at present supervisors are interpreting the existing guidance and CRR3 rule proposals in different ways. Two main points of friction are the lack of clarity and the bank-focused nature of the CRR regulation, which we think impede the maturity of the crypto market. That the existing CRR regulation is not appropriate for investment firms is apparent from, for example, the view of a market maker. As a market maker has opposing long and short positions in highly correlated instruments (which are price-sensitive to the same instrument) resulting from having a bid as well as an offer in multiple markets, netting should reflect the low resulting market risk from offsetting positions. The need for a “look-through” and netting methodology similar to how K-NPR treats equity positions is underscored by the fact that institutional adoption of crypto assets is ever increasing, as well as the fact that prominent exchanges have listed instruments that are price-sensitive to crypto.
- To recognize these developments and stimulate the development of a mature and efficient market, we suggest that the most effective course of action would be for crypto-assets to be explicitly incorporated into K-NPR. This would require an update to the definition of a trading book position for investment firms. Our preference is this is done specifically within IFD, rather than in CRR, and that the amendment makes clear that, alongside financial instruments and commodities, crypto assets can be included in an investment firm’s trading book. This would also require that risk-weighting and

netting methodologies be incorporated into IFD/IFR itself. The proposed risk-weighting in the most recent BCBS paper effectively imposes a 1250% weighting on a wide range of crypto assets, and for the most part this will vastly over-estimate the market risk in trading book positions. A more accurate reflection of the risk would be achieved by adopting an equity or commodity style set of risk weightings with similar “look-through” and netting treatment as described above. As an alternative to this option, the creation of a new crypto-specific K-factor could achieve a similar degree of clarity for investment firms, but we recognise that there would be legislative and methodological hurdles that might make it a less practical option. Further, and in the interests of market development, institutional adoption and maturity, we would recommend an explicit exemption from, or removal of, the proposed 1% cap proposed in the BCBS paper for positions in market-makers or proprietary trading firms’ trading books.

Q15: In the context of addressing operational risk for investment firm trading on own account, is there any further element to be considered to ensure that the requirements are proportionate to their trading activities?

- During SREP discussions NCAs mentioned potential additional sources of operational risk: cybersecurity risks and climate risks. It is good practice for our members to assess the impact of cybersecurity breaches in a Pillar 2 markup as this is varies across individual investment firms and the mitigating measures they take. Note that DORA and MiFID RTS’s control for operational risk, which largely removes the necessity for a capital markup.
- Climate risks can translate into acute or long-term market risk (portfolio values drop if a financial instrument is impacted by climate change) or operational risk. This, too, varies by investment firm and their businesses and is addressed in Pillar 2 by our members, using NCA models and guidance. Prudential requirements should accurately reflect the risk profiles of exposures and support institutions’ resilience to environmental and climate risks. For many proprietary trading firms, material climate and environmental risks (beyond common market risk or operational risk) may not arise given the hedged trading book and that no assets are being held for longer investment periods. For operational risk, acute or long-term climate effects are treated as ordinary operational risk. For example, a data center being struck is typically remediated by redundancy prescribed in other laws and ordinary operational risk management frameworks (or good practice) and does not require a separate capital charge. Again, this is a Pillar 2 assessment which works well in practice.

Q18: Investment firms performing MiFID activities 3 and 6 (trading on own account and underwriting on a firm commitment basis) are more exposed to unexpected liquidity needs because of market volatility. What would be the best way to measure and include liquidity needs arising from these activities as a liquidity requirement?

- It is stated that the requirement to hold just one third of the FOR as liquid assets is “very soft”. Why this is the case is not further explained. We would be interested to understand more of the reasoning behind this remark.
- We believe the existing provisions under IFR/IFD and related guidelines adequately cover liquidity risks specific to the business activities of investment firms. Given the diverse nature of investment firms' activities and the variability in liquidity requirements, a one-size-fits-all Pillar 1 requirement does not seem appropriate. Instead, the existing Pillar 2 SREP assessments (including robust strategies, policies, and processes for monitoring and assessing liquidity risk), supported by comprehensive supervisory tools, effectively address investment firm-specific liquidity risks. Therefore, APT believes that the scope of the liquidity framework should remain unchanged, leveraging the detailed and tailored assessments already in place. Furthermore, extending the current requirement from 1/3 FOR will not address risks that could not be better covered via Pillar 2. Therefore, such an increase would simply impose an unnecessary burden on investment firms without the benefit of enhancing financial stability.

- More specifically, for investment firms trading on own account, unexpected liquidity needs because of market volatility will be provided by the clearing bank/GMC and this is a separate affair from liquidity needed to ensure business continuity. Pillar 2 could be a way to address any insufficiencies.
- Although this question relates to liquidity, we would also like to make some remarks about ASA/FRTB discussed in chapter 6. Diversity in type of firms, trading books and associated risks warrants optionality in validated market risk models. Given the costs and complexities of implementing as well as the daily use of ASA/FRTB we embrace optional introduction of ASA/FRTB (option B mentioned in paragraph 145 of the CfA) and agree with the EBA that optionality appears to be more proportional considering that investment firms do not hold clients' deposits.
- This optionality should also be available for investment firms above the thresholds mentioned in paragraph 140 of the CfA (10% of the institution's total assets/ EUR 500 million), as balance sheet size/assets to determine the prudential treatment of investment firms that only deal on own account is not an adequate measure of the risk posed by non-bank proprietary traders/market makers. The risk profile of proprietary traders is very different to that of a bank, as these investment firms do not have clients and generally trade in listed (liquid) instruments. As the IFR aims to be a proportional regime for investment firms, a flat application of the EUR 500 million trading book size threshold would effectively subject investment firms surpassing that limit to the complex ASA/FRTB rules, which are costly to implement. Hence, as the Discussion Paper also mentions, investment firms passing this threshold should be able to opt-in to the ASA/FRTB methodologies, subject to supervisory approval (cf. B.J. Nieuwenhuijzen, *Prudential regulation of investments firms in the EU,* diss. Amsterdam VU, Deventer 2021, paragraph 421). We do not follow why, in case ASA/FRTB is chosen, CMG should no longer be applied to parts of the trading portfolio (cf. paragraph 146 of the CfA). Under the ASA/FRTB approach, institutions can apply the alternative internal model approach to one part of their trading book and the alternative standardised approach to another. The (alternative) internal model approach is reflected in the K-CMG approach through the internal model of the clearing member. Clearing members, after the implementation of CRR3, will be required to apply the alternative internal model approach as Article 1(194) CRR3 removes the regular internal model approach, relocating clearing members for eligibility under Article 23 IFR to the alternative internal model approach. Hence, it aligns with the ASA/FRTB reasoning to apply both the K-CMG and alternative standardised approach.
- It is also important to keep K-CMG as it aligns with day-to-day risk procedures, as well as to keep the current standardized CRR approach as many investment firms have implemented this and ASA/FRTB is too complex for smaller investment firms to implement. Bank-driven adjustments to CRR that are irrelevant for investment firms may inadvertently spill-over into IFR because of the cross-reference in IFR. We would suggest to either move the requirements of the standardized CRR approach directly into IFR or make sure cross-referencing with CRR excludes such spillover effects.
- For typical market makers, ASA/FRTB may render a result similar to, or lower than, existing K-NPR/K-CMG calculations, which were only recently calibrated and implemented. These current metrics well exceed the loss potential calculated under e.g. VAR by a factor 10-20x – and although we believe the current capital requirements overstate actual market risks inherent in market making firms, these investment firms are used to it following recent implementation. Also, the existing capital requirements have proven to be very effective in promoting resilience during recent crises, including the Covid crisis. Market makers are well equipped to deal with additional market volatility and are precluded from providing more liquidity when it's needed most, because of an artificial market risk capital requirement that inadequately acknowledges hedging. The capital requirements already materially penalize additional liquidity provision without any corresponding increase in actual risk. This effect is more profound in ASA/FRTB: although the methodology better acknowledges netting within its buckets, the large shocks applied in the model assume long holding periods. Because market makers are required to provide liquidity under all market circumstances, during sudden peaks in market volatility, market makers absorb high levels of inventory which lead to an overstated spike in capital requirements under ASA/FRTB. Market makers typically hedge their positions during a

(volatile) trading day and volatility usually subsides in a matter of days. However, unpredictable sudden spikes in capital requirements under ASA/FRTB due to shocking (assuming long holding periods) restrict market makers from providing liquidity for a longer period when it is most needed, even to a higher extent than under K-NPR, while the market risk for market makers in our view does not justify such spikes.

- We would also like to address a specific aspect of the ASA/FRTB mentioned in paragraph 141 of the Discussion Paper: the multipliers applied to the (simplified) standardized approach capital requirements under the amended Article 325(2) CRR3. A 3.5x multiplier, if also implemented into IFR will impact the amount of capital required by investment firms for their position risk. Unlike banks, the market risk component comprises over 90% of a proprietary trading firm's capital requirements. This would not be justified as the current capital requirement for market risk overstates actual risk multiple times, given the hedged nature of a market maker's book and short holding periods. Bank trading books typically contain positions with long, directional holding periods. Proprietary trading firms have simpler trading books compared to large investment banks, have no depositors affected by trading book losses, and their positions are hedged (which is not accurately recognized by CRR's market risk metrics in cases of multiple asset classes covering the same exposure, or exposures in different currencies). In this context, maintaining the current application of the simplified standardised model, without scalars, would be appropriate for these investment firms, paired with optional application of ASA/FRTB. A preliminary assessment of our members shows that ASA/FRTB's market risk capital requirement is in line with the current simplified standardized model, which indicates that the current K-NPR metric is still fit for use as-is.
- Any calibration of market risks incurred by investment firms, and proprietary trading firms in particular, should be grounded in a thorough quantitative assessment of actual market risks that need to be adequately covered. A quantitative assessment of the risks currently not covered by the standardized approach could calibrate these factors, considering the IFR's gone concern approach. For banks, the BCBS calculated that the share of market risk-weighted assets as a percentage of total risk-weighted assets would increase from 4.4% to 5.3% on average after implementing the ASA/FRTB, leading to a 0.9% increase in RWA for the average bank. This translates to a (roughly) 0.9% higher total capital requirement for banks due to a 22% higher market capital requirement. Proprietary trading firms predominantly have their capital requirement determined by RtM. Therefore, our members would experience a threefold increase in capital requirements, without corresponding elevated risk levels, which threatens their competitiveness or operations. Unlike banks, proprietary trading firms cannot rely on outside funding, issuing CET1 or CET 2 capital to outside investors, or rely on customer deposits to capitalize their operations.

Q25: Are differences in the regulatory regimes between MICAR and IFR/IFD a concern to market participants regarding a level playing field between CASPs and Investment firms providing crypto-asset related services? In particular, are there concerns on the capital and liquidity requirement regimes?

Our preference in this area is for prudential rules that are tailored to business type. The range of activities of a CASP is much more limited than those of a MIFID firm and the risk profiles also differ fundamentally. Converging their prudential rule-sets based on, as yet, unsubstantiated concerns about the 'level'-ness of the trading conditions risks losing valuable nuances in the rules. The presence of proprietary trading firms in this market will be key to its development and maturity in the EU, and it is because our member firms' function in the markets is different to the broader population of MiFID firms that we would therefore advocate for a narrow exemption permitting investment firms dealing on own account , namely those performing activity 3 in Annex 1, Section A of MiFID II, to apply the capital treatment set out in our response to Question 14 above.

Q26: Sections 5.2, 5.4 as well as this Section 9.1 all touch upon how crypto-assets (exposures and services) may influence the IFD and the IFR. Is there any other related element that should be considered in the review of the investment firms' prudential framework?

We are proponents of creating a separate prudential regime for investment firms without referencing CRD/CRR, so that both regimes can be tailored to the specific risks of both types of institutions and EU investment firms will not be subject to a regime developed for banks by the Basel Committee. Furthermore, we believe that the European Institutions must first make a thorough analysis of the consequences of such prudential framework for the crypto asset market in the EU.

Q28: Are the different provisions on remuneration policies, related to governance requirements and the different approach to identify the staff to whom they apply a concern for firms regarding the level playing field between different investment firms (class 1 minus under CRD or class 2 under IFD), UCITS management companies and AIFMs, e.g. in terms of the application of the remuneration provisions, the ability to recruit and retain talent or with regard to the costs for the application of the requirements?

- Whilst this does not directly relate to this question, we would like to make some remarks about the Risk and Remuneration Committees. The new IFR/IFD regime has introduced a stricter governance regime for investment firms than for banks, as Mr Dr I.P. Palm-Steyerberg of the Dutch Central Bank (DNB) notes in *Beleggingsondernemingen - Een nieuw regime na IFR/IFD* (2022) page 157. Under CRD, the obligation to instigate Risk and Remuneration Committees is only applied to banks that are considered *significant*. For investment firms, any firm above the EUR 100m balance sheet size threshold (based on IFRS) will have to instigate a Risk as well as a Remuneration Committee. Because of this low threshold, such Committees have to be instigated by many (very) small and mid-sized investment firms, even though their risk profiles differ significantly from banks as they only trade for own account. For most investment firms there is no legal requirement to instigate a Supervisory Board or add Non-Executives to the Board. Therefore, IFR/D requires these investment firms to instigate such bodies, at significant cost and effort. Furthermore, the Risk Committee has to be instigated at the level of the licensed entity, which means that when an investment firm does already have a Supervisory Board/Non Executives at Holding Level, a Supervisory Board/Non-Executives will need to be added at investment firm level as well, further adding to cost and effort. In addition, this requirement also applies on a consolidated basis where the investment firm with their headquarter located in the EU does not use the GCT. This makes the EU a less attractive place to do business or start a new investment firm. In our view, this is also disproportionate compared to the regime for banks. As is the case with the Remuneration Committee (Article 33(1) IFD), we suggest to at least allow a single Risk Committee at the Holding Level instead of one at Holding Level and the trading entity level. The Risk Committee should assess the different risks at these different levels. Furthermore, APT believes that the requirement that the majority of Committee Members must be independent is disproportionate, especially for smaller/medium-sized investment firms. In our view, one independent member should be sufficient.
- In addition, the EUR 100m balance sheet threshold applies for application of certain remuneration requirements, such as the requirement to pay out in instruments. This can be very impactful for investment firms, especially if they are non-listed and founder owned. Therefore, we suggest excluding smaller and mid-sized proprietary trading firms from this requirement. More specifically this should concern an investment firm solely dealing on own account, on an individual basis, which has a RtM K-factor requirement that is equal to or less than EUR 50 million on average over the four-year period immediately preceding the given financial year, or alternatively, an investment firm solely dealing on own account, on an individual basis, which has as a balance sheet that is equal to or less than EUR 1 billion on average over the four-year period immediately preceding the given financial year.