Amafi > Association française des marchés financiers
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EBA Consultation on a new prudential regime for investment firms

AMAFI contribution

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities. Nearly one-third of members are subsidiaries or branches of non-French institutions.

AMAFI welcomes the opportunity to comment on EBA's Discussion Paper published on November 4th, 2016 on the design of a new prudential regime for investment firms, and to make suggestions on the way the current regime could better achieve the objectives of simplification and proportionality.

Before responding to the specific questions of EBA's consultation document, AMAFI would like to point out the following general comments.

I. – GENERAL COMMENTS

We welcome very much the EU initiative in favour of a revision of the prudential regime applicable to investment firms and agree with the comments formulated in the first EBA report[1] regarding the complexity of the current regime. In order to cope with the diversity of businesses conducted by investment firms in terms of (i) activity and licensing, (ii) size and (iii) products, a revised regime should be based on the key principles of simplification and proportionality. It should also aim at ensuring a consistent prudential rules and own funds requirements applicable to all investment firms.

The new approach detailed in the discussion paper deserves great focus as it is based on a risk-based approach, seeking to capture the potential risks borne by clients and/or markets due to the firm's business. However, it differs substantially from current prudential principles derived from CRD/CRR. Such an approach leads to 6 comments:

1. Given that the proposed regime would lead to an entirely new framework, the time allowed to the stakeholders to assess its impact is too short. We understand the EBA's tight schedule constraints but we believe three months is too short to adequately assess the impacts of the new regime.

2. Any new regime must preserve the consistency between regulatory capital requirements applied to various institutions exercising similar activities even with different legal statuses (bank, investment firm etc.). At this stage it is not possible to ensure it is the case due to the absence of

[1] EBA/op/2015/20, Report on Investment firms, December 2015.

calibration. Therefore the regulator should pay particular attention to the potential effects of distorted competition between investment firms, systemic investment firms and credit institutions providing investment services.

3. Any situations where two sets of obligations would apply would not be acceptable. This means that appropriate solutions have to be found in the case of an investment firm that is part of a larger group as otherwise such a firm would have to implement a k-factor approach at individual level and a contribution to the CRR regime of the group at consolidated level. This would also be true in situations where an investment firm would have to apply k-factors for own funds calculations and CRD governance rules for risk management and internal control. This would miss the target for simplification of prudential rules for investment firms.

4. Regarding proposed k-factors, we are surprised that the activity of market-making is not encompassed, while investment firms play an important role in providing liquidity to the financial system. In any case, the role of market-making has to be taken into account specifically in the k-factor approach. In this respect the PTA k-factor is not appropriate and we suggest splitting it into two metrics.

5. It is critical that such a future regime maintains the current possibilities for investment firms belonging to a banking group to be supervised on a consolidated basis without any additional constraints. It is also critical that regime allow investment firms to opt for consolidated supervision as a full substitute to individual supervision. This is especially true of groups of investment firms where the various activities are exercised by different legal entities, are this usually leads to significant intra-group transactions. The unity of a group means it should be seen as single actor of the financial system.

6. The Discussion Paper mainly focuses on solvency and liquidity rules. However we consider that the implementation of the new regime requires encompassing the whole aspects of a prudential regime: governance, remuneration, Pillar 2, Pillar 3, recovery and resolution and the level of supervision...

For all these reasons, we consider the k-factor approach cannot be considered as a good alternative to the current regime until its metrics are further qualified and calibrated and the above-mentioned issues are considered. We really believe that this cannot be achieved in a reasonable lapse of time. By contrast, the current CRR regime could be more easily tailored to ensure further simplicity and proportionality in a reasonably short period of time and could provide an adequate framework during the transition period towards a future regime.

In our comments under questions 34 and 35, we suggest various options for amending the current regime for non-systemic investment firms in this respect:

- Remove the CVA capital charge for Class 2 and Class 3 investment firms.
- Keep exposures to CCPs and intragroup trades out of scope of the large exposure capital charge regime.
- Allow investment firms to apply either current CRR methodologies or revised approaches for counterparty credit risk and market risk.
- Keep the leverage ratio an element of Pillar 2 for investment firms.
- Exempt investment firms from CRR liquidity requirements.
- Remove prudent valuation adjustments.

In our opinion, greater simplification should apply to capital requirements computation, to reporting and to corporate governance including remuneration policies. We seek to provide various specific proposals in this paper. A summary of the key features of our proposal is summarised in the table below.

	CLASS 1 FIRMS	CLASS 2 FIRMS	CLASS 3 FIRMS
DEFINITION	Systemic firms	Other investment firms	Small and non-interconnected firms
CLASSIFICATION CRITERIA	G-SII or O-SII (same as systemic banks)	Other that Class 1 and Class 3	Multi-criteria approach based on: - Nature of licence - No client assets detention - Total assets (< EUR 100m) - Size of trading book (cf. art 94 §1 CRR) ***Cf. Q4***
OWN FUNDS DEFINITION	No change from current	No AVA / prudent valuation filters	No AVA / prudent valuation filters
CAPITAL REQUIREMENTS	No change from current	CRR simplified ***Cf. Q34-Q35***	FOR regime (wind-down approach) ***Cf. Q3-Q4***
LIQUIDITY REQUIREMENTS	No change from current (LCR/NSFR)	Pillar 2 and reporting-only approach based on: - 30-day cash inflows & outflows - liquid assets (larger definition)	Pillar 2 and reporting-only approach based on: - 30-day cash inflows & outflows - liquid assets (larger definition)
LARGE EXPOSURES REQUIREMENTS	No change from current	No change from current	No capital requirements (reporting only)
LEVERAGE RATIO	No change from current	Pillar 2 (reporting only)	No requirement
REPORTING GRANULARITY	Current or close to current	Limited	Low
GOVERNANCE	CRD governance requirements	CRD requirements with proportionality	MiFID II Rules
REMUNERATION	CRD governance requirements	CRD requirements with no maximum variable remuneration	MiFID II Rules
BRRD	No change from current	Pillar 2	No requirement

Regarding categorisation, our views are based on the following principles:

- Institutions that are currently out of the scope of CRD/CRR should remain out of the scope of the new regime (local firms, firms with a licence limited to reception-transmission of orders and investment advice).

- Class 3 should be appreciated via a combination of criteria, among which absence of client assets detention, size of balance sheet and size of trading book.

- Regarding balance sheet size, we believe that a EUR 100m threshold should be considered. The EUR 2m threshold mentioned in the paper is much too low and would lead too many small firms with little impact on the market to remain in Class 2. We believe an adequate segregation between Class 2 and Class 3 would enable supervisors to focus much more on institutions with a higher level of risk and/or multi-component business model which deserve more accurate supervision that smaller, single-activity firm.

We also stress the importance of applying the proportionality principle in the areas of Pillar 3 and Recovery and Resolution, based on the specifics of the investment firms market.

Finally, national supervisors should be allowed to rely on flexibility and proportionality in their supervision of investment firms, taking into account the idiosyncratic features of each firm, such as licence, size, business model, risk appetite, interconnectedness, number and types or counterparties, etc., in a context where national specificities regarding the investment firms market remain substantial.

II. – RESPONSES TO EBA SPECIFIC QUESTIONS

Question 1

What are your views on the application of the same criteria, as provided for G-SIIs and O-SIIs, for the identification of 'systemic and bank-like' investment firms? What are your views on both qualitative and quantitative indicators or thresholds for 'bank-like' activities, being underwriting on a firm commitment basis and proprietary trading at a very large scale? What aspects in the identification of 'systemic and bank-like' investment firms could be improved?

We agree with the proposed approach which would define 'systemic' investment firms based on G-SIIs and O-SIIs criteria as set out by the EBA for defining systemic banks. This appears to be an important factor to ensure a level-playing field between EU institutions providing investment services, regardless of their status. In particular, it is important that institutions providing similar investment services under the status of bank or under the status of investment firm be considered 'systemic' or non-systemic based of the same criteria. Regulation should also ensure that all systemic institutions would be submitted to the same prudential rules.

Regarding 'bank-like' activities, the report mentions that underwriting and /or placing financial instruments on a firm commitment basis, as well as trading on own account, could be considered 'bank-like' provided they are carried out "at a very large scale". We do not support this interpretation as underwriting and /or placing financial instruments on a firm commitment basis, and trading on own account are investment services.

We consider that potential confusion could arise from the combination of the 'bank-like' criterion with G-SII and O-SII criteria (size, interconnectedness, substitutability, complexity and cross-border activities). We believe that G-SII and O-SII criteria are self-sufficient in order to make an appropriate distinction between systemic firms falling into Class 1, and non-systemic firms falling into Class 2 or Class 3.

In a nutshell, we support a framework where 'systemic' investment firms would be classified in Class 1, and no 'bank-like' criterion would be considered, so as to avoid complexity.

Question 2

What are your views on the principles for the proposed prudential regime for investment firms?

The discussion paper lists 6 principles that a revised prudential regime must comply with. As answers to this question are closely related to answers provided to other questions of the discussion paper, the reader can refer to them for further detail on the rationale of our opinion.

<u>Principle a) *It is recognized that investment firms are not 'systemic and bank-like' and therefore, in general, the purpose of a prudential regime for investment firms is not to provide the same level of assurance as is provided for firms that are systemic and bank-like.*</u>

We receive this principle as an acknowledgement that proportionality should be further introduced in the prudential rules applying to non-systemic institutions. We agree with the statement that, in principle, an investment firm should not be viewed as systemic and that the case of systemic investment firms is an exception that applies to a small number of institutions.

However, we would like to stress that:

- 'Systemic', in the sense of G-SIIs or O-SIIs, is preferable to 'systemic and bank-like' as it is more straightforward (please refer to our answer under question 1).

- The proportionality principle does not imply that the principles of the regime applying to non-systemic firms differ substantially from those applying to systemic investment firms. Consequently, we support a framework in which CRR principles would apply to non-systemic firms, with a higher degree of simplification and proportionality (please refer to our answer under questions 34 and 35).

<u>Principle b) *It is recognized that the failure of investment firms may impact on customers and markets and therefore appropriate prudential requirements should be set for investment firms in order to minimize risk of harm and/or disruption to customers and markets.*</u>

Considering the damage that a bankruptcy could cause to the financial system, a systemic approach seems common sense and has been supported by the industry since the outbreak of the recent financial crisis. Moreover, systemic risk is particularly relevant in the case of firms providing investment services in a context of growing interconnection and integration of financial markets.

However, under principle b), the key factor that is taken into account is the risk that the system bears on the firm in case of failure, rather that the firm's own risk. In this respect, we would like the EBA to consider the following points:

- The new k-factor approach presented in the discussion paper considers the risk that the firm would cause to the system, however it would apply to non-systemic institutions; on the other hand, the current CRR-based approach is based on the firm's own risks. There is an apparent paradox as one would expect the regulator to seek to adopt a systemic risk-based approach primarily for systemic institutions.

- Considering the firm's own risk (as in the current framework) is consistent with the objective to mitigate systemic risk, as the objective of an approach based on own risks is to reduce the probability of failure due to excessive risk-taking. The lower the probability of failure, the lower the systemic risk.

Based on these assessments, we welcome the fact that prudential supervision cares about systemic risk when designing the prudential regime applicable to investment firms; however we recon the application of a 'systemic risk-based' approach to non-systemic institutions but not to systemic ones as counter-intuitive. Our opinion is that the design of a regime based on substantially new principles, and its application to some actors of the financial system but not all of them, deserve further consideration.

Particularly when principles address systemic risk, they have to be challenged against the global consistency of the prudential supervision framework. Such consistency seems difficult to reconcile with the existence of two very different sets of principles and rules that apply to actors of the same financial system that constantly interact with one another.

<u>Principle c) (…) *the prudential regime applicable to investment firms should address the specific risks associated with holding client money and securities*</u>*.*

Although we agree that the detention of client money or client securities involves a risk that has to be taken into account, we do not understand the rationale behind the proposals of the new regime. We would like to remind that, in France, rules already exist as regards the detention of client money or securities, namely:

- A minimum initial capital requirement of EUR 3.8m in case the firm has a license for custody account-keeping[2].
- As per MiFID II rules, client money must be segregated in dedicated bank accounts.

Therefore, we see this principle as redundant with existing rules that regulate the detention of client money. Please also refer to our comments under question 6 regarding the CMH k-factor.

Principle d) *The prudential regime applicable to investment firms should ensure a harmonised set of requirements for these firms across the EU.*

We agree with this principle and support harmonised rules within the EU single market.

However, this principle should allow the existence of national discretions, particularly in the case of investment firms' regulation, for at least two reasons:

- The investment firms market is characterised by a strong diversity and a variety of national specificities as regards business models, clients and products;
- With the possible exception of a small number of systemic firms, investment firms in the EU are supervised by national competent authorities.

The existence of national discretions should not undermine the level-playing field across the EU; it should rather allow national supervisors to better take into account specific aspects of the national investment firms market.

Principle e) *The prudential regime for investment firms should ensure that firms that pose more risk to customer or markets hold more capital than those that pose less risk (…).*

We agree with a risk-sensitive principle where the higher the risk, the higher capital requirements should be. However, we would prefer the principle to be formulated in line with the current CRD/CRR framework, that is: "the prudential regime for investment firms should ensure that firms that hold more risk in their balance sheet and off-balance sheet exposures hold more capital than those that hold less risk".

Principle f) *Among firms that pose similar risk to customers or markets, firms with more risky balance sheet or off-balance sheet exposures should hold more capital than those with less risky positions, as they present more of a risk of disruption to customers and/or markets.*

Please refer to our comment under principle e) and question 7. While we support a system where firms with a more risky balance sheet should hold more capital, we do not believe that the uplift factor as explained in the discussion paper is the most appropriate way of applying this principle operationally.

[2] Regulation CRBF n°96-15 dated December 20th, 1996 on investment firms' initial capital (https://cclrf.banque-france.fr/fileadmin/user_upload/cclrf/fr/pdf/reglements/1996/CRBF96-15.pdf)

Question 3

What are your views on the identification and prudential treatment of very small and non-interconnected investment firms ('Class 3')? If, for example, such class was subject to fixed overheads requirements only, what advantages and drawbacks would have introducing such a Class 3? Conversely, what advantages and drawbacks could merging Class 3 with other investment firms under one single prudential regime with 'built-in' proportionality have?

Class 3 investment firms are defined as 'very small and non-interconnected' investment firms. In other words, we understand that Class 3 would gather a large number of small firms that, given their size and business model, would not cause important harm to clients or markets in case of failure.

In our views the definition of a specific category for very small, non-interconnected investment firms would be an advantage because:

- For very small firms, the most important risk that needs to be covered is the risk of wind-down of the business, which would be naturally covered by Fixed Overhead Requirements (FOR), a straightforward, easy-to-understand approach.
- A Class 3 with a simple FOR regime would adequately cover the risk related to smaller institutions while making their supervisory framework simpler, in coherence with the proportionality principle.

Therefore, we support the definition of a class 3 for small firms. We believe that the criteria for firms to fall into Class 3 should be large enough to include most firms that pose little or no risk to the system. Please refer to our answer under question 4 for more detail.

Question 4

What are your views on the criteria discussed above for identifying 'Class 3' investment firms?

For the above question, it would be useful to receive detailed comments on each of the following items, which would preclude an investment firm from being in 'Class 3':

a) holding client money or securities,
b) ancillary service of safekeeping and administration (B1),
c) dealing on own account (A3)
d) underwriting or placing with a firm commitment (A6),
e) the granting of credits or loans to an investor (B2),
f) operating a multilateral trading facility (or MTF) (A8),
g) the MiFID II activity of operating an organised trading facility (or OTF),
h) being member of a wider group,
i) using a MiFID passport, and j) using tied agents.

On the above-mentioned list of items potentially used for making a difference between Class 2 and Class 3, our comments are the following:

- Dealing on own account (A3) is a licence that investment firms which execute orders on behalf of clients may have to require in order to face default by a counterparty or settlement-delivery problems; this criterion is therefore inadequate.
- Using a MiFID passport may be required by firms which only exercise reception and transmission of orders and/or investment advice, which are riskless activities; this criterion is therefore inadequate.

From a general perspective, the question arises as to how class 3 firms should be distinguished from Class 2 firms, bearing in mind that Class 3 can only include firms that hold neither client funds nor client securities. On this point, balance sheet size alone is not sufficient as a criterion. A combination of qualitative criteria appears to better reflect the specific characteristics arising from the diversity of business models encountered.

These criteria should seek to describe the consequences for the system of a firm's bankruptcy. If they are negligible or not present, the firm would be classified under Class 3.

Such is the case, in particular, for investment firms that trade exclusively for their own account, with no external client relationships, and thus hold no client assets, as these firms do not present any risk to the system[3].

In addition, the question arises of investment firms that execute orders for third parties. In theory, they pose a risk to third parties in the event of failure.

However, there are cases where the associated risk is very limited, insofar as:

- The period between the trade date and the clearing and settlement date is two business days on European markets.
- In cases where virtually all trades are made under the delivery-versus-payment model, the associated settlement risk is eliminated.
- Trades are usually cleared and guaranteed by a clearing house.

As such, even though they do pose a risk to third parties in the event of failure, such firms could be included in Class 3 provided that:

- The firm holds no client assets.
- The size of its third party trading book remains below a certain materiality threshold (under the principle of proportionality); this threshold could be determined taking into account balance sheet size, which has the benefit of being easy to assess and is representative of the size of the business (since mark-to-market positions are recognised in the balance sheet).

Finally, firms currently not subject to CRD/CRR should remain so under the new regime. This includes:

- Firms providing only reception/transmission of orders and investment advice.
- Local firms in the sense of CRD/CRR[4], which enter into positions solely for hedging purposes or on behalf of other participants, and whose trades are cleared by a clearing member.

On this basis, and drawing from Table 2 on page 15 of the December 2015 EBA report, the following investment firms could be classified as indicated in the table below:

[3] "However, for a firm that has no external clients, it has to be acknowledged that its insolvency can only affect the owners of the firm, which are often also the traders, and the risks involved are different from those incurred by a bank." (Page 93 of the report)

[4] A local firm is defined as "a firm dealing for its own account on markets in financial futures or options or other derivatives and on cash markets for the sole purpose of hedging positions on derivatives markets, or dealing for the accounts of other members of those markets and being guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such a firm is assumed by clearing members of the same markets" (cf. Article 4 (1) of CRR).

CURRENT CATEGORY	CURRENT REGIME	RECOMMENDED CATEGORY UNDER NEW REGIME	JUSTIFICATION
Local firms	Not subject to CRD/CRR	Not subject to the new regime	All positions are cleared by a clearing member
Firms that only provide reception/transmission of orders and/or investment advice	Not subject to CRD/CRR	Not subject to the new regime	No business that poses risks
Firms providing only reception/transmission and investment advice registered under the insurance mediation directive (directive 2002/92/EC)	Not subject to CRD/CRR	Not subject to the new regime	No business that poses risks
Firms that perform, at least, execution of orders and/or portfolio management	Subject to CRR Article 95 (2)	Category 3 below a EUR 100m total assets; Category 2 above EUR 100m	Limited market footprint below a certain threshold
Investment firms not authorised to perform deals on own account and/or underwriting/placing with firm commitment that do not hold client money/securities	Subject to CRD/CRR	Category 3 below a EUR 100m total assets; Category 2 above EUR 100m	- Limited market footprint below a threshold - No client assets held
Investment firms dealing on own account with no external customers and with a small trading book	Subject to CRD/CRR with simplified rules for operational risk	Category 3 if the size of their balance sheet and off-balance sheet trading book meets the criteria set out in CRR, art. 94 §1[5]. Category 2 otherwise	No risk to the system
Investment firms authorised to perform deals on own account and/or underwriting/placing with firm commitment that do not hold client money/securities	Subject to CRD/CRR	Category 3 if : - total assets are below EUR 100m; - AND the size of their balance sheet and off-balance sheet trading book meets the criteria set out in CRR, art. 94 §1. Category 2 otherwise	- Limited market footprint below a threshold - No client assets held

In a nutshell, should be classified as Class 3 firms the ones that combine the following criteria:

- They do not hold any client money or security.
- They are authorized to provide :
  - reception and transmission of orders ; and/or
  - execution of orders ; and/or
  - dealing on own account ; and/or
  - investment advice ; and/or
  - underwriting or placing without firm commitment.
- Their balance sheet is below EUR 100m.
- Their trading book meets the criteria set out in CRR Article 94§1, that is :
  - is normally less than 5 % of the total assets and EUR 15 million ; and
  - never exceeds 6 % of total assets and EUR 20 million.

[5] The condition set by article 94 §.1 CRR is the following: "the trading-book business meets both the following conditions: (a) it is normally less than 5 % of the total assets and EUR 15 million; (b) it never exceeds 6 % of total assets and EUR 20 million.

Question 5

Do you have any comments on the approach focusing on risk to customers (RtC), risk to markets (RtM) and risk to firm (RtF)?

The discussion paper outlines the main features of the so-called ‘k-factor approach’, focused on:

- Risk to customers (RtC), the risk of potential harm that investment firms may pose to their customers in case of failure.
- Risk to markets (RtM), the impact that investment firms could have on markets in which they operate (disruption in market access or market liquidity…).
- Risk to firm (RtC), the level of risk borne by the firm itself due to its activities.

RtC and RtM would be measured via a series of factors called ‘k-factors’ based on metrics that adequately represent the risk inherent to an authorised activity, calibrated via ‘scalars’ or percentages to reflect the level of capital to be held when the k-factor applies.

We see this approach as innovative in its logic, which differs substantially from the CRR approach based on risk types (i.e. credit risk, market risk, operational risk). As opposed to the CRR approach, which captures the level of risk borne by the firm, the k-factor approach seeks to capture the level of risk that the firm may have on other actors of the financial system.

That said, the k-factor approach deserves the following general comments.

- Instead of capital requirements being based on two metrics (solvency ratio and leverage ratio), the k-factor approach would rely on a single metric taking into account the activity of the firm and its leverage. In theory, this would simplify the way investment firms deal with the capital constraint.

- By being based on a limited number of factors, the k-factor approach could substantially simplify regulatory computations, provided the k-factors are defined unambiguously. However, k-factors must also be meaningful for investment firms in order to lead to capital requirements that reflect the level of risk of their business; firms should be able to apprehend and monitor the key drivers of the evolution of their capital requirements over time. As defined in the discussion paper, k-factors do not meet this requirement: conversely, they raise several unanswered issues (please also refer to our response under question 6).

- The k-factor approach is not connected to internal risk management processes: internal organisations are risk type-based, due, to a large extent, to CRD governance requirements[6]. The k-factor approach differs from CRD governance requirements. In this context, it is not clear how the k-factor approach and current risk governance requirements coming from CRD would work together (please also refer to our answer to question 31 on CRD governance requirements and Pillar 2).

Please refer to our answers to question 6 for specific comments about the proposed k-factors for RtC and RtM, and to question 7 for comments regarding the uplift factor.

[6] In this area, requirements were reinforced by CRD4 and transposed in France by the *arrêté* of November 3rd, 2014, on the internal control of banks and investment firms.

Question 6

What are your views on the initial K-factors identified? For example, should there be separate K-factors for client money and financial instruments belonging to clients? And should there be an RtM for securitisation risk-retentions? Do you have any suggestions for additional K-factors that can be both easily observable and risk sensitive?

First of all, in order for investment firms to make a precise judgement on the proposed prudential regime, further clarification would be required. More specifically:

- The absence of information on calibration makes impossible any quantitative and qualitative assessment of the new regime.
- The proposed regime lacks a precise definition of proposed metrics.

In this situation, we call for a new consultation where further information would be available.

At this stage, based on the provisions of the discussion paper, our comments on the seven k-factors described (six for risk to customers and one for risk to markets) are as follows.

<u>Assets under Management – AUM</u>: This factor essentially applies to asset management firms, are not AMAFI members.

<u>Assets under Advice – AUA</u>: It is not clear whether this metric seeks to capture the activity of investment advice as defined by MiFID II.

<u>Assets safeguarded and administered – ASA</u>: Here again, further clarification on what the metric seeks to capture would be welcome, although we understand it would cover client securities held. Conversely, providing customers with direct electronic access (DEA) for order taking relates more to customer orders handled (COH) than to ASA. Therefore we do not expect this metric to apply either to execution of orders on behalf of clients, or to the reception and transmission of orders. The exact scope of what it would capture lacks clarity.

<u>Client money held – CMH</u>: This indicator seems meaningful as we agree that the detention of client money generates a potential harm for clients in case of failure. However, as was stressed before, the risk linked to the detention of client money is already mitigated by regulatory rules set by MiFID.

<u>Liabilities to customers – LTC</u>: This metric would cover particular liabilities to customers arising when something goes wrong; conversely, it would not cover cash and other assets held as client money or client securities, which would be covered via ASA and CMH. Our concern lies in the difficulty of easily capturing the metric as it can cover a number of different cases. We believe that this metric requires further clarification.

<u>Customer orders handled – COH</u>: This would be the most relevant indicator for firms executing orders on behalf of clients. We acknowledge that the level of risk generated by this activity (in particular operational risk) is partially correlated with volumes of orders handled; however, the direct conversion of a number of orders into an amount of capital requirements via a scaling factor is not straightforward. In addition, this would require that investment firms set up new processes to capture the number of orders processed by their I.T. systems, as this indicator is usually not used for business monitoring at present.

Alternatively, the metric used for capital computation could be the amount of settlement-delivery accounts in the balance sheet, as they measure the total amount of customer orders pending settlement. The metric would be the sum, in absolute value, of settlement-delivery accounts on the assets side and the liabilities side of the balance sheet. It would be easily captured on a monthly basis.

PTA – Proprietary trading activity: This indicator would apply to the activity of dealing on own account, however we recommend that it is split into two metrics.

The first metric would apply to market-making activities. A relevant metric could be the VaR of the books because with a single scalar figure it encompasses all the portfolio's risks if the risk factors are appropriately chosen. The use of total amount of initial margin paid to CCPs or Clearing Members could also be considered but it would be difficult to harmonize with portfolios on OTC-led markets. A metric capturing the market share measured by turnover generated by the market-making activities could as well be envisaged.

The second metric would apply to non-market-making activities. In this case the volume of trades is not a relevant indicator as it does not capture market or counterparty risk. It could be replaced by a measure of VaR. Alternatively, a concept of nominal exposures could also be used, with different weighting factors for cash exposures and for derivatives exposures respectively: a x cash exposures + b x derivatives exposures with a<b.

In this case, only a metric which would allow exposures netting would be meaningful in order to capture net risk positions. Any k-factor must be more favorable for market-making activities than for other trading activities, as market-makers contribute to the stability of financial markets through the provision of market liquidity and prince transparency. They should therefore see their role acknowledged by regulators via a regime that ensures lower capital consumption for market-making activities.

Question 7

Is the proposed risk to firm 'up-lift' measure an appropriate way to address the indirect impact of the exposure risk a firm poses to customers and markets? If not, what alternative approach to addressing risk to firm (RtF) would you suggest?

We understand the uplift factor as a way of taking into account the degree of leverage induced by the firm's activity, as does the leverage ratio under the CRR regime. As such, the degree of leverage, reflecting the level of riskiness of the firm, would act as a multiplier of the measure of [RtC + RtM] computed via the sum of k-factors. It is consistent with principle f) set out in section 4.2.2. of the discussion paper, whereby firms with a higher leverage in their balance sheet and off-balance sheet exposures are more risky than firms with a lower leverage.

A potential source of complexity would be to isolate elements of the balance sheet already taken into account under the various k-factors. This would remain fairly easy if k-factors are based on accounting data, but there is no evidence in the provisions of the discussion paper that this would be the case. On the contrary, we understand that COH and PTA would be computed based on a number of trades. In our views, they should rather be based on accounting data capturing the total market value of instruments held on the balance sheet: securities, bonds and derivatives in the firm's balance sheet for PTA, settlement-delivery accounts for COH.

In any case, a k-factor approach must ensure that market-making activities, which fulfil the task of providing market liquidity to economic actors, and therefore contribute to financial stability, are taken into account through k-factors instead of through the uplift factor. Indeed, market-making is by no means designed to increase the degree of riskiness of the firm. Please also refer to our answer under question 6.

Question 8

What are your views on the 'built-in' approach to delivering simpler, proportionate capital requirements for Class 3 investment firms, (compared to having a separate regime for such firms)?

Defined as small, non-interconnected firms, Class 3 firms are usually very small organisations. In the case of such firms:

- Most of them have little resources to dedicate to prudential issues (one or two persons for only part of their time); the analysis of new regulations issued since the financial crisis is perceived as highly complex and time-consuming.
- Information required in regulatory reports is perceived as much too granular compared with the business models of small firms, which are, in most cases, based on a single activity; as a consequence, in many cases, only a small number of data required in a regulatory report template apply to small firms. Small firms spend a long time trying to understand how reports should be filled in, eventually finding that very few data apply to them.
- Small firms value a stable and simple regime that allows them to easily understand how much capital they need to exercise their business while complying with regulatory requirements. They are satisfied when the regime ensures that it is reasonably straightforward to compute regulatory own funds and that their volatility over time is reduced under stable business circumstances. In some cases the complexity of rules is more of an issue that the level of capital requirement itself.

For these reasons, for Class 3 firms the principles described in §. 63 to 73 of the discussion paper would make the new regime more complex than the present one. Indeed they would require (i) to compute all k-factors for the firm, the fixed overhead requirement and the uplift factor, (ii) to compare initial capital requirements, fixed overhead requirements and the k-factor and RFUM-based formula, (iii) to monitor all these metrics and the drivers of the various k-factors.

We are in favour of a simpler regime for small firms based on the fixed overheads indicator. It is indeed relevant for defining capital requirements for small, non-interconnected firms, a systemic analysis of which would lead to conclude that the only risk to the system would be the wind-down of their business. In such cases, the objective is for the firm to hold sufficient capital to cover all costs of closure arising from its obligations towards all stakeholders (clients, suppliers, staff, etc.).

Please also refer to our answer under questions 4 and 10.

Question 9

Should a fixed overhead requirement (FOR) remain part of the capital regime? If so, how could it be improved?

As also stated under questions 4 and 8, we believe that a fixed overhead regime for Class 3 firms would be appropriate. In our opinion, such an approach is relevant for small firms as it ensures that they have enough capital to secure an orderly wind-down.

For Class 3 firms, this regime could replace the "Pillar 1" approach based on the quantification of own funds requirements by risk type.

Question 10

What are your views on the appropriate capital requirements required for larger firms that trade financial instruments (including derivatives)?

§. 79 of the discussion paper refers to the possible use of margin requirements for firms which are active on the trading of derivatives, either centrally cleared (the amount of initial margin could be considered in this case), or non-centrally cleared OTC derivatives.

Should the k-factor approach be adopted:

- We think that a relevant metric could be the VaR of the books because with a single scalar figure it encompasses all the portfolio's risks if the risk factors are appropriately chosen. The use of total amount of initial margin paid to CCPs or Clearing Members could also be considered but it would be difficult to harmonize with portfolios on OTC-led markets. It would be a more relevant indicator than the number of trades for the calculation of risk to markets via the PTA factor (please refer to our answer under question 6 – PTA factor).

- Centrally cleared OTC derivatives should be favoured compared to non-centrally cleared OTC derivatives, as regulation provides clear incentives for central clearing.

Question 11

Do you think the K-factor approach is appropriate for any investment firms that may be systemic but are not 'bank-like'?

We do not have any comments on this specific issue. Please refer to our answer under questions 1 and 2 for our opinion on the 'bank-like' criterion.

Question 12

Does the definition of capital in the CRR appropriately cater for all the cases of investment firms that are not joint stock companies (such as partnerships, LLPs and sole-traders)?

We do not have any comments.

Question 13

Are the cases described above a real concern for the investment firms? How can those aspects be addressed while properly safeguarding applicable objectives of the permanence principle?

We do not have any comments.

Question 14

What are your views on whether or not simplification in the range of items that qualify as regulatory capital and how the different 'tiers' of capital operate for investment firms would be appropriate? If so, how could this be achieved?

AMAFI does not see any specific need to simplify or amend the current definition of capital and the different 'tiers' of capital. The current framework is sufficiently clear and does not generate excessive complexity or any other specific issue.

Question 15

In the context of deductions and prudential filters, in which areas is it possible to simplify the current CRR approach, whilst maintaining the same level of quality in the capital definition?

For the most part, prudential filters as defined under the current CRD/CRR regime are not a major issue for us. Therefore, they do not require substantial change.

However, we have reviewed the specific case of prudent valuation rules, as defined by article 105 CRR and by the European Commission's delegated regulation 2016/101 of October 26th, 2015. Prudent valuation rules aim at computing the amount that should be deducted from own funds due to valuation adjustments of fair-valued assets.

We believe that the prudent valuation regime should be reconsidered in the context of the new prudential regime for investment firms. As a matter of fact, prudent valuation reduces eligible own funds in proportion of balance-sheet fair valued assets; in so doing, it acts in a similar way as does the leverage ratio and can be seen as a 'double–counting' requirement.

In addition, the following points should be considered on current prudent valuation rules:

- We understand that their scope extends to all fair-valued assets and not only trading book assets.
- The rules come on top of accounting fair value rules that ensure 'fair price' determination defined as a marketability price. We consider prudential rules on top of accounting rules as double-counting requirements.
- The simplified approach for prudent valuation is limited to portfolios smaller than EUR 15bn (defined as the sum of the absolute values of fair-valued assets and liabilities). Firms with a balance sheet close to this threshold may prefer to remain smaller in size in order to avoid the complexity of the core approach and limit the growth of their business.
- The core approach seems very complex especially for mid-sized investment firms that apply the standardized approach for CRR computation. For these firms the feasibility of its implementation is a real issue. This complexity is not commensurate with the real impact of prudent valuation on the total level own funds, which would remain limited.

For all these reasons we believe that prudent valuation rules should be removed from the list of prudential filters applicable to Class 2 and Class 3 investment firms.

Please also refer to our answers under question 35.

Question 16

What are your views overall on the options for the best way forward for the definition and quality of capital for investment firms?

We do not have any particular comments (please refer to our comments under questions 14 and 15).

Question 17

What are your views on the definition of initial capital and the potential for simplification? To what extent should the definition of initial capital be aligned with that of regulatory capital used for meeting capital requirements?

We do not see current initial capital rules as a source of complexity requiring urgent simplification. To this extent, we do not have any comments and are satisfied with the current regime.

Question 18

What aspects should be taken into account when requiring different levels of initial capital for different firms? Is there any undesirable consequence or incentive that should be considered?

We do not have any comments.

Question 19

What are your views on whether there is a need to have a separate concept of eligible capital, or whether there is potential for simplification through aligning this concept with the definition of regulatory capital used for meeting capital requirements?

We have not examined this issue in detail, and do not have any comment.

Question 20

Do you see any common stress scenario for liquidity as necessary for investment firms? If so, how could that stress be defined?

From a general perspective, on the liquidity regime covered by questions 20 – 24, we would like to make the following comments.

First of all, we welcome the EBA's conclusion that current CRR liquidity rules, as defined by Part 6 of CRR, are inadequate for investment firms. In this respect, the EU Commission's Delegated Act 2015/61 states that prudential requirements regarding LCR and NSFR do not apply to investment firms, while reporting requirements apply for some investment firms. For them, liquidity reports are perceived as excessively granular compared with the size and complexity of most investment firms' business models. As a consequence, they currently feel that the current regime is burdensome and not commensurate with the actual liquidity risk incurred by their activities.

As a consequence, we believe that the following principles must be considered:

- An approach based on an economic assessment of predictable flows of cash that reflect the liquidity situation of the institution.
- A uniform approach for all institutions.
- In order to be applicable by all actors, the approach has to be kept as simple as possible.
- The approach must take into account the specific situation of investment firms compared to banks (e.g. they do not collect client deposits, and they have no access to central bank funding).
- The definition of liquid assets must be enlarged (please also refer to our answer under question 22).

The regime should be based on the following:

- A projection of cash inflows and outflows over a period of time, which appears to be the most sensible for measuring the liquidity situation of investment firms, as it is consistent with operational cash management processes and indicators.

- A 30-day time horizon for inflows and outflows measurement. This appears reasonable as market activities are characterised by a relatively short-term projected horizon (settlement date at D+2 after trade date; daily margin requirements; monthly expiry date for listed products). Other significant flows, essentially due to operational charges (e.g. premises rental, bonus payments, etc.) can usually be easily anticipated well ahead of schedule.

- A regime based on reporting obligations only (as is currently the case under CRR). This ensures that firms have a forward-looking view of their treasury and that they can anticipate their needs for funding. This is also consistent with the proportionality principle, and with investment firms being considered non-systemic.

In this context, the issue of stress calibration is not relevant.

We therefore favour an inflows / outflows reporting approach. Consistency should be sought with other regulations requiring the building of treasury indicators based on inflows / outflows, e.g. “financial position indicators” referred to in article 9 of the Banking Recovery and Resolution Directive.[7]

Question 21

What is your view on whether holding an amount of liquid assets set by reference to a percentage of the amount of obligations reflected in regulatory capital requirements such as the FOR would provide an appropriate basis and floor for liquidity requirements for ‘non-systemic’ investment firms? More specifically, could you provide any evidence or counterexamples where holding an amount of liquid assets equivalent to a percentage of the FOR may not provide an appropriate basis for a liquidity regime for very small and ‘non-interconnected’ investment firms?

A liquidity requirement based on a percentage of own fund requirements seems less relevant than a projected flow-based approach, for the following reasons:

- It generates confusion between the concepts of solvability and liquidity: in this approach, the more own funds are required, the higher the liquidity requirements. This is not easily observed in practice.
- As stated before, a prospective view of projected inflows and outflows of cash best reflects the liquidity situation of an institution.

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[7] Directive 2014/59/EU, May 14th, 2014.

Question 22

What types of items do you think should count as liquid assets to meet any regulatory liquidity requirements, and why? (Please refer to Annex 4 for some considerations in determining what may be a liquid asset).

Part 6 of the current CRR regime provides for a strict definition of liquid assets eligible to the LCR liquidity buffer. This definition applies to banking institutions.

The situation of investment firms differs from that of banking institutions in several respects. In particular, investment firms do not collect cash in the form of deposits[8]; they do not have access to central bank funding; their main sources of liquidity come from (i) cash available on bank accounts, (ii) credit and liquidity facilities granted by banks and (iii) financial assets (mostly common equity shares) that they may sell or repo in the financial markets.

The definition of liquid assets for investment firms should take these specifics into account and include, in particular, the following elements:

- Cash held in bank accounts directly owned by the firm (excluding client money held).
- The undrawn portion of committed credit or liquidity facilities negotiated with banks.
- Equity instruments held by the firm which have a high degree of liquidity in financial markets, e.g. common equity shares belonging to a major stock index; the list of major equity indices recognized for the LCR could be used as a reference.

In this respect, investment firms must be able to include common equity shares listed on a major index in their liquid assets without restriction, provided that they are unencumbered. In particular, no rule similar to that of the LCR (i.e. a maximum of 15% of liquid buffer assets invested in equity instruments) should apply. This would prevent situations where investment firms specialised in equities are forced to invest in sovereign bonds whereas they do not have appropriate skills, tools or processes to monitor risks on fixed-income instruments.

Question 23

Could you provide your views on the need to support a minimum liquidity standard for investment firms with the ability for competent authorities to apply "supplementary" qualitative requirements to individual firms, where justified by the risk of the firm's business?

As stated above (cf. our comments under question 20), we do not support a minimum liquidity standard for Class 2 and Class 3 investment firms. Apart from very few systemic institutions that would be classified in Class 1 and submitted to CRR liquidity requirements, we believe that the risk of investment firms' business is sufficiently mitigated by minimum own funds rules.

Question 24

Do you have any comment on the need for additional operational requirements for liquidity risk management, which would be applied according to the individual nature, scale and complexity of the investment firm's business?

The discussion paper mentions the objective of applying qualitative requirements in a proportional way commensurate with the level of size and complexity of the firm's activity.

[8] Within the meaning of bank deposit .

Given the diversity of business profiles of investment firms, qualitative requirements may be seen as a good way of adapting regulatory supervision to the specific case of each institution, as they enable each firm to define how best to apply requirements in the context of its own business model.

Therefore, we support the regulatory requirement to build a liquidity management policy adapted to the firm's activity. Each institution can make it consistent with its own assessment of liquidity required for a proper conduct of business. This is, in our views, more effective in preventing liquidity strains than a minimum liquidity standard.

The requirement to have a liquidity management policy in place is also consistent with the 'use test' principle, a cornerstone of prudential regulation since Basel 2.

Question 25

What are your views on the relevance of large exposures risk to investment firms? Do you consider that a basic reporting scheme for identifying concentration risk would be appropriate for some investment firms, including Class 3 firms?

AMAFI acknowledges that concentration risk may be a real concern from a risk management perspective and that additional own funds requirements should be computed when this risk materialises.

To this effect, the current large exposure regime requires that a firm which has exposures to a counterparty above EUR 150m or 25% of its Tier 1 capital holds additional own funds in order to cover the risk generated by the concentration of its exposures. We view this regime as a balanced compromise between the need to mitigate concentration risk on the one hand, and the limited capacity that investment firms may have to diversify their counterparties on a given market.

As mentioned in the December 2015 EBA report on investment firms, article 400 (j) of CRR exempts exposures to CCPs from the large exposure regime. In a context where more and more instruments must be cleared centrally, via a trade repository in the sense of EMIR or a swap data repository in the sense of the Dodd-Frank act, it is important that this exception be kept in order to avoid that abiding by regulatory obligations generate an increase in capital requirements.

Moreover intragroup exposures should be exempted from the concentration risk calculations

In the case of Class 3 firms (i.e. small, non-interconnected firms), a basic reporting scheme without additional capital requirements should be envisaged, given the low level of risk resulting from their small size.

Question 26

What are your views on the proposed approach to addressing group risk within investment firm-only groups? Do you have any other suggested treatments that could be applied, and if so, why?

Section 4.4.2. of the discussion paper tackles the issue of consolidated supervision for groups of investment firms or groups including authorised investment firms and non-authorised firms. It also deals with capital requirements applying to the parent holding company of an investment firm-only group structure.

In our views, it is essential, for groups of investment firms or groups including investment firms, to keep the possibility for competent authorities at national level to exercise their supervision at group level. The current possibility to opt for group-level supervision should not be removed.

From a general perspective, we favour an approach based on consolidated supervision for the following reasons:

- In the context of a group, strategic decisions such as capital allocation to businesses, including the decision to wind down activities in case of crisis, are usually taken at group level.
- In many cases the business of an entity is closely linked to the group it belongs to, and is not properly assessed if considered locally. This is especially true for liquidity, in groups applying centralised funding from the parent company based on a group-wide liquidity management policy.

Question 27

In the case of an investment firm which is a subsidiary of a banking consolidation group, do you see any difficulty in the implementation of the proposed capital requirements on an individual firm basis? If so, do you have any suggestion on how to address any such difficulties?

The case of investment firms that are part of a larger banking group is a real issue. These firms contribute to the consolidated capital and liquidity requirements of their group, based on CRR requirements.

Any new prudential regime should be compatible with the following principles:

- Competent authorities may continue to exercise supervision at group level.
- Investment firms that are part of a banking group must not be subject to two sets of requirements, one as contributor to the group's CRR ratios and the other on an individual basis.
- Investment firms that contribute to the requirements of their group should be exempted from any additional requirements on an individual basis.

However this would generate discrepancies if the CRR regime applied by investment firms that belong to a group and the approach applied by independent investment firms differ substantially.

This is one of the reasons why we favour an approach based on amended CRR rules (please also refer to our comments under questions 34 and 35). This option would ensure that all investment firms be submitted to a prudential treatment based on CRR principles, while allowing some flexibility in the way such principles are declined taking into account the specifics of investment firms.

Question 28

What other aspects should the competent authorities take into account when addressing the additional prudential measures on an individual firm basis under the prudential regime for investment firms?

Section 4.4.3. of the discussion paper tackles SREP and Pillar 2 considerations. Pillar 2 allows competent authorities to assess whether risk management policies, processes and controls are appropriate and commensurate with the size and nature of activities carried out by the firm.

Under Pillar 2, firms have formalised their risk appetite and risk management framework via ICAAP and ILAAP, and deployed risk management policies based on risk type (i.e. credit risk, market risk, operational risk, etc.).

This risk type-based management framework fits the way institutions actually monitor their risks operationally. It is also consistent with the risk management framework that CRD/CRR promotes. There is therefore a consistency between Pillar 1 (i.e. definition and computation of own funds) and Pillar 2, i.e. the risk management governance framework in place within investment firms.

It is not clear from the discussion paper whether the k-factor approach will replace Pillar 1 only or if it would also substitute to current Pillar 2 obligations. However, it does not seem to be compatible with current Pillar 2 principles.

Consequently, should the k-factor approach be adopted, ICAAP and ILAAP requirements would have to be removed or seriously revised. If they are not, the new prudential regime would miss its target of greater simplicity. Investment firms would be submitted to a double requirement, via Pillar 1 and k-factors on the one hand, and ICAAP/ILAAP on the other, which would not be acceptable.

Question 29

What examples do you have of any excessive burden for investment firms arising from the current regulatory reporting regime?

Due to the single rulebook principles, the granularity of information to be reported is the same for all regulated entities, regardless of their size, portfolio of activities or business model, or of their status as 'systemic or non-systemic'.

Moreover, the granularity of some reports, especially on liquidity, is increasing over time. For investment firms subject to the LCR reports, only a small number of cells are relevant. The same situation arises regarding asset encumbrance and ALMM reports. These are examples of a tendency for regulators to collect additional information which is not directly used in regulatory own funds computation, in order to get a very granular view of the portfolio of assets held by institutions. While this is understandable for systemic institutions in order to get advanced risk indicators, this proves to be too burdensome for non-systemic firms compared to the real value added of information collected.

Therefore, in our opinion, the proportionality principle should apply to reporting obligations, with three different sets of reports applicable to 'systemic' firms, Class 2 firms and Class 3 firms respectively:

Class	**1 (systemic)**	**2**	**3**
Granularity of reports	Current or close to current	Limited	Low

For Class 3 firms in particular, sufficient information would consist in:

- A light report based on aggregate exposures to key financial risks, e.g. gross exposures to counterparty risk (with a breakdown by counterparty type) and market risk.
- Data based on fixed overheads and main wind-down assumptions that directly help compute the minimum own funds ratio, under a FOR approach.
- Aggregate 30-day cash inflows and outflows split into a limited number of flow types, plus an inventory of liquid assets.

For Class 2 firms, more granular data by risk type is justified, but data collected should be limited to information that is directly useful to compute own fund requirements.

On this topic, we consider that a specific EBA workshop with the industry would be very helpful.

Question 30

What are your views on the need for any other prudential tools as part of the new prudential regime for investment firms? And if required, how could they be made more appropriate? In particular, is there a need for requirements on public disclosure of prudential information? And what about recovery and resolution?

The banking recovery and resolution directive, as designed for systemic institutions, would not be appropriate for class 2 and Class 3 investment firms. We have not considered in detail the case of its adequacy to systemic (i.e. Class 1 investment firms) as we do not expect French investment firms to be considered systemic in the sense of G-SII or O-SII criteria.

Question 31

What are your views on the relevance of CRD governance requirements to investment firms, and what evidence do you have to support this?

CRD states that banking institutions and investment firms must set up a risk management framework where general management and the Board must endorse a number of responsibilities. These principles were transposed into French law via an *arrêté* enacted by the French Finance Ministry and published on November 3rd, 2014. It covers the areas of internal control, the compliance and anti-money-laundering control framework, the risk control framework. This includes a number of requirements for the management of credit and counterparty risk, market risk, interest rate risk, intermediation risk, liquidity risk, settlement & delivery risk, leverage risk, operational risk, as well as risk-sensitive remuneration principles.

Paragraph 171 of the discussion paper states that CRD/CRR governance rules should continue to apply to systemic firms only, while non-systemic firms could stick to MiFID II governance rules only.

We would like to highlight the following points:

- CRD/CRR rules, considered as qualitative requirements for risk measuring and mitigation within organisations, have been deployed in all investment firms, including Class 2 and Class 3 firms.

- The rules are generally considered relevant, even if more proportionality would be welcome in order to take into account the size of these firms. Overall adoption of CRD/CRR rules contributed to reinforce risk governance and the internal control function of investment firms, with related benefits for the system. Most investment firms would not be prepared to abandon the benefits of stronger control functions, even if regulatory requirements are loosened.

- CRD/CRR governance principles are organised by risk type and this approach is meaningful for institutions. To this extent, in a k-factor regime, capital requirements calculations would be disconnected from the measurement systems and models in place for each risk type, which most institution will preserve.

- If, other things being equal, a k-factor regime came into effect, investment firms would have to face a situation where they would have to comply with two different systems of risk measurement: the current CRD governance framework used for internal risk measurement and monitoring, which firms have already endorsed; and a measurement system based on k-factors, used for computing regulatory capital requirements. As already stated, this would not be acceptable as it would add a new requirement to the existing framework. It would therefore miss the target for simplification of the prudential regime of investment firms.

Therefore, our preference goes to a regime where (i) the CRD risk governance and risk monitoring principles would be maintained with more proportionality for Class 2 firms (ii) the regulatory framework remains consistent with these principles. For Class 3 firms, MiFID II rules are sufficient.

Question 32

As regards 'systemic and bank-like' investment firms, do you envisage any challenges arising from the full application of the CRD/CRR remuneration requirements, and if so, what evidence do you have to support this? For all other investment firms, what are your views on the type of remuneration requirements that should be applied to them, given their risk profiles, business models and pay structures?

We do not have any comments.

Question 33

What is your view on a prudential remuneration framework for other than 'systemic and bank-like' investment firms that should mainly aim to counteract against conduct related operational risks and would aim at the protection of consumers?

The question of the governance of remunerations is a key issue for non-systemic investment firms. In particular, the 100% ratio between fixed and variable remunerations is not appropriate for non-systemic investment firms.

The legitimate reason for Europe and the Member States to regulate the ratio between fixed and variable remunerations for credit institutions and investment firms is directly linked to the possibility that overly-high variable remuneration packages increase the likelihood of systemic risk. As the financial crisis showed, this may create systemic risk in the medium or long term, then forcing governments and financial authorities to take action.

This legitimacy inherently does not exist when a given institution, considering its size and the nature of its activities, is not in a position to create systemic risk. This is especially the case when, to avoid staff taking excessive risk, it is required to apply a number of rules that oversee the conditions for awarding variable remuneration as mentioned above.

For those institutions, the introduction of a strict ratio between variable and fixed remuneration only weakens their competitiveness. On average, fixed remuneration for staff targeted by this rule has increased significantly in large-scale institutions in recent years in order to tackle the issue this fixed/variable ratio created in terms of retention and attraction of talent.

For smaller firms, for which personnel costs account for a higher proportion of total costs than for larger firms, the equation is impossible to solve (to deal with competition from other labour markets, including asset management) without also increasing fixed remuneration substantially.

This results in a substantial increase in the fixed costs base of smaller institutions. As they are active in very cyclical market activities, this would impact their resilience, which is exactly the opposite of the effect that was desired when remuneration rules were drafted.

Therefore, we consider that:

- Class 2 investment firms should not be submitted to the maximum variable remuneration rules issued from the CRD/CRR framework; other governance rules are acceptable if they are implemented with proportionality.

- Class 3 firms, which most of the time are very small organisations with a straightforward decision process on remunerations, should remain subject to simpler governance rules, and we believe the application of MiFID II rules in this area would be sufficient.

Question 34

What are your views on having a separate prudential regime for investment firms? Alternatively, should the CRR be amended instead to take into account a higher degree of proportionality? Which type of investment firms, if any, apart from systemic and bank-like investment firms, would be better suited under a simplified CRR regime?

As already stated in this document, we favour a simplified CRR regime rather that a k-factor-based new prudential regime. We believe that CRR could be adequately adapted based on the principles of greater simplicity and proportionality.

In practical terms, we support a simplified regime for non-systemic firms (Class 2 firms) based on a CRR framework with several adjustments. Class 3 firms would be submitted to fixed overheard requirements.

For further detail on possible simplifications, please refer to our answer under question 35.

Question 35

What are the main problems from an investment firm perspective with the current regime? Please list the main problems with the current regime.

The current CRR regime appears in line with the risk management and internal control framework that banks have reinforced in recent years, based on risk-sensitive computations of capital requirements for each risk type, via standardised or internal model-based approaches, an internal risk and liquidity adequacy assessment process (ICAAP / ILAAP) and stronger governance principles. We support a framework where these features subsist in the future prudential regime applicable to investment firms.

However, the specifics on investment firms in terms of size and heterogeneity of business models, as well as the existence of other regulations (e.g. on market infrastructure and central clearing) should be taken into account for considering potential adjustments to the current CRR regime. The principles of greater simplicity and proportionality should also be considered.

Possible adjustments could include:

- **Remove the CVA capital charge for Class 2 and Class 3 investment firms.**

In our opinion the CVA capital charge is in itself a source of complexity as regards data aggregation and calculation on a counterparty-by-counterparty basis. However, the total CVA capital charge is not significant for investment firms compared to total capital requirements.

In addition, regulatory change, especially EMIR, tends to force central clearing of OTC instruments, further reducing the average CVA capital charge of investment firms.

In this situation, based on the proportionality principle, we support a removal of CVA capital charge from regulatory capital requirements applied to investment firms.

- **Keep exposures to CCPs and intragroup exposures out of scope of the large exposure capital charge regime.**

AMAFI would like to draw attention to the appropriateness, in our opinion, of the current regime, which authorises firms to exceed regulatory thresholds (€150 million or 25% of trading book exposure) provided that they hold additional capital (calculation of capital requirements in respect of large exposures). We feel it is appropriate to maintain this regime, since it is a good compromise between the requirement to cover risks arising from concentration of exposures and the limited capacity of medium-sized investment firms to diversify their counterparties within a given market.

As emphasised in the report (see page 51), Article 400 (2) (j) of CRR provides for exemption for exposure to clearing houses and central counterparties (CCPs). This point is being reviewed by the European Commission.

In AMAFI's opinion, it is important that exposure to clearing houses and clearing members (which, moreover, must systematically be used under new regulations applicable to broad categories of instruments[9]*) be exempt from requirements relating to the monitoring of large exposures. Indeed, it would be illogical if compliance with regulatory requirements on the centralised clearing of financial instruments were to result in increased regulatory capital requirements.*

Intragroup exposures should also be exempted from concentration risk calculations, as they do not materialise a risk on external counterparties.

- **Allow investment firms to apply either current CRR methodologies or revised approaches for counterparty credit risk and market risk.**

Most investment firms use current standardised approaches for counterparty credit risk and market risk. Such approaches are currently under regulatory review and should be soon replaced by SA-CCR and FRTB respectively.

While SA-CCR and FRTB seek to better capture risk via revised standard and internal methods and a more granular approach (e.g. calculation at trading desk level for FRTB in the internal model approach – IMA), the complexity of their implementation may not be commensurate with the activity of investment firms, especially for single-activity firms, the majority of them.

In this context, taking into account the proportionality principle should lead to allow investment firms to opt either for current CRD/CRR rules or for future CRD5/CRR2 rules.

- **Keep the leverage ratio an element of Pillar 2 for investment firms.**

The current CRR regime is based both on the minimum solvency ratio, a risk-weighted one, and on the leverage ratio. The latter is due to become part of Pillar 1 as of January 1st, 2018.

We support a regulatory framework where the leverage ratio would be part of Pillar 2 with a reporting-only requirement for CClass 2 firms. Again this is, in our view, justified for proportionality reasons, considering the size of Class 2 Class as well as their activities which are mostly collateralised and/or based on client-backed transaction patterns (e.g. execution of orders on behalf of clients, market-making activities…).

[9] See in particular the requirements for central clearing, for certain derivatives, through a trade repository within the meaning of EMIR, or through a swap data repository within the meaning of the US Dodd-Frank Act.

Exempt investment firms from CRR liquidity requirements.

We welcome the EBA conclusions on the irrelevance of LCR and NSFR for investment firms and we support a non-binding approach based on the reporting of cash inflows and outflows and of an extended concept of liquid assets. Please refer to our answer under questions 20 to 24 for more detail.

Within this regime:

- Liquidity monitoring should be part of Pillar 2, with a reporting-only requirement.

- Regulatory reports should follow a proportionality principle, i.e. they should be less granular for Class 2 firms than for systemic firms, and less granular for Class 3 firms than for Class 2 firms.

- In all cases, reports should be built in the reference currency of the firm (e.g. EUR for most French firms); we are not supportive of requiring investment firms to produce indicators with a breakdown by currency. As a matter of fact, foreign exchange risk is already captured in the computation of capital requirements, therefore we consider that it is appropriately covered. Therefore, since a lot of additional workload would result from the production of indicators by currency, this would not be commensurate with the level of risk incurred by non-systemic investment firms' activities.

Remove prudent valuation rules as currently defined by the EBA

As explained in our answer under question 15, we believe that prudent valuation rules, as defined by article 105 CRR and by the European Commission's delegated regulation 2016/101 of October 26th, 2015, are:

- Overly complex, especially for small or mid-sized investment firms that would have to apply the core approach with all AVA.
- Inadequate as they can be seen as 'double-counting' requirements with leverage ratio and accounting IFRS 9 rules.

In addition, when considering French investment firms, the amount of deduction from own funds due to prudent valuation would not affect materially their capital ratio.

Therefore, we believe that prudent valuation rules should be removed from a CRR simplified framework. This would enable substantial simplification for Class 2 and Class 3 investment firms' prudential rules and would not affect the ability for the regulator to have an adequate view of risks and capital requirements within non-systemic investment firms.

Apply a Pillar 2 approach for liquidity.

The issue of liquidity was discussed under questions 20 to 24. Please refer to them for further details.

Finally, we would like to comment on other prudential aspects related to investment firms.

Operational risk

We believe that the current operational risk framework has the advantage of simplicity and relative stability due to the latest three years' average value. We are keeping an eye on current developments regarding the reform of the standardized approach for operational risk, based on the BI (business indicator) and on risk factors depending on the institution's size. While we have not reviewed this project in detail, we believe that simplicity and stability should be preserved in the future regime.

We are also concerned that this reform could make operational risk more RWA-consuming for Class 2 investment firms, which in our views is not desirable since operational risk is currently the highest risk in terms of RWA consumption for most investment firms.

The possibility of keeping the current regime for investment firms, or leaving them the option to keep the current regime upon agreement by the national regulator, should be considered.

Recovery and resolution

To date, the future recovery and resolution regime is not fully defined and a number of aspects are tackled in the CRR2 draft proposal issued by the European Commission on November 23rd, 2016.

We will not consider all details of the future regime, however we would like to comment on a few general aspects.

First, the recovery and resolution framework[10], covers qualitative requirements, essentially the obligation to document precisely the institution's recovery plan. In this respect, it reminds the requirement that has long applied to investment firm to document their orderly wind-down plan. For Class 3 investment firms, as we support a wind-down approach for capital requirement definition, a BRRD requirement regarding the documentation of their recovery plan would be redundant with the wind-down approach and must therefore be removed.

For Class 2 investment firms, here again we believe that proportionality should be considered. While we see the usefulness for the firm to precisely qualify the actions that would be undertaken in case of major stress, we view, we support the ability for regulators to appreciate the quality of the recovery plan commensurate with the size and complexity of the firm's activities. In the case of non-systemic investment firms, documenting orderly wind-down scenarios should ensure that a failure would not entail unexpected consequences or disorderly actions, which would ensure non-contagion to the financial system.

Second, the BRRD framework includes new prudential ratios that are still under construction (MREL/TLAC). We believe that the application of MREL and TLAC should be limited to systemic firms (Class 1 firms) only. As opposed to large banking institutions, investment firms usually do not raise large amounts of debt on financial markets, and in most cases have never done so, which make the concept of eligible debt in the sense of MREL and TLAC meaningless.

In conclusion, while we believe that it is useful for all investment firms to anticipate the possibility of a failure via an orderly wind-down scenario, we consider that the proportionality principle must fully apply to this topic. Appreciating the appropriateness of the recovery plan must be a case-by-case issue, as it depends on idiosyncratic factors such as size, activities, operational setup (e.g. market memberships), legal structure, level of risk taken by the firm, level of interconnectedness, etc. In this respect, full application of BRRD requirements should be strictly limited to systemic (Class 1 investment firms) as it would be inappropriate for non-systemic investment firms.

[10] As reflected in the *Banking Recovery & Resolution Directive* (BRRD) – Directive 2014/59/EU dated May 15th, 2014.

Pillar 3

Pillar 3 requirements relate to the public disclosure of information regarding the institution’s exposure to different risk types as well as its risk management framework. The purpose of Pillar 3 is to ensure proper functioning of financial markets and build trust between market participants.

The EBA has been active in improving the comparability of disclosures, via the identification of best practices and the issuance of disclosure guidelines. We believe that this action has been useful for banks and other institutions to help them appreciate the regulator’s expectations.

In 2016, the Basel Committee issued a proposal for the strengthening of Pillar 3 disclosure which includes alignment with the latest regulatory developments (e.g. identification of FRTB-related data that should be disclosed). This proposal reflects the tendency towards increasing normalization of Pillar 3 information.

In this respect, given the vast diversity of investment firms, we support a proportional approach depending, among others, on the following factors:

- Whether the institution is public or not (public institution are a small minority of investment firms).
- The firm’s classification as Class 1, Class 2 and Class 3.
- The size of its balance sheet.

While it is important that major financial institutions (e.g. systemic institutions and/or those directly supervised by the European Central Bank) have to comply with Pillar 3 obligations in a similar way, we believe compliance of non-systemic institutions with Pillar 3 should be assessed by the regulator with sufficient level of proportionality, based on its appreciation of the firm’s specific features.

Finally, the objectives of Pillar 3, i.e. proper functioning of financial markets, are irrelevant for class 3, which is supposed to include only small, non-interconnected firms.