EUROPEAN
PRINCIPAL TRADERS
ASSOCIATION

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European Commission,
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5 September 2017

Re: FIA EPTA comments on EBA's preliminary recommendations for a new IF prudential regime

Dear Didier,

I am writing to you on behalf of the FIA European Principal Traders Association (**FIA EPTA**) concerning the European Banking Authority's (**EBA**) technical advice to the European Commission on a new prudential regime for investment firms. Our views expressed below and in annex are based upon the EBA's 58 preliminary recommendations presented to interested stakeholders at a public hearing on 03 July 2017 and our subsequent discussions with EBA staff and members of the EBA's working group of supervisors.[1]

We trust these views will be helpful for you and your team as you prepare your legislative proposals. We would welcome the opportunity to meet with you and FISMA D2 colleagues in the coming weeks to discuss the EBA's recommendations and our members' views.

About FIA EPTA

FIA EPTA is comprised of 28 principal trading firms (**PTFs**) which deal on own account in a wide range of financial instruments traded on trading venues across Europe. PTFs play a key role in the modern financial ecosystem, bridging gaps in supply and demand between market participants and facilitating price discovery, especially at times when markets are volatile. FIA EPTA members engage in manual, automated and hybrid methods of trading. Collectively, FIA EPTA members are an important source of liquidity for trading venues and end-investors, allowing those who use the capital markets (whether to invest or to manage their business risks), to buy or sell financial instruments efficiently and at low cost. FIA EPTA's mission is to support transparent, robust and safe markets with a level playing field for all market participants. We strongly believe access to markets should be open to all and non-discriminatory in order to minimise barriers to entry and increase competition and efficiency.

FIA EPTA position on proposed new prudential regime

(1) Suggested principles for new regime

We welcome the EBA's view that a less complex and more proportionate prudential regime is required for non-systemic investment firms.[2] We note that this view is shared by the European Commission and

[1] EBA Presentation on the "State of play of the EBA Advice on the design of a new prudential framework for MiFID investment firms" (03 July 2017) [link].

[2] See Recommendation 1 of EBA: Report on Investment Firms: Response to the Commission's Call for Advice of December 2014 [EBA/Op/2015/20] (14 December 2015) [link].

stated in its Communication on the Mid-Term Review of the Capital Markets Union (**CMU**) Action Plan.[3] To deliver a less complex, more proportionate regime, in line with CMU objectives, we suggest to the Commission to apply the principles listed below. We believe that legislation reflecting these principles would deliver a new prudential regime tailored to the requirements of investment firms while avoiding the shortcomings of the CRD IV/CRR regime.

Principle 1 *Investment firms should hold regulatory capital sufficient to finance their orderly wind down should the investment firm become insolvent.*

Principle 2 *Regulatory capital requirements for investment firms should recognise that investment firms undertake activities which are complementary to those of banks, and with a different risk profile.*

Principle 3 *Capital rules for non-systemic investment firms should promote greater diversification in the financial system in the EU and should not serve as a barrier to entry, an impediment to innovation and competition, or a disincentive to invest in EU capital markets.*

Principle 4 *Regulatory capital requirements are a prudential tool and should not be used as an alternative or substitute for Union conduct and market regulation.*

Principle 5 *Legislation for a new regime should serve to reduce regulatory capital requirements for non-systemic investment firms, set minimum harmonised standards applicable across the Union and dissuade national competent authorities from applying excessive additional requirements.*

Principle 6 *Any new regime should reflect, support and acknowledge risk management practices long established in EU capital markets, which constitute an additional line of defence to default maintained by clearing firms who are either systemically-important credit institutions or investment firms.*

(2) General comments

As a matter of principle, we believe that capital requirements should be proportionate to the inherent risks of the firms subject to them. As regards PTFs, it should be noted that, firstly, they are non-systemic and typically do not hold or manage client money or assets. They operate in a very competitive environment with high levels of substitutability amongst firms. The failure of a PTF is very unlikely to have any disruptive impact on markets, investors, or financial stability. Secondly, PTFs hold positions that are largely off-set ('netted') to a relatively low net exposure, regardless of the size of their trading portfolios, which makes them less risky than an investment firm holding directional speculative positions. Thirdly, all PTFs effectively submit their transactions to a clearing firm for clearing and/or settlement. This practice greatly lowers the residual risk at the level of a PTF as the risks are assumed on the balance sheet of the clearing firm. As a safeguard, the clearing firm will require the PTF to post collateral reflecting any potential risk the clearing firm could face. The clearing firm will calculate this collateral requirement based on very conservative risk models which are known to the clearing firm's supervisory authorities. It should be noted that there will be significant double-counting of risks in case of a PTF using multiple clearing firms. This will raise the required collateral to even higher levels.

Further, we note the reference to the concept of a 'level playing field' between PTFs and banks. In the manner it has been expressed, this concept disregards the fact that PTFs undertake activities that are complementary (rather than identical) to those of banks and that there are inherent structural differences which cause PTFs to have a significantly different (lower) risk profile than banks. The fact that some banks may undertake trading activities that are similar to those of PTFs is not in itself sufficient reason to subject PTFs to a bank-oriented capital requirements regime. In particular, because banking activity has more risk associated with it as a result of its role in the financial system and the over-all funding and

[3] European Commission: Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Mid-Term Review of the Capital Markets Union Action Plan [COM (2017) 292 final] (08 June 2017) [link].

business structure of banks. At the same time, we consider that where a bank would engage in proprietary trading through a separate stand-alone entity, using its own funds (not its clients') and submitting its positions to an unaffiliated clearing firm, hence being subject to the same collateral posting requirements as any other firms, this entity should be able to avail itself of a less onerous regulatory regime similar to that applying to investment firms such as PTFs undertaking the same activity.

(3) Classification of investment firms

We broadly support the EBA's Recommendations 1-4 with respect to the overall categorisation of investment firms that would either (i) remain subject to the provisions of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (**CRD IV**) and Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (**CRR**) or (ii) be subject to a new prudential regime. We consider the EBA's Opinion on the first part of the call for advice on investment firms to be clear and unequivocal.[4] We therefore do not see a reason for additional qualification of Class 1 investment firms. All investment firms identified as global systemically important institutions (**G-SIIs**) or other systemically important institutions (**O-SIIs**) per Article 131 CRD IV, and them alone, should remain subject to the provisions of CRD IV and CRR. All other investment firms should be subject to a new prudential regime.

We do not support the concept of classifying non-systemic investment firms based on their permissions. We consider such classification as proposed by the EBA in Recommendation 5 to be arbitrary and contrary to the objective of delivering a less complex, more proportionate regime for non-systemic investment firms. We have examined various proposals put forward by the EBA to support the classification of investment firms and believe, however, that Class 2 and Class 3 investment firms should be distinguished on the basis of common and objective measures. To this end, we have previously proposed a quantitative threshold based on the three-month fixed overhead requirements (**FOR**) with a EUR 3.5 million ceiling. We continue to believe this to be the best approach to the differentiation between Class 2 and Class 3 firms.

(4) Consolidated supervision

We agree with the EBA's Recommendations 8-10 on consolidated supervision. However, we believe that consolidated supervision should extend only to institutions established in a European Economic Area (**EEA**) jurisdiction. EEA capital requirements should not apply to non-EEA entities, neither on a consolidated nor on an individual level. We also believe that consolidated capital requirements should not exceed the sum of the EEA capital requirements of each individual EEA undertaking subject to EEA prudential requirements within the group. We are also dubious of the merits of including Class 3 investment firm affiliates within the scope of consolidation given their negligent contribution to group risk.

(5) Capital composition

We are broadly supportive of the EBA's Recommendations 11-14 on the definition and composition of regulatory capital. However, we caution that the provisions on capital composition in the new regime should not be more complex or restrictive than the current CRR regime (rather less so) and, whilst we would not oppose alignment with CRR, adjustments for investment firms should be made where necessary in order to simplify the regime.

In particular, we question the appropriateness of deductions relating to holdings in so-called "financial sector entities" as prescribed in Articles 44-47 CRR. We are of the view that the purpose of these CRR provisions is to avoid contagion risks in the banking sector (i.e., between credit institutions). The current CRR requirements burden investment firms that act as market makers or that provide liquidity in securities issued by financial institutions and restrict the ability of investment firms to quote in these financial instruments. We suggest that the new regime dispense with these deductions.

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[4] EBA: Opinion of the European Banking Authority on the First Part of the Call for Advice on Investment Firms [EBA-Op-2016-16] (19 October 2016) [link].

(6) Capital requirements

We welcome the evolution in the EBA's latest thinking on own funds requirements. Recommendations 16-32 set out an own funds regime for investment firms that is both simpler and less onerous than that proposed by the EBA in its previous discussion paper.[5] We support Recommendation 23 on a minimum own funds requirement for Class 3 investment firms, our comments in section (3) of this letter notwithstanding. We also support Recommendation 32 insofar as own funds requirements for Class 2 investment firms ought be the higher of their FOR or capital requirements determined by the proposed K-factor formula.

We are of the opinion, however, that the K-factor formula remains overly complex and ill-suited for non-systemic investment firms. Applied per Recommendations 27, 30 and 32, the formula is bound to specify own funds requirements for Class 2 investment firms that are substantially higher rather than lower than requirements per Article 92 CRR today. We advocate that the Commission amends the formula to reflect Principles 1-5 above thereby avoiding the risks of applying a bank-centric and, as yet, untested market risk standard.

Moreover, we believe that the management of a Class 2 investment firm is best placed to assess and quantify risk and determine what resources are required for the orderly wind down of their business. To that end, we believe that Class 2 investment firms should remain permitted to apply models of their own design for the purpose of calculating own funds requirements sufficient to ensure the orderly winding down of that investment firm should it fail. Indeed, we believe that in any new legal instruments should specify conditions and parameters for such models. However, we do not believe that such models need to replicate the internal-ratings based approach of Part III CRR.

(a) Risk to Customer (**RtC**)

FIA EPTA members do not generally have "customers" as variously defined in CRD IV and CRR and thus the EBA's analysis on RtC and the proposed K-factors for RtC are not generally applicable to our members. However, Recommendations 26 and 27 lack clarity on the treatment of bilaterally-executed (so-called "over-the-counter" or **OTC**) transactions with third parties, regardless of the classification of such counterparties or such investment firms under MiFID II. Key is whether an investment firm attracts a duty of care in managing or holding customer money or assets. If not, then such dealing is essentially proprietary and provided these transactions are generally cleared and settled by credit institutions or Class 1 investment firms such transactions should not to be subject to any RtC K-factor.

If an investment firm, on the other hand, does attract, hold, or manage customer money or assets and has a corresponding duty of care, their risk profile changes and RtC could become a relevant factor. However this should be carefully calibrated to the actual risk exposure the investment firm's service model would present to the customer.

We question the coefficients proposed by the EBA under Recommendation 27. We consider the coefficients for cash securities and derivatives transactions to be inordinately high and likely to dissuade investment firms from transacting in equities, bonds and exchange-traded funds (**ETFs**) if applied for either of the proposed K-factors on "customer orders executed" ($\mathbf{K_{COE}}$) or "daily trading flow" ($\mathbf{K_{DTF}}$). Such punitive coefficients cannot be reconciled with the Commission's stated CMU objectives.

(b) Risk to Market (**RtM**)

We consider the proposed RtM K-factors an improvement on what the EBA proposed in its Discussion Paper of 04 November 2016 but it remains complex and we would welcome a more proportionate prudential regime for non-systemic investment firms. As a general principle, where an investment firm submits its transactions to a clearing firm for clearing and/or settlement, any associated risks with such positions are assumed by the clearing firm. In return for this risk assumption, the clearing firm requires the investment firm to post collateral which must be sufficient to cover these risks. This means that there will be no residual prudential risk at the level of the

[5] EBA Discussion Paper – Designing a new prudential regime for investment firms [EBA/DP/2016/02] (04 November 2016) [link].

investment firm, except for RtC (if applicable), and sufficient own funds to facilitate an orderly wind-down.

We are greatly concerned by the EBA's Recommendation 30 on the RtM K-factors. The complexity and costs of the K_{NPR} proposal aside, we do not believe that non-systemic investment firms should be subject to regulatory capital provisions derived from the Basel Committee on Banking Supervision's revised market risk standard (also known as the "Fundamental Review of the Trading Book" or **FRTB**). This standard, which has yet to be adopted in Union law and the efficacy of which has yet to be proven, was developed specifically for systemically-important banks. The standard rests upon bank internal models for the calculation of market risk and corresponding own funds requirements. As we understand it, non-systemic investment firms would in practice be precluded from using internal models. If the revised standard was to be applied under any new regime, investment firms would be obliged to apply the revised standardised approach. The EBA suggests in Recommendation 31 that non-systemic investment firms may be permitted to use the "simplified standardised approach". However, this approach is exactly what is required today for investment firms under Part III CRR. While we see merit in some aspects of the revised market risk standard, including more practical provisions on off-setting positions, these merits do not outweigh the prospective costs and additional own funds required under the standard. In this regard, the EBA recommendations offer no proportionality, no simplification and no reduction in own funds requirements for market risk of non-systemic investment firms.

We oppose the K_{DTF} factor. We are dubious that an investment firm without significant end-of-day positions could create "a big footprint in the market" in prudential terms. This factor would effectively reach the opposite of the intended outcome, as it penalises market makers. This is because the K_{DTF} factor is based solely on trading volumes and does not take into account the specific type of financial instrument traded, the nature of the transaction or the risks involved. The K_{DTF} factor does not discount for offsetting trades (which market makers undertake continuously) but instead adds these up which is at odds with its purpose. We suggest that market risk for investment firms without significant end-of-day positions would be better addressed under a revised K-factor based on clearing firm collateral models subject to our discussion above.

We also oppose the calculation of own funds requirements for derivative positions based on the notional value of the derivative contract as proposed in Recommendation 30 point (c). We consider the focus on notional value rather than value-at-risk to be a key failing of the current CRR standardised approach. Combined with a narrow and impractical definition of off-setting positions, the standardised approach requires investment firms to hold huge own funds for their positions in fixed income derivatives. This restricts PTFs and other investment firms in providing liquidity to the fixed income markets, weakening the quality of these markets, and is at odds with both G20 and CMU policy objectives. We believe that amendments to legislative provisions, which would base own funds calculations on the value-at-risk of an investment firm's positions in these financial instruments and permit offsets according to market practice, would reduce own funds requirements for such positions to sensible levels. Investment firms would no longer be dissuaded from making markets or providing liquidity in these financial instruments, which would in turn foster greater use of these financial instruments by end investors to hedge risk in a transparent trading venue environment. We believe this to be essential for promoting more direct investment in EU bond markets under the CMU.

We are generally supportive of the K_{CMG} factor set out in Recommendation 32 whether as a de-facto (outsourced) internal model, or otherwise. We have long championed an assessment of own funds based on the collateral models applied by our clearing firms, which are generally large credit institutions or Class I investment firms subject *inter alia* to CRD IV and CRR in full. These models have been proven to be very resilient over time, and are easy to implement as they are already widely used for PTFs.

Almost all transactions entered into by FIA EPTA members are cleared and settled by large credit institutions or Class I investment firms. These clearing firms hold the positions of FIA EPTA members on their balance sheet and ensure that transactions entered into by a clearing customer are settled. Clearing firms must comply with CRR provisions, including those of Part III CRR on own funds. In the event of a clearing customer becoming insolvent, the clearing firm will liquidate the clearing customer's positions. In order to manage the various risks of these positions, the clearing firm will calculate margin to be posted as collateral with the clearing firm by the clearing customer. As these models account for any potential risk, the residual prudential risk for the PTF is zero (save for orderly wind-down). Clearing firm collateral models are designed to ensure that the clearing firm manages the risks posed by its clearing for other market participants, consistent with the relevant CRR requirements. For this reason the competent authorities for these large credit institutions and Class 1 investment firms will assess the operation of these models in the same way as they do for other regulated activities undertaken by these institutions. Models that would enable a credit institution or investment firm to take on excessive risk or 'compete on margin' are prohibited. It should also be noted that the K_{CMG} factor will overestimate the actual risk. The collateral models of clearing firms are sophisticated but, by design, very conservative as they seek to reflect any potential risk clearing firms may face in assuming the positions of their client's portfolios. In addition, where an investment firm would use multiple clearing firms, the individual clearing firm will not off-set or reduce risk exposures for correlated positions held at different clearing firms, therefore substantially overestimating risk.

We do not support the proposal in Recommendation 32 that RtM be set on the basis of the larger of K_{NPR} and K_{CMG}. As proposed, K_{NPR} can be expected to result in own funds requirements many times the aggregate collateral across all positions required by a FIA EPTA member's clearing firm and so in practice K_{CMG} would never be applied.

Further, we question the appropriateness and relevance of some of the conditions for applying K_{CMG} proposed by the EBA. We believe the conditions in Recommendation 32 point (a) are inappropriate. These conditions are copied from Article 96(1)(b)(ii) CRR and presented without justification. We see no reason for restricting a Class 2 investment firm to dealing on own account exclusively. We note that CRR offers no guidance as to what is meant by "no external customers" in that provision and we are aware of inconsistent application of this requirement today across EU Member States. Class 2 investment firms should be permitted, if not encouraged, to deal bilaterally with eligible counterparties and professional clients. A prohibition on external customers would preclude such dealing, contrary to the Commission's stated objectives for CMU.

We caution the use of the term "guaranteed" in respect of transactions cleared by a clearing firm cited in Recommendation 32 points (b) and (f). While the obligations of a clearing customer may be guaranteed by a clearing firm under so-called 'agency' clearing arrangements, such arrangements are rare today. Most clearing arrangements are 'principal-to-principal', meaning that cleared transactions consist of back-to-back transactions between a clearing customer and a clearing firm and between a clearing firm and a central counterparty. The corresponding transactions have the same effect as a guarantee where the clearing customer defaults but the arrangement does not constitute a guarantee in law.

We do not support the condition of Recommendation 32 point (c) that own funds requirements would be set on the basis of the highest total intra-day collateral posted to a clearing firm by a Class 2 investment firm. Such a proposal, if applied, would result in disproportionately large own funds requirements. We suggest that, if the Commission were to include this condition, own funds be calculated on the basis of average total intra-day collateral posted. We are broadly supportive of the conditions of Recommendation 32 points (d), (e) and (f).

We consider K_{NPR} and K_{DTF} inappropriate and unnecessary. A suitably-amended K_{CMG} would capture the credit risk, market risk, settlement risk and counterparty credit risk to which a Class 2 investment firm would be reasonably exposed. We suggest that own funds for positions resulting from transactions not cleared by a clearing firm could be calculated on the basis of a simplified formula derived from Part III CRR. We also suggest that the Commission consider a harmonised minimum requirement for operational risk for Class 2 investment firms. We believe that such a requirement could be set at a proportion of FOR. Although the K_{CMG} factor is a valid starting point, it should remain possible for investment firms to appropriately calculate their capital requirements by adequately modelling actual exposure beyond K_{CMG} (accounting of course for operational risk). If the Commission were to take the same approach as the EBA, we urge it to include provisions limiting the discretion of competent authorities to require substantially more own funds for operational risk. Moreover, the Commission's chosen approach must recognise the extensive regulatory requirements addressing operational risk to which firms are already subject and ensure that the prudential regulation is not duplicative.[6]

(c) Risk to Firm (**RtF**)

We note that the EBA has dispensed with the RtF "uplift factor" it proposed in its Discussion Paper. This is to be welcomed. However, we are concerned by what the EBA has proposed instead. Mindful that none of the 58 recommendations pertain to the proposal specifically, we are unclear as to the relevance of the proposed K-factor on "trading counterparty default" (**K_{TCD}**) which should be confirmed to be zero in case of transactions submitted to a clearing fim for clearing and/or settlement. If an investment firm were to attract such risks (e.g., where it self-clears), this factor may become relevant but should be calibrated appropriately. As noted above, the vast majority of transactions entered into by FIA EPTA members are cleared and settled by clearing firms. Clearing firms take on the counterparty credit risk of these transactions and will require collateral from the clearing customer in return. As such, we expect counterparty credit risk to be covered by an appropriately crafted and revised K_{CMG} calculation, rendering the application of such a K-factor redundant.

We also question the relevance of the proposed K-factor on "concentration risk" (**K_{CON}**). We are grateful to the EBA for acknowledging the drafting errors in Recommendation 44. However, nowhere in Recommendations 41-46 does the EBA explain why a variant of the Part IV CRR large exposures regime is appropriate and required for Class 2 investment firms generally.[7] We are sceptical that a variant of Part IV CRR requirements would address risks not already addressed by suitably-amended RtM K-factors. As above, where an investment firm does attract such risks where it e.g. 'self-clears', the factor may become relevant but should be calibrated appropriately .

We consider the RtF K-factors proposals to be lacking a policy objective. We suggest that the Commission ignores Recommendations 41-46.

(7) Liquidity requirements

We believe that the principal objective of a liquidity regime for non-systemic investment firms should be to ensure that such investment firms have sufficiently liquid funds to facilitate an orderly wind-down should they become insolvent. To that end, we support a liquidity regime that is both simple to understand and to implement. We recognise that the EBA has sought to devise such a regime and we are generally supportive of Recommendation 35.

However, we do not believe that such a liquidity regime should be restricted to the small number of assets deemed to be "high quality liquid assets" in Commission Delegated Regulation 2015/61.[8] We note that this list of assets, developed expressly and exclusively for credit institutions, classifies liquid equities as Level 2B assets, subject to a 50% haircut for liquidity requirements. We question the appropriateness of such an onerous haircut. PTFs will typically trade in liquid, listed instruments which can easily and quickly be converted into cash and these instruments should qualify in full without haircuts being applied.

(8) Pillar 2

We are concerned by the EBA's Recommendations 47 and 48. We recognise that competent authorities have a duty to maintain financial stability in respect of their jurisdiction and persons established in that jurisdiction that are subject to prudential requirements. We are aware of many examples of varying Pillar 2 discretions and we believe that investment firm-specific assessments by competent authorities have become so inconsistent as to hinder the efficient functioning of the internal market contrary to the legal basis of CRD IV and CRR.

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[6] i.e. Article 17 of Directive 2014/65/EU on markets in financial instruments (MiFID II) (15 May 2014) [link] and Commission Delegated Regulation (EU) 2017/589 supplementing Directive 2014/65/EU with regard to regulatory technical standards specifying the organisational requirements of investment firms engaged in algorithmic trading (19 July 2016) [link].

[7] We note that so-called "limited licence", "limited activity" and Commodities Dealer investment firms are all currently exempted from Part IV CRR requirements.

[8] Commission Delegated Regulation (EU) 2015/61 to supplement Regulation (EU) No 575/2013 with regard to liquidity coverage requirements for credit institutions (10 October 2014) [link].

We would ask the Commission to legislate on conditions, common standards and restrictions on Pillar 2 discretions for competent authorities. We are concerned that without conditions, common standards and restrictions the harmonised minimum regulatory capital requirements sought by the Commission will be ineffectual and the Commission's CMU objectives will be unrealised.

(9) Reporting, disclosure, governance and remuneration

We are broadly supportive of the EBA's Recommendations 50-57. We support the EBA's proposed "reporting framework", save for Recommendation 50 point (d) sub-section (v) in respect of concentration risk. We support Recommendation 51 on public disclosure. We support the EBA's Recommendations 52-55 in respect of Commodities Dealers, although we are sceptical of specific treatment for Commodities Dealers proposed in Recommendations 53-55.

We welcome the EBA's Recommendations 56 and 57 on governance and remuneration, although we believe that the EBA could have gone further in respect of the Article 94(1)(g) CRD IV limitation on variable remuneration (the so-called 'bonus cap'). We have consistently and will continue to oppose any such restriction on variable remuneration. The objective of this CRD IV provision is to curb the risk-taking culture in financial institutions that pose systemic risk. We do not believe the bonus cap provision to be remotely relevant to non-systemic investment firms, whether Class 2 or Class 3.

With regard to PTFs it should be noted that, unlike institutions which provide chargeable services to clients, principal trading firms do not have fixed revenue streams to balance an increased fixed cost base. The revenues of a PTF depend on their trading strategies and how these strategies fare across changing market conditions. As such, remuneration structures of PTFs generally include relatively low fixed remuneration (salary) with potentially high variable remuneration (bonus) that may or may not be paid depending on firm, team and/or individual performance. PTFs do not place client moneys or assets at risk. Also they do not compete for talent with credit institutions, but rather with unregulated technology companies which are not subject to any remuneration rules. Most critically, the discretionary nature of the payments means that PTFs are able to withhold payments and use these funds as a 'capital buffer' to strengthen their capital base in times of stress. Moreover, PTFs' performance-based remuneration policies serve as 'skin in the game' and promote prudent risk management amongst all employees. Variable remuneration structures thus promote risk awareness and prudent behaviour rather than increase risk.

We believe that the provisions on remuneration in the recast Directive 2014/65/EU on markets in financial instruments to be more than sufficient for Class 2 and Class 3 investment firms.[9] We encourage the Commission to exclude inappropriate restrictions on variable remuneration from the new legislative proposals.

Yours sincerely,

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[9] Articles 9, 23 and 24 of Directive 2014/65/EU on markets in financial instruments (MiFID II) (15 May 2014) [link] and Commission Delegated Regulation (EU) 2017/565 supplementing Directive 2014/65/EU as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (25 April 2016) [link].

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<tr><th colspan="3">FIA EPTA – Assessment of EBA preliminary recommendations for a prudential framework for investment firms</th></tr>
<tr><th colspan="2">Recommendation</th><th>Preliminary views</th></tr>
<tr><th colspan="3">Categorisation</th></tr>
<tr><td>1</td><td>This regime is appropriate for all MiFID investment firms.</td><td>Oppose
– Should exclude systemically important investment firms.</td></tr>
<tr><td>2</td><td>Recommendation for a new categorisation of MiFID investment firms distinguishing between:
a) large and systemic investment firms to which the full CRD/CRR requirements should be applied (Class 1);
b) other non-systemic investment firms, which activities and services combine but are not limited to asset management, advisory, trading on own account, executing orders on behalf of clients, transmission and reception of orders, holding client money and administrating and safeguarding client financial instruments, and above specific thresholds for the various activities and services should apply a more tailored prudential regime based on the activities/services risks – K-factor approach(Class 2); and
c) Small and non-interconnected investment firms extending some limited and non-combined services to which a very simple regime should be applied (Class 3).</td><td>Oppose
– All systemic investment firms should be Class 1. “Large” is not a relevant criteria.
– There is no risk based argument for automatically classifying proprietary trading firms as Class 2.
– The EBA has maintained the activity based exclusions to Class 3.</td></tr>
<tr><td>3</td><td>In line with the EBA Opinion on the identification of Class 1 firms of 19 October 2016 dedicated Level 2 regulation should be developed for the identification of systemic investment firms (Class 1) taking the specificities of IFs into account.</td><td>Support</td></tr>
<tr><td>4</td><td>It is recommended to develop a consolidated single rulebook, separate from the one applied to credit institutions, for all MiFID investment firms not falling in Class 1 based on the recommendations given in this Advice.</td><td>Support</td></tr>
<tr><td>5</td><td>All the investment firms that fulfil one or more of the following conditions should be excluded from Class 3:
a) AUM (for assets under management) + AUA (for assets under advice) combined is higher than EUR 1.2 bn;
b) NPR, DTF, TCD are higher than zero;</td><td>Oppose
– Class 2 and 3 investment firms should be distinguished on the basis of a common and objective measure i.e. quantitative threshold based on 3-month FOR.</td></tr>
</table>

	Recommendation	Preliminary views
	c) ASA (for assets safeguarded and administered) is higher than zero; d) COE (client orders executed) is higher than 500 order a day over a year; e) CMH (for client money held) is higher than zero; f) Balance sheet total is higher than EUR 100 million; g) Total gross revenues are higher than EUR 30 million. h) The thresholds under (a), (d), (f) and (g) should be applied on a combined basis for all investment firms that are part of the same group. The threshold under (b), (c) and (e) should be applied on a solo basis. i) The conditions above should be reviewed after 3 years after the implementation.	– The EBA has maintained the activity based exclusions to Class 3. – No basis for K_{DTF} or K_{TCD} K-factors. – Balance sheet gross revenue threshold inordinately low.
6	All the investment firms that are not included in Class 1 or Class 3 should be considered Class 2 investment firms.	**Support**
7	All the investment firms should meet the prudential requirements on an ongoing basis. Investment firms should be reclassified to Class 2 immediately if one of the categorisation thresholds is exceeded; however, a Class 2 firm should meet the criteria for being in Class 3 for at least 6 months before being re-categorised in that class.	**Oppose**
Consolidated Supervision		
8	For the consolidated supervision of investment firm-only groups the following should be considered: a) The group should not include any credit institutions or systemic investment firms (Class 1). b) The composition of entities that should be included within the scope of such a group should include all the prudentially regulated entities and should include tied agents where they are owned by the investment firm. c) The parent company should be subject to a group capital test that addresses situations of excessive leveraging risks and multiple gearing of capital. Such test can be developed based on the conditions required under Article 15 and 17 of the CRR for derogation from consolidated supervision and adjusted for the specificities of investment firms. d) Each investment firm in the group should have in place systems to monitor and control the sources of capital and funding of all regulated entities within the group; this should include the compliance with the liquidity requirements.	**Neutral** – Consolidation should be limited to persons established in EEA. – Agree that EEA consolidation should only extend to prudentially regulated EEA entities. – Consolidated EEA capital requirements should not exceed the sum of EEA requirements for each group undertaking subject to EEA prudential regulation.

FIA EPTA – Assessment of EBA preliminary recommendations for a prudential framework for investment firms		
Recommendation		**Preliminary views**
9	All investment firms part of a group containing a credit institution and/or systemic (Class 1) investment firm should be subject to: a) the new prudential regime for investment firms on a solo basis unless waived in accordance with a provision equivalent to Article 7 of the CRR and where such a waiver is only applicable to Class 3 firms; and b) all the CRR requirements on a consolidated basis, as part of any obligations for consolidated supervision that fall upon institutions subject to the CRR.	**Support**
10	An investment firm group subject to consolidated supervision should apply the capital requirements at consolidated level. However, liquidity requirements should be applicable at consolidated or sub-consolidated level subject to supervisory approval and the existence of centralised liquidity management functions. Concentration limits should apply at solo level.	**Neutral** – Do not support any concentration limits for Class 2 firms.
11	The new prudential regime should identify only one single composition of regulatory capital for all types of investment firms. The definition of the regulatory capital in the new prudential framework should be aligned to the one in the CRR for credit institutions, while the composition should be adapted to the new framework.	**Neutral** – Insufficient information on eligible capital.
Capital composition		
12	The following instruments should be eligible for meeting the regulatory capital requirements: a) CET1, Additional Tier 1 and Tier 2 instruments as defined in Articles 25 to 71 of the CRR; b) Additional Tier 1 is eligible up to one third (1/3) of CET1 capital. c) Tier 2 capital is eligible up to one third (1/3) of T1 capital.	**Neutral** – Broadly supportive, provided new regime is not more restrictive than current CRR regime.
13	The use of prudential filters should be aligned to the treatment suggested in the EBA Opinion EBA/Op/2014/05 where it is recommended not deviating from the prudential treatment which is currently applied at the international level under CRR rules (i.e., full deduction of own credit risk).	**Neutral**
14	Investment firms should always be required to deduct the items referred to in Articles 37 to 47 of the CRR, in particular intangible assets and deferred tax assets. Such deductions should always be applied in full and should not be subject to any of the thresholds currently applied in the CRR.	**Neutral** – Question the appropriateness of deductions relating to holdings in so-called "financial sector entities" as prescribed in Articles 44-47 CRR. Would advocate for the deletion of these provisions from the new regime.

Recommendation		Preliminary views
15	Taking into account that the legal form of MiFID investment firms is not prescribed under Union law, the new prudential regime may include a mechanism to recognise alternative legal forms of investment firms, such as limited liability partnerships (LLPs), partnerships, and sole-traders. It is also recommended introducing a mechanism similar to the one included in the CRR for the approval of CET1 capital. This mechanism should be designed to ensure that the forms of capital available to such non-joint stock companies provide equivalence to the general principles of permanence and loss absorbency required for capital instruments for joint stock companies.	**Support**
16	It is recommended that the definition of capital used for the purposes of meeting the minimum levels required as a condition for initial authorization of an IF under MiFID should be aligned with the definition of own funds for the purposes of meeting the on-going capital adequacy requirements of IFs (i.e., Permanent Minimum Capital, fixed overheads requirements and, where applicable, capital requirements under the K-factor formula).	**Support**
Capital requirements		
17	The new prudential regime for Class 2 and Class 3 investments firms should include provisions for the application of an Initial Capital Requirements (IC) for the authorisation phase, which could either include Level 2 legislation or rely on MIFID services. It should also require meeting the Permanent Minimum Capital (PMC) requirements and minimum levels of Fixed Overheads Requirement (FOR) on an ongoing basis. Both the PMC and the FOR should be set as a minimum to the capital requirements for all IFs.	**Support**
18	It is recommended setting the levels of Initial Capital (IC) for the authorization of an investment firm to: a) EUR 750 000 for firms that are authorised to provide the investment services and activities listed in points (3), (6), (8) and (9)of Section A of Annex I to Directive 2014/65/EU; b) EUR 75 000 for firms that are not permitted to hold money or securities belonging to their clients and which for that reason may not at any time place themselves in debt with those clients and are not authorised to provide the investment services and activities listed in points (3), (6), (8) and (9) of Section A of Annex I to Directive 2014/65/EU; c) EUR 150 000 all the other investment firms.	**Support**
19	It is recommended setting the levels of Permanent Minimum Capital (PMC) differentiating between classes:	**Support**

	Recommendation	Preliminary views
	a) EUR 5 million for investment firms that meet the conditions for being subject to full CRR requirements (Class 1 firms); b) Equals to the initial capital for all other firms.	
20	A transitional period should be envisaged to allow IFs that are currently subject to IC to afford the new level of Permanent Minimum Capital or of FOR requirements. Those investment firms should be required to comply with the requirements of Permanent Minimum Capital only after a transitional period of five years, increasing of a fixed amount each year.	**Support**
21	The FOR requirement should be set to at least one quarter of the fixed overheads of the previous year, calculated using the methodology in the Delegated Regulation 488/2015. The consistency of the current methodology for the calculation of FOR should be reviewed in light of the new prudential regime.	**Support**
22	Investment firms in Class 2 should be subject to a minimum Pillar 1 capital requirement equal to the higher of: a) the Permanent Minimum Capital (PMC) requirement; b) the Fixed Overheads requirement (FOR); a) the capital requirements determined by the K-factor formula, as set out below.	**Neutral**
23	Class 3 investment firms should be subject to a minimum Pillar 1 capital requirement equal to the higher of: a) the Permanent Minimum Capital (PMC) requirement; b) the Fixed Overheads Requirement (FOR).	**Support**
24	The total capital requirements for Class 2 investment firms should be based on the following elements: a) They should consider the potential risk that individual investment firms can pose to their customers (RtC); b) They should consider the potential impact an investment firm can have on the markets in which it operates, should the firm fail or otherwise need to exit that market, in particular where a failure or exit leads to a sudden and/or a temporary dislocation in market access or market liquidity or a loss of market confidence or market integrity (RtM). c) Any risk to the firm itself (RtF) shall be measured by the K-factor based on the simplified approach	**Oppose** – Varying interpretations of RtM. – Oppose revised RtF metrics.

<table>
<tr><th colspan="3">FIA EPTA – Assessment of EBA preliminary recommendations for a prudential framework for investment firms</th></tr>
<tr><th colspan="2">Recommendation</th><th>Preliminary views</th></tr>
<tr><td>25</td><td>The new prudential regime should include all the following elements:
a) Specific capital requirements for the Risk to Customers (RtC), Risk to Market (RtM) and Risk to Firm (RtF), based on appropriate proxies (K-factors);
b) The formula for the calculation of the capital requirements that takes into consideration all those elements.
c) The following formula is recommended: K-factors Capital Requirements = RtC + RtM + RtF</td><td>Oppose
– As currently drafted, the K-factors and proposed formula would result in substantially higher capital requirements for Class 2 firms than the current regime.
– Welcome the EBA’s departure from its proposed RtF uplift factor.</td></tr>
<tr><td>26</td><td>For the calculation of RtC, the new prudential regime should specify all the relevant factors and their calculation:
a) The factors that are relevant to capture the risk to customers (K-factors for RtC) and their respective metrics are the following:
i. K-AUM: amount of assets under management;
ii. K-CMH: amount of client money held;
iii. K-ASA: amount of assets safeguarded and administered;
iv. K-GIA: income from giving investment advice other than on assets covered by management agreement;
v. K-COE: number of customer orders executed (value of transactions of execution-only in name of client). For cash trades value means the absolute gross settlement and for derivatives value means notional amount of trades executed.</td><td>Oppose
– The K-$_{COE}$ is not risk sensitive.
– Lack of clarity as to the treatment of bilaterally-executed transactions with eligible counterparties and professional clients. Such transactions should be addressed by a revised K$_{CMG}$.</td></tr>
<tr><td>27</td><td>It is recommended calculating the capital requirement corresponding to RtC using the following formula: RtC = Sum ai * Ki, where Ki are the K-factors above and the coefficients ai are specified within the ranges provided in the following table:
<table>
<tr><th>K-Factor</th><th>Coefficient</th></tr>
<tr><td>K-AUM</td><td>0.02%</td></tr>
<tr><td>K-CMH</td><td>0.45%</td></tr>
<tr><td>K-ASA</td><td>0.04%</td></tr>
<tr><td>K-GIA</td><td>16.34%</td></tr>
<tr><td>K-COE/ K-DTF cash trades</td><td>1.50%</td></tr>
<tr><td>K-COE/ K-DTF derivative trades</td><td>0.06%</td></tr>
</table></td><td>Oppose
– Query the inordinately high coefficients for cash trades and derivative trades. Such punitive coefficients could be to the detriment of the CMU objectives.</td></tr>
</table>

FIA EPTA – Assessment of EBA preliminary recommendations for a prudential framework for investment firms		
Recommendation		**Preliminary views**
28	For K-CMH (client money held) it is recommended that a harmonised definition is given making unequivocally clear that the K-CMH factor applies to investment firms that have control of money belonging to clients, regardless of the legal arrangements on asset segregation and irrespective of the accountancy treatment under national law of client money held by an IF.	**Neutral**
29	For advisory firms, it is recommended that the K-AUA factor for assets under advice not covered by management agreements is replaced by the K-GIA factor for giving investment advice. The calculation of K-GIA should be based on the income generated from giving investment advice (MiFID II service A5), i.e. disregarding other advisory services that are not regulated by MiFID II, such that K-GIA will only apply to very large advisory firms, that are allocated to Class 2.	**Neutral**
30	For the calculation of the capital requirements for RtM, the new prudential regime should specify all the relevant factors and their calculation. It is recommended to calculate the RtM as the higher of: a) K-NPR: an RtM requirement for net position risk for investment firms, calculated on (net open) positions end-of-day, measured on the basis of the FRTB methodology and; b) K-DTF: a daily trading flow (value of transactions where the firm is dealing in their own name) requirement in order to capture those IFs whose dealing activity creates a big footprint in the market, but does not lead to material market risk requirements, measured on the basis of the same methodology and calibration used for the RtC of K-COE. c) For cash trades 'value' means the absolute gross settlement and for derivatives 'value' means notional amount of trades either averaged or the highest reached over a period of time.	**Oppose** – Non-systemic investment firms should not be subject to regulatory capital provisions derived from the FRTB methodology. – Questions remain as to how to calculate K-factors. – Generally oppose K_{DTF} as a factor. The market risk of firms without significant end-of-day positions would be better addressed under a revised K-factor based on clearing firm collateral models. – We oppose the calculation of OFR for derivative positions based on the notional value of the derivative contract. OFR calculations should be based on the value-at-risk of an investment firm's positions and should permit offsetting according to market practice.
31	Specific characteristics of the investment firms may justify the introduction of some adjustment in the calculation of K-NPR, such as removing the relative thresholds for using the Simplified Standardized Approach.	**Support** – Generally support Simplified Standardized Approach but oppose K_{NPR} as a concept.
32	Conditional to supervisory approval and subject to a number of strict conditions, RtM can (alternatively to Rec 30) be set as max(K-NPR, K-CMG) (for clearing member guaranteed). The metric for K-CMG would be the highest total intra-day haircut or margin posted at the clearing member in a previous period (covering at least the preceding 12 months). At least the following conditions should apply:	**Oppose** – Generally supportive of the proposed $K_{-CMG.}$

	Recommendation	Preliminary views
	a) The trading firm exclusively deals on own account (MiFID II activity A3) and has no external customers; b) All execution and settlement transactions take place under the responsibility of a (general) clearing member and are either guaranteed by that clearing member or settled on a delivery-versus-payment basis; c) The capital requirements for position risk are calculated as the highest total intra-day margin ('haircut') posted at the clearing member in a previous period (e.g. the past year); d) The trading firm is outside the scope of prudential consolidation of a banking group (i.e. the IF is not part of a banking group); e) The calculation of the intra-day haircut or margin is based on an internal model that is assessed and approved by a competent authority; f) The (general) clearing member that guarantees the execution and settlement transactions is subject to full CRD and CRR. (or – if relevant – supervisory and regulatory arrangements of a third country that are at least equivalent).	– Concerned by the interaction between K_{-NPR} and K_{-CMG}. K_{-CMG} will never be used if need to use the higher of the two K-factors. – Condition (a) is inappropriate and without justification. – Condition (c) would result in disproportionately high OFR. Instead OFR should be calculated on the basis of average intra-day margin posted. – The use of terminology on clearing is imprecise. In particular, we would caution the use of the term "guaranteed".
Liquidity requirements		
33	The application of liquidity requirements of the Delegated Act EU 2015/61 on LCR should be extended to all Class 1 investment firms; however the scope could be subject to adjustments in outflow rates. This recommendation should not be intended applying to the NSFR as well, because the design of the NSFR requirements is still under development and, at this juncture, it is not possible to conclude whether it is suitable for Class 1 investment firms or not.	**Neutral**
34	Class 2 and Class 3 investment firms should have internal rules and procedures that allow them to monitor, measure and manage exposures and liquidity needs to ensure the adequacy of liquidity resources. Furthermore, Class 2 firms should be subject to additional liquidity reporting requirements.	**Support**
35	Class 2 and Class 3 investment firms should be required to hold an amount of liquid assets for an amount equal to one third of the FOR requirements (i.e. equal to funding 1 month worth of Fixed Overheads).	**Support**
36	The liquid assets eligible to meet the liquidity requirements under the new prudential regime for investment firms should be aligned with the list of high quality liquid assets (HQLA) of Level 1, 2A and 2B assets as set out in the Delegated Act on LCR,2 supplemented with unencumbered own cash of the firm (which cannot include any client money). There should be no limit to the type of liquid assets to be held to meet the minimum liquidity requirements.	**Neutral** – The liquidity regime should not be restricted to the small number of assets deemed to be "high quality

	Recommendation	Preliminary views
		liquid assets" in Commission Delegated Regulation 2015/61. – This list of assets, developed expressly and exclusively for credit institutions, classifies liquid equities as Level 2B assets, subject to a 50% haircut for liquidity requirements. We question the appropriateness of such an onerous haircut.
37	Haircuts should be applied to the market value of assets held by the investment firms for the purposes of meeting the minimum liquidity requirements. The level of haircuts should be aligned with the one prescribed in the Delegated Act on LCR. Unencumbered own cash of the firm should receive a 0% haircut.	**Support**
38	The level of liquidity requirements should be adjusted by deducting form the amount of liquid assets held, the 1.6 percent of the total amount of guarantees provided to customers.	**Neutral** – Recommendation does not appear to make sense.
39	For Class 3 firms, trade debtors and fees or commissions receivable within 30 days should be allowed to meet the minimum liquidity requirements, conditional to the following conditions: a) They may account to up to a one third of the minimum liquidity requirements; b) They should not be allowed to meet any of the liquidity requirements above the level set at 1 month of FOR, such as additional liquidity requirements requested on a firm-specific basis (Pillar 2); c) They should be subject to a haircut of 50%.	**Support**
40	During exceptional and unexpected circumstances, investment firms may monetarise their liquid assets to cover liquidity needs, even if such a use of liquid assets may result in the amount of liquid assets held falling below the minimum liquidity requirements. In such cases, investment firms should notify their competent authority immediately.	**Support**
Concentration risk		
41	The new prudential framework for investment firms should require all investment firms to monitor, identify and manage any concentration risk, including in respect of RtC.	**Oppose** – We do not see the relevance of K_{CON}. We are sceptical that a variant of Part IV CRR

<table>
<tr><th colspan="2">Recommendation</th><th>Preliminary views</th></tr>
<tr><td></td><td></td><td>requirements would address risks already addressed by suitably-amended RtM K-factors.
– Recommendations 41-46 should not be taken into account by the Commission.</td></tr>
<tr><td>42</td><td>It is recommended that Class 2 investment firms report to competent authorities on concentration risk, and in particular (where applicable) on:
a) concentration risk associated with the default of counterparties for trading exposures, both on an individual counterparty and aggregate basis;
b) where client money is held;
c) where client securities are deposited;
d) the firm’s own cash at bank; and
e) concentration risk from earnings.</td><td>Oppose</td></tr>
<tr><td>43</td><td>Class 3 firms should not be subject to reporting requirements on concentration risk.</td><td>Neutral</td></tr>
<tr><td>44</td><td>Class 2 firms with positive K-NPR, K-DTF should be subject to the following requirements:
a) Maximum exposure should be set to a limit equals to 10 percent of the regulatory capital;
b) The measurement of the exposure values should be the value used by the IF for the purposes of calculating market and counterparty credit risk.
c) Concentration risk multipliers of the capital requirements for an individual exposure that should be set in line with what is prescribed for banks for the treatment of Large Exposures in the trading book.</td><td>Oppose
– EBA has acknowledged the drafting mistakes in this recommendation. The maximum exposure should not be limited to 10% of regulatory capital.
– Counterparty credit risk should be covered by an appropriately crafted and revised K_{CMG} calculation.</td></tr>
<tr><td>45</td><td>Where applicable, the exemptions from concentration limits should be aligned with the exemptions of the CRR large exposures regime.</td><td>Neutral</td></tr>
<tr><td colspan="3">Additional requirements on an individual firm basis – Pillar 2</td></tr>
<tr><td>46</td><td>A harmonised process for the individual assessment of concentration risk of investment firms within the framework of the supervisory review and evaluation process (Pillar 2) should be ensured via Level 2 regulation.</td><td>Oppose
– Would urge the Commission to legislate on conditions, common standards and restrictions on</td></tr>
</table>

	Recommendation	Preliminary views
		Pillar 2 discretions for competent authorities to ensure coherence and consistency in application.
47	Recommendation for a requirement for investment firms to also be responsible for assessing the adequacy of the new minimum requirements to their own risk situation and for CAs to undertake individual firm-specific assessments (i.e. a proportionate Pillar 2 tool for investment firms). Recommendation to provide CAs with appropriate supervisory powers and possibility to take actions, notably the possibility to increase capital and liquidity requirements and limit concentration risk	**Oppose**
48	Recommendation to pursue harmonization via Level 2 instruments addressed to CAs for the individual assessment of investment firms, which are sufficiently flexible and proportionate (and potentially for Class 2 investment firms only, but with CAs having the option to apply to some or all Class 3 investment firms as deemed appropriate).	**Oppose**
Reporting		
49	The new prudential framework for investment firms should include a simplified reporting framework for Class 2 and Class 3 investment firms. Class 1 investment firms should be subject to the requirements of the CRD/CRR.	**Support**
50	The new reporting framework for Class 2 and Class 3 investment firms should be based on the following elements: a) It should be addressed to all the investment firms without any exemption for any type of firm or business model; b) All investment firms should report the key attributes highlighted in this Advice, e.g. solvency and K-factors, and on all the parameters needed for the firm's categorisation; c) The reporting requirements should be proportional to size and complexity of the firm; d) Class 2 firms should be required to report more granular information than Class 3 firms, including: i. Solvency; ii. Capital composition; iii. Capital requirement calculations; iv. Liquidity requirements; v. Concentration risk;	**Support** – Generally supportive, save for Recommendation 50 point (d)(v) in respect of concentration risk.

	Recommendation	Preliminary views
	vi. Additional requirements for specific business models.	
51	It is recommended to reduce the disclosure requirements (Pillar III) to the strict minimum. In particular: a) Class 3 firms should have no disclosure requirements; b) Class 2 firms should have disclosure requirements limited to the level of capital requirements and the solvency ratio.	**Support**
Commodity derivative firms		
52	Commodity derivative firms in the scope of MiFID 2 should be in the scope of the new prudential framework.	**Neutral**
53	The new prudential regime should be tailored to the specificities of commodity derivative firms trading in specific markets or to specific aspects of their accounting practices.	**Neutral**
54	A transitional regime or phase-in period for the introduction of the new prudential regime should be envisaged considering that the scope of the commodities firms may be unclear for a while and that the prudential regime is new for a number of firms.	**Neutral**
55	The new prudential regime should include criteria that would allow the exemption form the prudential requirements of positions that are objectively measurable as reducing risks directly related to commercial activities (positions for hedging purposes).	**Neutral**
Remuneration and governance		
56	In the context of governance the following recommendation should be considered: a) No changes to the provisions within Article 109 CRD are recommended in the context of this review, independent of the category of investment firms involved. b) The governance requirements set out in CRD should fully apply to Class 1 firms, while a lighter governance framework should be applied to Class 2 and Class 3 firms. c) It is not considered necessary to apply Art 74 CRD to Class 2 and Class 3 investment firms, as MiFID's governance requirements are deemed to sufficient to ensure robust governance arrangements.	**Neutral** – Support the lighter governance framework. – Oppose Article 83 CRD IV related requirements.

	Recommendation	Preliminary views
	d) Additional risk management requirements as developed in Article 76 (1) CRD and the requirement to commit sufficient time for risk management within Article 76 (2) CRD should be applied to Class 2 firms that are authorised to hold clients assets. e) The investment firms that deal on own account and are at the same time allowed to hold client assets should be subject to the provisions within Article 83 on market risks. f) Article 85 CRD should be applied to Class 2 firms and competent authorities supervising them. g) The application of Article 89 CRD (country by country reporting) is recommended for Class 2 firms only.	
57	In the context of remuneration the following elements should be considered: a) Class 1 investment firms should fully remain under the remuneration framework set out within CRD. b) The new remuneration framework should differentiate between Class 2 and Class 3 firms and not between different business activities. c) Class 3 firms should only be subject to the remuneration provisions of MiFID, no additional requirements are deemed necessary. d) The remuneration requirements for Class 2 firms should be similar to Articles 92 and 94 CRD and apply to the staff that has a material impact on the firms risk profile. Class 2 firms should still be subject to MiFID remuneration provisions for sales staff. The pay out in instruments requirement in Article 94 (1)(l) CRD should only be applied to Class 2 firms that are regularly involved in the issuing of instruments and to listed companies. e) The European Commission should carefully consider the advantages and disadvantages of a restriction of the variable remuneration encoded in Article 94 (1)(g)(i)and (ii), when proposing a legal framework for Class 2 firms.	**Neutral** – Greater ambition needed in respect of Article 94(1)(g) CRD IV on variable remuneration. We do not consider provisions on variable remuneration to be remotely relevant for non-systemic investment firms, whether Class 2 or Class 3.
Review		
58	It is recommended that a legislative proposal for a new prudential framework for Class 2 and Class 3 investment firms contains a review clause, e.g. three years after the date of application of this new regime, based on a monitoring report.	**Support**