Response by the
FIA European Principal Traders Association (FIA EPTA)
to the FCA Discussion Paper on a new UK prudential regime for MiFID investment firms

17 September 2020

FCA DP20/2

Contents

1. Executive summary

1.1. The FIA European Principal Traders Association (FIA EPTA) appreciates the opportunity to provide feedback to the Financial Conduct Authority (FCA) on its Discussion Paper regarding the implementation of the new UK prudential regime for MiFID investment firms.

1.2. FIA EPTA represents 29 independent European Principal Trading Firms (PTFs) which deal on own account, using their own money for their own risk, to provide liquidity and immediate risk-transfer in exchange-traded and centrally-cleared markets for a wide range of financial instruments, including shares, options, futures, bonds and ETFs. Our members are independent market makers and providers of liquidity and risk transfer for exchanges and end-investors across Europe, including the UK. FIA EPTA's members are based in the Czech Republic, Germany, Ireland, The Netherlands and the UK (~70% of our members having been licensed by the FCA).

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

1.4. As such, we have consistently welcomed the new prudential regime for investment firms contained in the EU Investment Firm Regulation and Directive (IFR/IFD), which is aimed at creating a tailored and proportionate prudential framework for firms such as those we represent. In line with this, we have consistently argued for a robust, fair and proportionate prudential regime to be applied to our members. Therefore, our members strongly welcome the Government's intention, as communicated by HM Treasury, to introduce a new prudential regime for investment firms in the UK by means of the Investment Firms Prudential Regime (IFPR).

1.5. This document constitutes FIA EPTA's consolidated response to the FCA's discussion paper on a new UK prudential regime for MiFID investment firms. In our response we focus on a number of key areas where we believe the FCA should consider our feedback to enable a proportionate, effective and practicable prudential regime for investment firms, in line with the original intent of the Investment Firm Review. For ease of reference we have summarised these points below. Further data and evidence are provided in our extended response.

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

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K-NPR and K-CMG

- We propose an approach to make internal models an effective and workable approach, that can be available for any investment firm that wishes to make use of it
- We believe the scope of K-CMG should be expanded to also allow direct and indirect clearing and the use of third-country clearing members and CCPs.
- We support the FCA's proposal for the alignment between portfolios and trading desks.
- We propose a definition of total margin required.
- In the case of multiple clearing members, we agree the use of 'third highest' should be based on the same day only.
- We provide views and ask for clarity on the approval process for approval of K-CMG and prevention of arbitrage.

K-DTF

- We support the treatment for notional value of derivatives and ETDs as 'cash trades', including the use of the premium for the calculation of DTF.
- However, we have concerns, of which we would like to make the FCA aware, regarding the adjustment for 'exceptional circumstances' only, as proposed by the EBA. We therefore propose to the FCA to consider instead the concept of 'stressed market conditions' and suggest two alternative approaches; a statistical method and one based on MiFID II Level 2 practice.

Prudential consolidation

- We have concerns regarding the extra-territorial application of prudential consolidation.

Fixed Overheads Requirement (FOR)

- We believe the FCA should consider several clarifications and amendments which would need to be done, when considering the draft EBA regulatory technical standards, in order to make the rules workable in practice. Specifically, we urge the FCA to consider the following:
    - Clarity regarding the basis of calculation;
    - Inclusion of a full list of deductions;
    - Ability to deduct staff bonuses to be linked to 'net profits';
    - Ability to deduct fees only where they are passed on and charged to customers;
    - That expenses related to items already deducted from own funds to be deducted from total expenses.

- Finally, we would like to make the FCA aware of our concerns regarding the fixed amount threshold, proposed in the EBA's draft regulatory technical standards, to determine a material change in an investment firm's business activity.

Risk management, governance and review process

- We ask for clarity on the scope and level of application of the ICARA process, especially in case of prudential consolidation.
- We believe that, for the purpose of a proportionate implementation, the FCA should keep in place current waivers, specifically on governance arrangements.
- To ensure proportionality, we believe the FCA should consider providing additional guidance of its expectations regarding risk committee composition which would allow for it to be made up of a mix of executive and non-executive members of the management body.
- We ask the FCA to provide further clarity on how it plans to set specific liquidity requirements and what is the proposed liquidity monitoring that will be in place.
- We believe the FCA should consider a more appropriate approach to the transition from existing IFPRU/BIPRU ICG and we provide alternative approaches.

Remuneration

- Instead of implementing the new remuneration rules mid-way through the year we suggest aligning the implementation with an investment firm's year-end.
- We provide views on how proportionality should apply regarding different matters.
- We propose a definition for the prudential definition of 'total value of assets' based on the Leverage Ratio calculation in CRR.

Regulatory reporting requirements

- We ask the FCA to collaborate with EU national competent authorities and the EBA, to achieve a reporting framework that is proportionate and at the same time as consistent as possible across both the UK and EU member states.

2. K-NPR and K-CMG

Chapter 6 – K-factor requirements

K-NPR and K-CMG – Paragraphs 6.54 to 6.74

Internal model for the purpose of calculating K-NPR – (paragraph 6.65)

2.1. FIA EPTA members note that the FCA states that any UK investment firm that may be considering an internal model for the purposes of calculating K-NPR under any UK domestic rules for this should approach the FCA at an early stage to discuss the process for gaining regulatory approval.

2.2. As is currently set out in the FCA handbook (IFPRU 6.3), based on EU CRR requirements, an Investment Firm that wishes to use internal models for the calculation of market risk has to meet certain conditions. The FCA handbook also includes a requirement for competent authorities to verify compliance with the conditions. These general provisions are specifically stated in:

> **IFPRU 6.3.1** – Article 363 of the EU CRR (Permission to use internal models) states that permission for an institution to use internal models to calculate own funds requirements is subject to competent authorities verifying compliance with:
>
> (1) the general requirements;
>
> (2) requirements particular to specific risk modelling; and
>
> (3) requirements for an internal model for incremental default and migration risk.
>
> **IFPRU 6.3.2** – This section describes some of the standards that the *FCA* expects to be met for it to consider that a *firm* is compliant with the requirements in *IFPRU 6.3.1 G*.

2.3. It is FIA EPTA members' understanding that, under the new UK prudential regime for MiFID investment firms, if a large number of firms decide to apply for a permission to use internal models for the calculation of K-NPR, this may cause a strain on FCA's resources, limiting the ability for investment firms to make use of internal models for the calculation of K-NPR.

2.4. We believe that, in order to make internal models an effective and workable approach, that can be available for any investment firm that wishes to make use of it, subject to the general conditions, the FCA should consider providing the option for an external verification that should provide a degree of comfort regarding compliance with the conditions above. This would be similar to how the FCA relies on interim profit verification for the inclusion of these in a firm's own funds. This approach would also have the benefit of allowing the FCA to put in place a less burdensome process, for approval of permissions or waivers regarding the use of internal models for the calculation of K-NPR, reducing the impact on the FCA's resources.

2.5. The current IFPRU and EU CRR requirements represent a large burden for investment firms both to obtain and then also maintain internal model approval. FIA EPTA members support sharing this burden with other investment firms by working with a third-party platform that specialises in VAR model calculations and can complete some of the necessary model documentation and model validation requirements. This could then be refined by each investment firm to meet its particular trading strategy and product set. Together with external verification, this could streamline process from both perspective of FCA as well as investment firms seeking to use this approach.

2.6. FIA EPTA members would, therefore, ask the FCA to consider putting in place a list of third-parties which are known to be able to provide systems that allow for the use of internal models for the calculation of K-NPR.

2.7. FIA EPTA members would further suggest to the FCA, when developing the UK domestic requirements, to consider introducing a rule providing the option, as part of the process to apply for a permission or waiver to use internal models to calculate K-NPR, for investment firms to have an external verification of its model and compliance with:

1) the general requirements;
2) requirements particular to specific risk modelling; and
3) requirements for an internal model for incremental default and migration risk, if applicable.

Portfolios and trading desks – (paragraph 6.61)

"Question 9 – Do you have any comments on the use of K-CMG 'on a portfolio basis'? (See paragraph 6.61)"

2.8. FIA EPTA members support both the alignment of portfolios with trading desks and the definition of 'trading desk' itself mentioned by the FCA in DP20/2. The concept of trading desks is aligned with how firms operate in practice and is consistent with other regulations, among other with the CRR2 amendments. In this regard, FIA EPTA members note that this would allow investment firms to define trading desks depending on their business models and would cover the diversity of their trading strategies. As such, and to ensure uniform interpretation, FIA EPTA members would encourage the FCA to clarify the concept of trading desk further in its guidelines, along the lines set out in paragraph 2.9 below.

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

Calculation of the amount of the total margin required – (paragraph 6.68)

2.10. FIA EPTA members note that the EBA further specified what is meant by 'total margin' within its proposed EU Regulatory Technical Standard (RTS). Article 2(1) of the draft delegated regulation proposes that the amount of the total margin required to be calculated as follows:

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

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

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

b. *Reference to collateral account* – it should be noted that firms may have more than one collateral account, which may include financial and non-financial collateral. Given that, as currently proposed, the draft definition is not aligned with common market practice, <u>we would therefore suggest making no reference to either a 'collateral account' or to 'financial collateral'</u>.

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

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

total margin required include a reference to 'exposures resulting from change in the market value of net positions'.

2.12. Based on the above comments, we would suggest the FCA to consider the following definition of 'total margin' when developing the UK domestic rules:

> ***"The amount of the total margin shall be the amount of collateral required by the clearing member's margin model, to cover for current and potential future exposures resulting from change in market price of net positions, for the trading desks subject to CMG."***

Method of calculation of K-CMG in case of multiple clearing members – (paragraph 6.69)

2.13. FIA EPTA members agree with the FCA's view that, where an investment firm uses multiple clearing members, it would be more consistent with the overall concept of clearing margin given for an investment firm to first add up, across all clearing members used, the margins for each day.

2.14. FIA EPTA members would not support an approach of first determining the third highest amount by each clearing member separately and then adding those amounts. It is our view that this would not reflect how the underlying risk is managed in practice by firms and would therefore be overly conservative. In addition, the proposed calculation of K-CMG already includes a high degree of prudence that does not need to be further increased. In this regard we would like to offer the following observations:

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

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

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

d. *Inconsistent outcomes* – determining the third highest amount by each clearing member separately and then adding those amounts, may lead to inconsistent outcomes between different investment firms where firm A uses one clearing member and firm B uses more than one clearing member. For example, even in the case that risks are the same in two investment firms, an investment firm that uses only one clearing member will have lower capital requirements than the one that uses more than one clearing member, for no other reason other than the way margin requirements are added up across multiple clearing members.

e. *Concentration risk* – the sum of the third highest amounts of margin given to each clearer would incentivise investment firms to use only one clearing firm, which may lead to further concentration of client clearing activity in a more limited number clearing members or CCPs, without any underlying economic rationale. This in turn would increase the risk to the firm, in case of a clearing member's failure, and the risk to financial stability.

Scope of K-CMG (paragraph 6.71)

2.15. FIA EPTA members are conscious of the apparent discrepancy between the definition of 'clearing margin given' or 'CMG' and the operative provisions in paragraph 1 of Article 23 of the IFR. If a narrow view is taken, the combination of the definition of 'clearing member' in Article 4(1)(3) of the IFR and Article 23 of the IFR, limits the use of K-CMG to investment firms where they are direct clients of a UK clearing member. However, it should be noted that alternatively, EU investment firms can also be clients of direct clients of UK and third-country clearing members (i.e. *indirect clients*), or even direct members of a CCP (i.e. *clearing members*). In such circumstances, all these would not benefit from the use of K-CMG, even if the models used to set margin requirements are set at an appropriate level of prudence and meet all conditions in paragraph 1 of Article 23 of the IFR. If such a narrow approach were to be mirrored in UK domestic rules, this would similarly complicate the use of non-UK (client) clearing services.

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

Periodic assessment – (paragraph 6.72)

2.17. FIA EPTA members agree with the FCA's expectation that in introducing a margin method in the UK to incorporate the reviews, to ensure the model continues to meet the risk characteristics of an investment firm's portfolio, into the FCA's regular supervisory assessments (as set out in the sections on Risk review in Chapter 11).

2.18. FIA EPTA members would not support the introduction of specific thresholds or events that should trigger the comparison between the calculation under the K-CMG compared to the one under the K-NPR.

Initial assessment – (paragraph 6.73)

2.19. FIA EPTA members support the FCA's proposal that for the FCA to permit an investment firm the use of a margin method such as K-CMG in the UK, an investment firm would be required to:

a. justify that its use is not driven by interests to arbitrage capital requirements

b. justify that, based on its business model, that the relevant portfolio is traded under the responsibility of a clearing member

c. demonstrate that the trading book and trading strategy applied fits more appropriately with use of a margin method in rules that reflect K-CMG, rather than applying the market risk rules of on-shored CRR through rules that reflect K-NPR.

2.20. FIA EPTA members understand the information required would likely include a detailed comparison of the own funds requirements calculated according to the rules for the two alternative K-factors, K-NPR and K-CMG.

2.21. We would like to bring to the FCA's attention our view that its Guidelines should reflect that certain trading strategies are expected to give rise to an inherently large difference between K-NPR and K-CMG, due to the nature of how standardised approaches to market risk in CRR interact with the structural characteristics of certain financial instruments, for example, the enhanced maturity ladder for general interest rate risk in the case of short term interest rates (e.g., for STIR exchange traded derivatives (ETDs).

2.22. However, we consider that such a difference should not in itself prevent the use of K-CMG as a more appropriate methodology to capture risk to market. The more so, as the margin models of clearing members are regarded as prudentially sound. These have undergone extensive testing to ensure their efficacy and accuracy and they are subject to stringent governance criteria. Therefore, we would propose to the FCA, when developing the UK domestic rules, to include guidance as follows:

> ***"some trading strategies are expected to give rise to a large difference between K-NPR and K-CMG. A difference between K-NPR and CMG, even if large, should not be sufficient to prevent the use of K-CMG provided that K-CMG meets the conditions of approval and is assessed by the FCA as prudentially sound"***

Prevention of arbitrage – (paragraph 6.74)

2.23. FIA EPTA members fully support the prevention of regulatory arbitrage which can undermine the stability of the financial market, and we support the introduction of a commitment period once an investment firm begins using rules that reflect K-CMG. However, FIA EPTA members do not support this to be a period of 2 years.

2.24. FIA EPTA members note that investment firms will have to conduct an annual assessment of their capital adequacy and risks. We believe that an approach to preventing arbitrage would be more appropriate if aligned with this risk assessment requirement. As such, we propose that the period of '2 years' is replaced by a period of '1 year'.

3. K-DTF

Chapter 6 – K-factor requirements

K-DTF – Paragraphs 6.46 to 6.53

Exchange traded options – (paragraphs 6.49 and 6.50)

3.1. FIA EPTA members agree with the FCA that a 'cash trade' should include transactions where purchase and settlement of the instrument takes place on the same trading day, or in line with a market standard settlement or delivery date (or earlier). We agree this to include transactions covering transferable securities, money-market instruments, units in a collective investment scheme or exchange traded options.

3.2. We support, therefore, the proposal that the value should be regarded as the total amount paid or received for each trade, which for exchange traded options may be taken as the premium.

Notional value of derivatives – (paragraph 6.51)

"Question 8 – Do you agree with our views on how to calculate the notional value for derivatives for DTF and COH? (See paragraph 6.51)"

3.3. FIA EPTA members agree with the FCA's views on how to calculate notional value of derivatives for K-DTF and K-COH.

Stressed market conditions

3.4. FIA EPTA members note that pursuant to paragraph 5 of Article 15 of IFR, the EBA was tasked with developing draft RTS to specify when the K-DTF coefficient should be adjusted in the event of 'situations of market stress'. We note that the FCA does not cover this in DP20/2.

3.5. We note further that the current EBA proposal references 'exceptional circumstances', which constitute a more narrow concept. By contrast, FIA EPTA members are strongly of the view that returning to a broader concept of situations of 'market stress' would be more aligned with objectives stated in the IFR primary legislation.

3.6. FIA EPTA members consider that there are several examples of situations of market stress and are concerned that, a coefficient adjustment only when there are 'exceptional circumstances', would have a very limited or no impact at all.

3.7. Empirical feedback from trading venues confirms that exceptional circumstances almost never occur, or only very rarely for extremely limited periods of time, perhaps just a few minutes. It should be noted that even the extreme market volatility during the depth of the COVID-19 crisis in March 2020 did not change this picture. In addition, when exceptional circumstances are called under MiFID II, this is specifically designed to relieve investment firms of their obligation to provide liquidity on a regular and predictable basis (i.e., to not trade), which means that adjusting only for 'exceptional circumstances' does not achieve the objective of incentivising liquidity in the markets.

3.8. FIA EPTA members would strongly recommend, therefore, to the FCA, when developing the UK domestic rules, to consider an approach based on the concept of 'stressed market conditions'.

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

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

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

3.12. Our suggested solutions are as follows:

Statistical method

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

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

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

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

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then consider the resumption of trading after volatility interruptions as stressed market conditions.

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

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

Cadj = C * (DTFexcl / DTFincl)

Where:

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

DTFincl = the DTF of derivatives measured in accordance with Article 33 of Regulation (EU) 2019/2033, including the value of any trade that occurs during periods of stressed market conditions.

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

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

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

Period of stressed market conditions

Periods of stressed market conditions shall be determined as the trading days where historic volatility is in the highest 10% of the last 3 years for a given market and product.

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

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

3.24. Option 2 – historical volume:

Period of stressed market conditions

Periods of stressed market conditions shall be determined as the trading days where market volume for that day was in the highest 10% of the last 3 years for a given market and product.

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

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

MiFID II definition

3.27. 'Stressed market circumstances' is a concept used in MiFID II RTS 8. This definition may even allow for it to be applicable more generally rather than only UK and EU trading venues.

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

3.29. This approach can be implemented as follows:

Cadj = C * (DTFexcl / DTFincl)

Where:

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

DTFincl = the DTF of derivatives measured in accordance with Article 33 of Regulation (EU) 2019/2033, including the value of any cash trade that occurs during periods of stressed market conditions.

3.30. Include the definition of ‘period of stressed market conditions’, as follows:

Period of stressed market conditions

Periods of stressed market conditions shall be those situations referred to in paragraph 2 Article 6 of Commission Delegated Regulation (EU) 2017/578. For instruments where a volatility interruption occurs 100% of the trading hours on that day shall be considered stressed market conditions.”

<u>*Additional prudence*</u>

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

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

<u>Treatment of ‘cash trades’ in bonds – (paragraph 6.50)</u>

3.30 FIA EPTA members would like to note that there is a discrepancy in the treatment of cash trades in bonds, when compared to bond futures. This is because the bond futures would have their notional amount adjusted for the time to maturity of those contracts, as described in paragraph 6.50 of the DP20/2, while the cash bonds would be included in the calculation of K-DTF by the amount paid or received. In addition, we would reiterate that market makers and liquidity providers, who as firms dealing on own account will be subject to K-DTF, play an important role in improving market quality and lowering execution and risk management costs for retail and institutional end-investors in government bonds, which also benefit the liquidity of UK sovereign debt issuance.

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

3.32 Therefore, FIA EPTA members would ask the FCA, when developing the UK domestic rules, <u>to include an additional provision specifying that the amount paid or received for trades in government bonds, which are subject to a 0% specific risk own funds requirement according to Article 336 of the CRR, is also adjusted for the time to maturity (in years) of the bond, specified in Article 33(2)(b) of the IFR</u>.

Prudential consolidation

Chapter 7 – Prudential consolidation

Scope of application of consolidation – Paragraphs 7.9 to 7.15

"Question 11 – Do you have any comments on the composition of an investment firm group including the concepts of 'control' and 'ancillary service undertaking'. (See paragraphs 7.14 and 7.15)"

3.32. FIA EPTA members note that the implied extraterritorial application of IFR consolidation is troublesome in our view for three reasons:

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

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

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

4. Fixed Overheads Requirement (FOR)

Chapter 5 – Own funds requirements

Fixed Overheads requirement (FOR) – Paragraphs 5.13 to 5.15

"Question 2 – What level of detail would you find helpful when calculating the fixed overheads requirement (FOR)? (See paragraphs 5.13 to 5.15)"

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

4.2. FIA EPTA members also note the FCA does not provide additional detail regarding the FOR calculation, referring to the EBA being mandated to develop a new technical standard to set out further details for how investment firms should calculate the FOR, under Article 13 of the IFR.

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

Full list of deductions

4.4. FIA EPTA would ask the FCA to include in its UK domestic rules a full list of items, to be deducted from total expenses. We would urge that this should also cover the reference to 'fully discretionary' staff bonuses be included, rather than the reference to 'net profits'.

Basis of calculation

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

4.6. FIA EPTA members would ask the FCA to consider, when developing the UK domestic rules, to clarify that 'annual financial statements' are regarded as being annual financial statements approved by the directors or other competent body of the investment firm.

Staff bonuses

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

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

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

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

4.11. FIA EPTA would ask the FCA, when developing the UK domestic rules, <u>to disregard this reference to 'net profits' and suggest to revert to 'fully discretionary staff bonuses'</u>, where it can be added, as guidance, that the link to net profits can be used as an example where discretion exist, but not as the mandatory condition to meet.

4.12. Finally, we note that this linkage between the deduction of staff bonuses and 'net profits' is likely not to have been considered in the EBA impact assessment of its proposed new regime, as this is likely to have considered investment firms' responses aligned with the current CRR regime that only refers to 'fully discretionary' bonuses. We consider that this change can have a material impact that should not be underestimated and, if kept, <u>we urge that it should be reflected in the cost-benefit analysis and impact assessment to be conducted by the FCA</u>.

<u>Deduction of fees only where they are passed on and charged to customers</u>

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

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

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

<u>Additional items to deduction from total expenses</u>

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

<u>Material change in activities on an investment firm</u>

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

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

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

i. To not include a similar GBP condition for the EUR 2 million condition to determine a material change; or

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

FIA EPTA
EUROPEAN PRINCIPAL TRADERS ASSOCIATION

5. Risk management, governance and review process

<u>Scope and level of application – (paragraphs 11.16, 11.17, 11.21, 11.22 and 11.34)</u>

5.1. FIA EPTA members note that the FCA clarifies that although the IFD does not legally require a consolidated ICARA process, the obligations under Article 29 of IFD, to monitor and manage risks to own funds and liquid resources, apply on both an individual and consolidated basis.

5.2. This means that there is a practical overlap and the FCA can require the group's relevant parent undertaking to operate a consolidated ICARA process for the group. The FCA expects that where IFR Article 7 prudential consolidation is applied, <u>and</u> the group has implemented a consolidated ICARA process, the SREP applies on an individual and consolidated basis.

5.3. This seems to state that groups will need to perform an ICARA at both group and individual level. This differs from the current approach where an ICAAP is only required at the group level (IFPRU 2.2.47).

5.4. We would ask the FCA, as part of creating the UK domestic rules, <u>in addition to requiring the ICARA processes to be separately documented, also allowing the separate ICARA processes to be documented in a single document, where adequate coverage is provided for the material operating entities, from a business and risk perspective, within the group</u>. This, amongst other things, would avoid duplication of effort and governance and be more proportionate.

5.5. FIA EPTA members would also welcome if the FCA could <u>clarify the scope of the SREP process for both individual firms and groups subject to prudential consolidation</u>. For example:

1) Will the FCA carry out one SREP with a focus on the material risks in each entity or is there potentially need for multiple SREPs?

2) Currently firms are designated with different prudential categorisations, based risk levels, (P1/P2/P3) and the frequency of a SREP is based on this. Will the FCA use a similar system or does it plan to provide further guidance as to how frequent a SREP will occur for different firms?

3) If a firm has, for example, a SREP cycle occurring every 3 to 4 years and a firm assesses a material change in their business such that their P2R estimate is significantly altered, will there be a process for a change to their VREQ/OIREQ prior to the next SREP?

<u>Impact of adopting a similar approach in a UK domestic regime – (paragraphs 11.28 to 11.32)</u>

5.6. FIA EPTA members agree with the FCA's interpretation of the application of proportionality as presented in the IFD. <u>However, we believe that the new UK prudential regime for MiFID investment firms should offer investment firms similar levels of flexibility as is available under the existing CRD IV prudential regime</u>.

5.7. We note that one particular area where the FCA has to date applied proportionality, which we would urge to be retained, relates to waivers from the requirement for all non-SNI firms to create separate risk and remuneration committees. Requiring all non-SNI firms to create separate risk and remuneration committees would create an un-level playing field between banks that are not significant under CRD IV, but may still be quite large, and non-SNI investment firms under IFR.

5.8. Considering the relatively small size and limited complexity of many investment firms, these should not be required to have such burdensome requirements, such as the creation of these committees. We appreciate the effort to create a more appropriate prudential regime for investment firms, but do think it should result in an approach to governance requirements which is not more burdensome that the requirements applied under CRD IV.

5.9. FIA EPTA members also note that the IFD imposes a requirement for the risk committee to be made up of members of the management body who do not perform any executive function in the firm. It is unclear if the requirement imposed on firms is for the risk committee to be solely composed by non-executive members of the management body, or to a certain proportion.

5.10. We note that for smaller firms, having a risk committee composed entirely by non-executive members of the management body, is a disproportionate requirement. FIA EPTA members would ask the FCA to consider providing additional guidance of its expectations regarding risk committee composition which would allow for it to be made up of a mix of executive and non-executive members of the management body.

5.11. Furthermore, FIA EPTA members fully support the importance of strong oversight of investment firms' risk and remuneration systems, but would note that these can be, and have to date been, effectively overseen by many investment firms' full boards, rather than specialist subcommittees.

5.12. FIA EPTA members would suggest to the FCA that, when developing the UK domestic regime, this retains the possibility for the FCA to apply proportionality and retain the discretion to waive the application of certain requirements depending on the nature and complexity of the investment firm concerned and the risks that it poses to the broader financial system.

Wind-down and Recovery plans – (paragraphs 11.62 to 11.67)

5.13. FIA EPTA members note that the FCA expects that investment firms with EUR 750 thousand of initial capital will remain caught under the Recovery and Resolution Directive (RRD). As part of developing the UK domestic rules, we ask the FCA to develop a revised set of Guidelines on recovery indicators which are more appropriate for investment firms, so that they can be calibrated together with the wind-down planning in the ICARA process.

Specific liquidity requirements – (paragraphs 11.96 and 11.97)

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"Question 17 – Do you agree with our proposal regarding additional own funds requirements and specific liquidity requirements? This includes the articulation of requirements and guidance, stacking order and the use of VREQs to set own funds and specific liquidity requirements. (See paragraphs 11.77 to 11.100)"

5.14. FIA EPTA members note the FCA anticipates that in setting any specific additional liquidity requirements on an individual basis, these could be as one or a combination of the following:

- *Liquid assets requirement* – the amount and quality of liquid resources which is appropriate, having regard to the liquidity risk profile of that investment firm.
- *Funding profile requirement* – a prudent funding profile, considering the extent to which the investment firm's liabilities and sources of liquidity risk are adequately matched by inflows or liquid resources, able to be monetised on a timely basis. This is likely to be based on a liquidity monitoring tool.

5.15. It is still unclear what type of additional liquidity reporting, if any, the FCA may put in place in order to monitor firm's liquidity risk. Currently, a small number of investment firms are required to submit the FSA047 and FSA048 returns which provide this information, and FCA Individual Liquidity Guidance (ILG) is in many cases determined based on the stress scenarios embedded in the Liquidity Metric Monitor (LMM) based on such returns.

5.16. FIA EPTA members would urge the FCA to provide further guidance as to what will replace these returns, if any, and therefore the exact type of specific liquidity requirements that might be set based on liquidity monitoring tools, including the calibration of stress testing. We would also welcome if the FCA, as part of setting specific liquidity requirements, to take into account the differing funding models of investment firms, including the use of prime brokers to provide funding and settling of trades.

Transition from existing IFPRU/BIPRU ICG – (paragraph 11.102)

"Question 18 – What are your views on the proposed approach for the transition from existing IFPRU/BIPRU ICGs? (See paragraph 11.102)"

5.17. FIA EPTA members note that some investment firms will currently have in place individual capital guidance (ICG) that may deliver an inappropriate outcome, if directly applied to a new 'Pillar 1' requirement under a UK domestic regime reflecting the IFR. To facilitate transition, the FCA envisages that those investment firms with capital guidance, in summary would apply the following:

- If IFR Pillar 1, as at the date the new regime comes into force (day 1), is higher than total CRR requirements (Pillar plus Pillar 2), as at the date immediately prior to the new regime coming into force (day 0), ICG is no longer valid.
- If IFR Pillar 1, as at day 1, is lower than total CRR requirements, as at day 0, ICG as a percentage of Pillar 1 is rebased to the new Pillar 1, maintaining total

amount of capital requirements. The investment firms would need to submit a VREQ to confirm this.

- Current Capital Planning Buffers remain in place.

5.18. We note that the proposed approach asks investment firms to calculate capital requirements, for the current and new regime, on two different days, and compare those numbers. We would like to comment that for certain types of firms and business models the exposures and thus the resulting capital requirements can be quite volatile and this day-on-day comparison may therefore be inappropriate. FIA EPTA members would ask the FCA, therefore, to consider an approach where the comparison is made using capital requirements for the *same* day.

5.19. FIA EPTA members note that although the proposed approach would limit potential impacts from the new regime, this seems limited and does not address certain important components that come with the new regime. With this proposal, investment firms would not be able to benefit from the principles behind the new prudential regime by lowering the amount of total capital requirements, even if that is the appropriate outcome.

5.20. This seems at odds with the underlying objective of the new UK prudential regime for MiFID investment firms, which is to provide a prudential regime that addresses the specific risks of investment firms and should therefore provide a better estimate of an investment firm's Pillar 1 capital requirement. It may also be the case that under the old regime, a firm's Pillar 2 estimate was lower than the Pillar 1 requirement and it was subject to Pillar 1 floors.

5.21. For example, CRR credit risk does not exist in the IFR. However, the CRR Pillar 1 'credit risk' amount may have been included as a floor under the old regime. If a firm's own assessment of an equivalent risk is actually lower than the CRR Pillar 1 requirement, the investment firm would not be able to consider this in the calculation of its total capital requirements.

5.22. In addition, since firms can only have a capital increase, if new Pillar 1 requirements are higher the current total capital requirements, this means that, for the industry as a whole, capital requirements will go up. The industry will therefore either unduly economically impacted or have to charge higher fees or wider spreads to the detriment of the counterparties and ultimately end-investors. Even in normal times this would not be an effective outcome, but, given the current economic circumstances, potentially requiring the industry to hold additional capital seems counter to the current regulatory intention.

5.23. FIA EPTA members would urge the FCA,therefore, to consider a more appropriate and proportionate approach to the transition of current ICGs, where it takes into account the firm's own assessment of risks, rather than simply keeping the status quo of the old regime. We propose some alternative approaches that could be considered below:

1) The FCA could ask investment firms, who are willing to complete the ICARA process in advance of the implementation of the new prudential regime, to be

allowed to use their assessment instead and apply for a revised VREQ to confirm this and obtain a new P2R. This can be subject to a simplified FCA desk-based review, focused on key outcomes of previous SREPs, to ensure the assessment is reasonably appropriate.

2) The FCA could allow investment firms to calculate the current and new ‘Pillar 1’ requirement over a longer time period rather than on a single day. This is because for some firms the current and new ‘Pillar 1’ requirements are volatile thought the year. Allowing firms to take an average over a longer time period, for example 6 months, would better reflect the actual difference in the two calculations.

3) The FCA could consider requesting information from investment firms, as part of its cost benefit analysis (CBA) and impact assessment, to better understand the impact of the new prudential regime and determine a better alternative approach.

6. Remuneration

Chapter 13 – Remuneration

6.1. FIA EPTA members would like to share the following views on what we believe the FCA should consider when developing the new remuneration regime for investment firms:

1) *Application of Proportionality:* the FCA in its rules should maintain its ability to assess and decide on the application of requirements based on the principle of proportionality on an individual firm basis.

2) *Risk and Remuneration Committees:* these should not be required for all non-SNI firms. Doing so would be disproportionate compared to the governance requirements imposed on banks, including many that while not significant are much larger than most investment firms.

3) *Alternative Instruments:* the FCA should clarify in its rules that firms may make use of instruments issued by parent company or affiliates, including third country, as variable remuneration, provided they apply deferral, malus and clawback, including for misconduct.

4) *Alternative Instruments:* the FCA should ensure guidance on alternative instruments is appropriately flexible to reflect the wide array of compensation structures that are available to firms in reality, provided they allow for appropriate deferral, malus and clawback. For example, references to the credit quality of the investment firm would be inappropriate (and onerous to implement) for most subsidiary entities.

5) *Gender Pay Disclosures:* the FCA should rely on the existing UK gender pay regime, rather than creating a new one in prudential legislation.

6) *Gender Diversity on Committees:* we agree with the FCA's wording of how this should be applied.

7) *Application of Remuneration Rules to Third Country Subsidiaries:* we believe the exemption for this requirement in IFD is too narrow.

Timing of application – (paragraphs 13.19 and 13.20)

6.2. FIA EPTA members note that the FCA is aware that the timing of application may raise a number of questions about the performance year to which non-SNI investment firms would first have to apply the new remuneration requirements.

6.3. We would strongly caution the FCA that applying a new remuneration code mid-way through a performance year can be expected to cause a significant administrative burden for a number of firms that will have to pro-rate variable remuneration awards to take into account different remuneration rules.

6.4. To mitigate for such an undue administrative burden, we would suggest that it would be better to only require investment firms to apply the new remuneration code from

<u>the start of the accounting period/year-end, following the date of adoption of the new prudential regime</u>.

<u>Exemption for smaller non-SNI investment firms – (paragraphs 13.22 and 13.31)</u>

<u>Total value of assets</u>

6.5. FIA EPTA members note that Article 3 of the EBA's draft regulatory technical standards for the calculation of the threshold referred to in Article 8a(6)(b) of the CRD describes how to calculate the total value of assets for relevant institutions. Three possibilities are provided, firstly a prudential approach, secondly the use of IFRS and finally the use of an applicable national accounting law. We understand the proposed definition of 'total value of assets' can also be used for purpose of the threshold in point (a) of paragraph 4 of Article 32 of the IFD.

6.6. FIA EPTA members consider that total asset value from an accounting standards perspective may not always be the best approach for determining the risk profile of an investment firm, and it welcomes the introduction of the alternative ability to use a prudential approach in measuring total assets, as a fairer representation of total assets for investment firms. This is mainly due to the strict netting pre-requisites under (IFRS) accounting standards, which particularly penalises investment firms with active trading portfolios.

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

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

6.8. <u>FIA EPTA members support the use of the prudential measures, as prescribed within the Leverage Ratio calculations, to determine total assets and would strongly urge the FCA to include in the UK domestic rules that such can indeed be applied in this manner</u>. Using the approach taken in the calculation of the 'total exposure measure' and applying it to calculate the 'total value of assets', the investment firm would exclude the off-balance sheet, SFTs, add-ons and outstanding settlements. The calculation of 'total value of assets' would be the sum of the following:

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

6.9. FIA EPTA members would suggest to the FCA, when developing UK domestic rules, to provide firms with optionality of method to use, as follows:

1) *national accounting laws (UK GAAP), or*
2) *IFRS, or alternatively, at the discretion of the firm*
3) *prudential individual reporting*

Application: categories of staff – (paragraphs 13.52 to 13.61)

6.10. FIA EPTA members note that the FCA, in paragraph 13.55 of DP20/2, refers that in the EU, the EBA, in consultation with ESMA, is to develop draft technical standards to specify appropriate criteria by which to identify material risk takers (MRTs) for the purposes of the IFD (paragraph 4 of Article 30). The technical standards must be broadly consistent with existing ESMA guidelines on identifying categories of staff in scope of the remuneration provisions of the UCITS Directive, AIFMD and MiFID.

6.11. FIA EPTA members note that Article 5 of the EBA's draft technical standards (EBA/CP/2020/09) refers to members of staff deemed to have a material impact on an investment firm's risk profile. The article includes staff members, of the management body, in its management function and supervisory function. It is unclear whether or not this includes non-executive directors on a management body. Non-executive directors do not have a day-to-day management role but are involved in high level decision making. FIA EPTA members would not expect directors, non-executive in nature, to be in scope, especially as there is a deemed conflict of interest given any remuneration committee, that needs to be set up in accordance with Article 33 of the IFD, has to wholly include non-executive directors who will be the decision makers around how staff under the scope of Article 32 are being paid.

7. Regulatory reporting requirements

Chapter 12 – Regulatory reporting requirements

"Question 19 – What are your views on the level of detail required to meet regulatory reporting requirements?"

7.1. FIA EPTA members would like to note that they have always been supportive of the development of an appropriate and proportionate new prudential regime for investment firms. This includes proportionality in regulatory reporting requirements as well. However, we note that for groups that operate across the EU and the UK, it would also be positive to have regulatory reporting requirements which are as consistent as possible across the different jurisdictions where they operate.

7.2. FIA EPTA members <u>would ask the FCA to consider the development of regulatory reporting requirements in collaboration with EU national competent authorities and the EBA, with the objective to achieve a reporting framework that is proportionate and at the same time as consistent as possible across both the UK and EU member states</u>.