FIA EPTA
EUROPEAN PRINCIPAL TRADERS ASSOCIATION

Celebrating 10 YEARS 2011 - 2021

Response by the FIA European Principal Traders Association (FIA EPTA) to the EBA consultation on Draft Regulatory Technical Standards on the reclassification of investment firms as credit institutions in accordance with Article 8a (6)(b) of Directive 2013/36/EU

16 July 2021

EBA/CP/2021/23

1 Introduction

1.1 FIA EPTA welcomes the opportunity to respond to the EBA's consultation paper (the ***Consultation Paper***) on proposed revised Regulatory Technical Standards relating to the reclassification of investment firms as credit institutions in accordance with Article 8a(6)(b) of Directive 2013/36/EU (the ***Reclassification RTS***).

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

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

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

2 Executive Summary

2.1 FIA EPTA notes that the EBA's intention in revising the draft Reclassification RTS is to ensure a level playing field. However, we have strong concerns that the revised draft, in fact risks creating a highly unlevel playing field among similarly sized EU firms with similar risk profiles. We therefore urgently suggest to the EBA to adopt a different approach which would mitigate such unintended consequences. To this end, FIA EPTA proposes for the Reclassification RTS **to**

apply a group threshold which focuses on the assets of relevant EU firms and EU branches rather than a global group assets test. We are confident that this alternative approach is fully consistent with both the spirit and the letter of the Level 1 text, while minimising any undue side effects. This alternative approach is set out in more detail in Sections 4 and 5 below.

2.2 Our key concern with the draft Reclassification RTS is that it will require smaller EU investment firms to be authorised as credit institutions simply because of the non-EU activities of non-EU undertakings within the same group. However, these smaller EU investment firms do not themselves present any systemic risks to the Union which justify bank-like prudential treatment under the CRR.[1] The same is true for the non-EU activities of non-EU undertakings in the same groups as these smaller EU investments firms, which similarly present no systemic risks to the Union. **The non-EU activities of non-EU group undertakings are purely a function of the business model and geographic footprint of the non-EU group; they are by no means a regulatory arbitrage device** used to circumvent the EUR 30bn assets threshold for credit institution authorisation. To base the Reclassification RTS on the latter assumption would not be factually correct and lead to negative side-effects as further set out below.

2.3 We consider that the outcomes which would flow from the revised draft Reclassification RTS as currently proposed by the EBA are inconsistent with the policy intention of IFR / IFD,[2] which was to develop a prudential regime proportionate to the nature, risk profile and activities of investment firms, and will cause severe unintended consequences which do not appear to have been contemplated or assessed in the EBA's cost-benefit analysis or impact assessment:

(i) It will lead to smaller EU investment firms being subjected to CRR requirements which were designed for firms with a very different business model and risk profile to those of most investment firms undertaking dealing on own account activity, and which would be **wholly disproportionate and not fit for purpose for smaller EU investment firms**;

(ii) Subjecting some smaller EU investment firms to ongoing regulation as credit institutions will **create significant burdens for national competent authorities and/or the ECB as supervisors**. We respectfully suggest that it would not be a good use of prudential supervisory resources to subject smaller EU firms to intensive supervision and oversight as credit institutions simply because of the non-EU profile of the non-EU group in which they sit;

(iii) By subjecting smaller market participants to CRR, national authorities may be incentivised to develop additional domestic approaches and derogations to address the unintended consequences (e.g., to allow derogations from the CRR requirements to which deposit-taking firms are subject). This would **risk undermining the level playing field in the treatment of EU investment firms across member states** that IFR/IFD was intended to create;

(iv) In the medium to longer term, the Reclassification RTS could lead to **adverse outcomes for end-investors and consumers**. Establishing or maintaining EU

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1 Regulation 575/2013, as amended.

2 Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014 (**IFR**) & Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU (**IFD**).

investment firms may become less attractive to third country headquartered groups. Existing EU firms might also be incentivised to make changes to their business model in order to prevent the disproportionate consequences of the Reclassification RTS – which could lead to less competition and liquidity in relevant markets for EU consumers and end-investors;

(v) The disproportionate regulatory treatment of investment firms could lead to these firms holding **higher capital without providing additional prudential benefits, while constraining their ability to provide market liquidity**, which could lead to less competitive market pricing as well as to undue pro-cylical effects during volatile market circumstances when liquidity provision by non-bank market makers is most needed. All of this would disadvantage end consumers, including EU end-investors such as pension funds, companies and retail investors.

(vi) The proposal in the revised draft Reclassification RTS also gives rise to a range of **significant operational implementation and interpretation challenges** – e.g., which non-EU entities should be considered, the preparation of accounts on an entirely different basis, the netting of intra-group exposures on a different basis, and challenges for EU firms and national competent authorities in monitoring the non-EU positions of non-EU groups.

2.4 FIA EPTA agrees with the principle of a level playing field and strongly believes that it can be achieved without departing from or expanding the scope of what was envisaged by the Level 1 text. We believe it is in keeping with the Level 1 text to **apply a group threshold which focuses on the assets of relevant EU firms and EU branches rather than a global group assets test.**

2.5 In particular, FIA EPTA considers that the Reclassification RTS should be amended to clarify that, for the purposes of calculating the EUR 30bn group assets test,[3] firms (whether part of an EU group or third country group) should include the assets of:

(i) EU undertakings in the same group which conduct the activities referred to in points (3) and (6) of Section A of Annex I of MIFID II (***Relevant MiFID II Activities***), and which individually have total assets of less than EUR 30bn; and

(ii) EU branches of third country firms in the same group that are authorised in the EU and which conduct Relevant MiFID II Activities.

2.6 If the group total assets calculated in accordance with §2.5 above exceed EUR 30bn, the relevant EU undertaking will need to apply for authorisation as a credit institution. This achieves a level playing field between EU and non-EU headquartered firms, as it focuses on the assets of entities or branches conducting the relevant activities in the EU and ensures therefore that the test focuses on the risks posed to the Union by group activities. By focusing only on the assets of relevant EU undertakings / EU branches for the purposes of the Class 1 threshold group assets test, it does not penalise EU firms which are the parent entities of a broader group. The profile of the entire group would of course continue to be considered for other purposes (e.g., capital treatment or consolidation under IFR if the Class 1 classification threshold

[3] EU undertakings which conduct Relevant MiFID II activities and which individually have total assets of more than EUR 30bn would of course meet the individual total assets test and require Class 1 authorisation as a result. The test set out here is in relation to the group assets threshold.

is not met). Similarly, it does not penalise EU firms which are members of a third country headquartered group by requiring them to consider the non-EU assets of non-EU undertakings in calculating the EUR 30bn threshold.

2.7 FIA EPTA firmly believes this is in line with the intention and purpose of the Level 1 text, as well as ensuring the level playing field the EBA has indicated as a particular concern. It also counters the risk that firms would circumvent the individual threshold by establishing multiple undertakings within the EU to stay below the EUR 30bn assets test, by capturing all relevant EU undertakings / branches within the third country group that are carrying out Relevant MiFID II Activities.

3 Policy implications of the revised RTS

3.1 By way of reminder, FIA EPTA notes that the prudential framework established by IFR and IFD was designed to be more appropriately tailored to the nature, size and complexity of investment firms' activities, in particular by delivering a flexible prudential regime that was proportionate to the nature, risk profile and activities of investment firms. At the heart of the regime is a focus on the risks posed by firms or groups established in or conducting activities / providing services within the Union (see Recitals 1 and 37-39 of IFR).

3.2 While FIA EPTA is supportive of measures that ensure a level playing field, we have serious concerns regarding the draft Reclassification RTS. In particular, the revised Reclassification RTS risks undermining the policy objectives of the IFR/IFD and causing severe unintended consequences, including new level playing field concerns.

The current proposals will require smaller EU investment firms to be authorised as credit institutions despite the risks presented by such firms not justifying bank-like prudential treatment:

3.3 FIA EPTA notes that the EBA has said that the second public consultation on the draft RTS aims to respond to concerns raised during the first consultation regarding the need to ensure a level playing field (see §11 of the Consultation Paper**).** We note, however, that **it has never been the aim or intention to seek to regulate activities in the Union simply on the basis of activities conducted by other group entities outside the Union.** As a general matter, neither CRR/CRD nor IFR/IFD are intended to have extra-territorial effect, and instead apply at the individual CRR institution / investment firm level or at the consolidated EU parent level.

3.4 As currently drafted, the Reclassification RTS will lead to EU investment firms with small balance sheets having to be authorised as credit institutions despite the fact that they pose **no systemic risk for EU markets**.

3.5 Take a hypothetical example of a global group which has the majority of its assets (e.g. EUR 28bn) and/or operations in Asia but which also has a relatively small EU regulated subsidiary (e.g. assets of EUR 2.5bn).[4] The Reclassification RTS would lead to smaller entities operating in the EU being required to obtain credit institution authorisation despite their own activities presenting no risks to the EU justifying bank-like prudential regulatory treatment (e.g. systemic risks for EU financial or markets infrastructure or for clients), and despite the activities of the non-EU affiliates also having no impact on the EU. If the group fails, then it is possible that this may impact on the viability of the EU undertaking but this would not translate into a systemic risk to the EU markets as a whole (and would not differ materially from the risks to

[4] Conducting Relevant MiFID II Activities

EU markets of a similarly sized EU entity which was not required to register as a credit institution). Given that all investment firms, regardless of size, need to incorporate any interconnectedness risk posed to them by any of their affiliates, regardless of jurisdiction or size, in their internal capital, liquidity, and wind-down assessments (which are designed to ensure firms are adequately capitalised to effect an orderly wind-down on a stand-alone basis and which are subject to review by competent authorities), **there is no need for the small EU subsidiary to be subject to CRR as opposed to IFR; the regime set out in IFR already adequately addresses these risks.**

3.6 The approach that would follow from the revised draft Reclassification RTS is directly at odds with the policy objectives behind IFR / IFD. It does not support a proportionate prudential regime that is tailored to the risks and activities of the relevant investment firms. Further, it **risks creating an unlevel playing field between EU investment firms just because of the profile of the non-EU group in which they sit.** Referring back to the example in the previous paragraph, another small EU regulated subsidiary which is part of an EU-headquartered group would be subject to IFR rather than CRR even though its activities in the EU (and the risks presented to the EU) may be just as (or even more) significant than the activities of the EU subsidiary cited in the example. The mere fact that an entity is part of a non-EU group does not justify such differential treatment.

3.7 Where non-EU undertakings are part of an EU consolidation group, **there are existing measures in place under IFR** (e.g., in relation to capital treatment) which take account of the impact of these subsidiary undertakings on the EU consolidation group. That is a distinct issue from the test for determining which institutions should be treated as credit institutions because of the size, scale or significance of their activities in the Union.

3.8 We set out in **Sections 4 and 5 below** our views to how the group assets test for Class 1 authorisation should be formulated in a manner consistent with both the policy objectives of IFR/IFD and the relevant Level 1 text.

Adverse consequences for firms and regulators of disproportionate treatment of small EU investment firms:

3.9 The consequences of the approach indicated by the revised draft Reclassification RTS for investment firms with smaller balance sheets located in the EU are disproportionate and unduly burdensome. IFR was designed to deal specifically with the risks of investment firms in both a practical and proportionate manner. We would point in particular to the following aspects:

3.9.1 **Re-authorisation process:** The re-authorisation process itself will be **administratively and operationally burdensome**, for firms, for national competent authorities and the ECB.

3.9.2 **Application of CRR:** More importantly, the fact that these investment firms would be subject to CRR rather than the IFR brings them a **competitive disadvantage compared to other EU investment firms of the same size and activities** which happen not to be part of groups with significant non-EU activities. Many of these requirements have been designed with banks in mind. The application of the CRR requirements to smaller investment firms with a very different business model will be **complex, burdensome and wholly disproportionate while not providing additional prudential benefits**. The fact that certain investment firms with small size balance sheets located in the EU are

part of a third-country group does not change this reality. We note the following aspects:

(i) Firms would be subject to the strictest form of regulatory capital and liquidity requirements as well as a binding leverage ratio requirement and large exposure rules (as opposed to the IFR concentration risk rules which are more appropriate to the business model of investment firms). The leverage and liquidity risk of an investment firm is typically very different to the average credit institution, given that investment firms typically obtain financing via regulated credit institutions (i.e., clearing banks) rather than through deposit-taking.

(ii) As CRR institutions, such firms would be subject to rules designed for firms with a very different business model and risk profile to that of an investment firm undertaking Relevant MiFID II Activities, whereas their EU peers subject to the IFR/IFD will receive a more proportionate treatment.

(iii) In addition, although such investment firms will have already been subject to (at least parts of) CRR, their classification as "credit institutions" will mean that they will become subject to stricter rules compared to the pre-existing CRR regulatory position as well as to the post-IFR/IFD position, even though their business models and thus their risks are very distinct from those of traditional credit institutions:

(a) in relation to liquidity, these firms will become subject to the Liquidity Coverage Ratio (LCR) for the first time (as the LCR only applies to credit institutions at the EU level). The key requirement imposed by the LCR is for a credit institution to hold a minimum level of high-quality liquid assets (HQLAs) to fund its net liquidity outflows over a 30-day period of high stress. The ratio of a credit institution's HQLAs to its net liquidity outflows over a 30-day stress period must be 100%. Compliance with the LCR is not a straightforward matter and firms are required to build internal systems and controls and report their short-term liquidity.

(b) certain investment firm-specific waivers and simplifications that existed in CRR have been deleted (after the implementation of IFR and CRR2) on the basis that CRR institutions now will only consist of "credit institutions" (i.e., Class 1 firms and credit institutions). Therefore, any parts of CRR that were disapplied in respect of these investment firms will now apply to them (subject to any grandfathering).

(c) the CRR/CRD IV have been recently amended by CRR2 (most of the provisions became applicable on 28 June 2021) and CRD V (which was due to be transposed by member states on 28 December 2020). CRR2 and CRD V introduced a number of new requirements such as the long term liquidity ratio (the net stable funding ratio, NSFR) which is particularly onerous for firms that enter into repos and SFTs, amendments making the large exposure rules stricter, a binding leverage ratio (which was until now a reporting requirement in most jurisdictions) as well as new requirements relating to consolidation under the CRD V.

These changes do not appear to have been written in contemplation of smaller investment firms having to be authorised as credit institutions, and do not appear to be readily capable of appropriate application to such firms.

(d) in addition, investment firms re-authorised as credit institutions must liaise with local regulators to ascertain whether pre-existing waivers and permissions under CRR will continue to apply or whether they will have to submit new filings.

3.9.3 **Change in supervisors and rulebook:** In certain jurisdictions re-authorisation as a "credit institution" will lead to a change of prudential supervisor. In addition, in certain cases re-authorisation as a "credit institution" with more than EUR 30bn in assets means that the tests of a "significant credit institution" under the SSM Regulation are met and the ECB might decide to supervise such significant credit institutions. Apart from supervision by a joint supervisory team (JST), this would also lead to the relevant institutions having to comply with the ECB's regulatory guides and rulebooks. Further, the ECB can often impose additional requirements to those in the CRR for significant credit institutions.

3.9.4 **Resolution:** The EU resolution regime (the BRRD, and where relevant SRMR) only applies to deposit-taking banks and certain larger investment firms but does not extend to medium-sized CRR investment firms. Re-authorisation as a "credit institution" would bring firms within the scope of the EU resolution regime (which involves both substantive changes to the group as well as technical requirements for recovery and resolution planning).

3.10 Quite apart from the consequences for firms, subjecting smaller EU investment firms to ongoing regulation as credit institutions will create significant **burdens for national competent authorities and/or the ECB as supervisors**. We respectfully suggest that it would not be a good use of prudential supervisory resources to subject small EU firms to intensive supervision / oversight as credit institutions simply because of the non-EU profile of the non-EU group in which they sit. It also risks fragmentation of approach and an unlevel playing field because other similar EU firms will not be supervised as credit institutions despite having the same or similar business model and presenting just as much or more risk within the EU.

3.11 FIA EPTA fears also that by subjecting smaller market participants to CRR, national authorities will be incentivised to develop additional domestic approaches and derogations to address the unintended consequences (e.g., to allow derogations from the CRR requirements to which deposit-taking institutions are subject). This would create **additional regulatory fragmentation in the EU and risk undermining the level playing field** in the treatment of EU investment firms across member states that IFR/IFD was intended to create.

Adverse impact on competition and consumers:

3.12 The medium to longer term consequences of the Reclassification RTS could lead to adverse outcomes for end-investors and consumers.

3.13 In particular, establishing EU investment firms may become less attractive to third country headquartered groups that are not regulated as credit institutions anywhere in the world and will not wish to become so simply by establishing (or acquiring) an EU undertaking. It may also

lead to such groups divesting existing EU undertakings, or to the EU undertakings making changes to their business model (e.g. no longer conducting Relevant MiFID II Activities) in order to avoid the consequences of the Reclassification RTS – which could in each case lead to **less competition and liquidity in relevant markets** for EU consumers and end-investors.

3.14 Further, smaller firms which continue to operate but as credit institutions might end up needing to hold higher capital, which would lead to **fewer possibilities to commit capital to market making activity and hence lead to reduced market liquidity**. This would be counterproductive and potentially unduly pro-cyclical as the provision of liquidity is a key benefit that is brought by FIA EPTA's membership of non-bank market makers to EU financial markets. While restrictions on each smaller investment firm might not be significant regarding their trading capacity, the combined negative effect on EU markets could be material.

3.14.1 Liquidity provision, in particular during periods of market stress (such as that experienced in March and April 2020), is one of the primary services investment firms provide as market makers to EU markets. Making it more expensive and onerous for market makers to provide this service will ultimately lead to less (or more expensive) liquidity. In addition, the IFR/IFD K-factor regime was explicitly designed to take into account the risk of liquidity providers, in particular around times of market stress. Credit institution status is not required to address this risk. The exact impact of potentially diminished liquidity in Europe combined with unnecessary regulatory burdens needs to be fully assessed prior to this RTS being finalised. As it stands, FIA EPTA believes these potential consequences will be counterproductive to many of the objectives of IFR/IFD, MiFID II and the Capital Markets Union.

3.14.2 Furthermore, because of the nature of their business, market makers take positions that do show on both sides of the balance sheet. A concrete consequence of the draft RTS would be to disincentivise those market participants to provide liquidity in certain types of assets such as shares, listed options and government bonds, as these have significant impact on the balance sheet under IFRS. In a downturn situation, instead of ensuring their role of providing liquidity, market makers would be disincentivised to provide additional liquidity to EU markets and end-investors as they would be forced to actively manage their balance sheets to prevent their total assets exceeding the Class 1 threshold, with likely an undue procyclical effect.

3.15 Overall, FIA EPTA is concerned that these changes to the methodology will **make the EU a less attractive destination for the establishment of investment firms**, compared to all other major financial centres where a similar approach is not taken. FIA EPTA furthermore fears that these changes will lead to **less competition in EU markets** due to the high barriers to entry for investment firms to establish themselves in the EU. FIA EPTA is concerned this could **significantly reduce liquidity on EU markets** which will ultimately lead to inefficient market pricing and disadvantage EU end-investors as well as end consumers including EU pensions funds and companies.

Need for further cost benefit analysis

3.16 Introducing such a significant change in approach at such a late stage in the implementation of IFD/IFR requires careful analysis, including a detailed cost benefit analysis and impact assessment. It appears from the consultation paper that no such detailed analysis and assessment has been undertaken, which reinforces FIA EPTA's reservations about the adverse unintended

consequences of the revised draft Reclassification RTS. Both competent authorities and the investment firm community must conduct further analysis based on data to fully assess the consequences of the current proposal.

4 Alternative policy approach

4.1 FIA EPTA considers that the concerns regarding the need for a level playing field could be addressed by means of an **adjusted approach**, which would be more proportionate while being **fully in line with both the policy objectives of IFR/IFD and the specific wording of the Level 1 text**. It would be in line with the intention to ensure an appropriate prudential regulatory framework for investment firms, including that the largest firms in the EU and those posing the greatest risk are subject to the more extensive regime in CRD/CRR, whilst ensuring a level playing field and not creating unintended consequences due to non-EU activities by non-EU undertakings in the same group as the EU investment firm.

4.2 FIA EPTA agrees with the principle of a level playing field and strongly believes that it can be efficiently achieved without departing from or expanding the scope of what was envisaged by the Level 1 text. We note that the necessary level playing field is one that treats all equally, in the context of the risk that firms pose to EU markets and meets the purpose for which the group test was established – namely to counter the risk that firms would circumvent the individual threshold by establishing multiple undertakings within the EU to stay below the EUR 30bn assets test.

4.3 Consequently, we believe it is in keeping with the Level 1 text to **apply a group threshold which focuses on the assets of relevant EU firms and EU branches** rather than a global group assets test.

4.4 In particular, whilst also ensuring that the Reclassification RTS is in line with the Level 1 text, FIA EPTA considers that the Reclassification RTS should be amended to clarify that, **for the purposes of calculating the EUR 30bn group assets test, firms (whether part of an EU or third country group) should include the assets of:**

- **(i)** **EU undertakings in the same group which conduct Relevant MIFID II Activities, and which individually have total assets of less than EUR 30bn; and**
- **(ii)** **EU branches of third country firms in the same group that are authorised in the EU and which conduct Relevant MiFID II Activities.**

4.5 If the group total assets calculated in accordance with §4.4 above exceed EUR 30bn, the relevant EU undertaking will need to apply for authorisation as a credit institution. This achieves a level playing field as between EU and non-EU headquartered firms, as it focuses on the assets of entities or branches conducting the relevant activities in the EU. By focusing only on the assets of relevant EU undertakings / EU branches for the purposes of the Class 1 threshold group assets test, it avoids penalising EU parent entities of a broader group. The profile of the entire group would of course continue to be considered for other purposes (e.g. capital treatment or consolidation under IFR if the Class 1 classification threshold is not met). Similarly, it does not penalise EU firms which are members of a third country headquartered group by requiring them to consider the non-EU assets of non-EU undertakings in calculating the EUR 30bn threshold.

4.6 In summary, this proposal ensures that groups only need to take into account assets which are held in, and have nexus to, the EU. FIA EPTA firmly believes this is in line with the intention and purpose of the Level 1 text, as well as ensuring the level playing field the EBA has now indicated is of particular concern.

5 Legal interpretation of alternative policy approach

5.1 FIA EPTA is confident that the revised approach put forward above is fully consistent with the Level 1 text of CRR and CRD (as amended by IFR and IFD). Further, FIA EPTA considers that the approach put forward in the draft Reclassification RTS is inconsistent with, and beyond the scope of, the Level 1 text. In particular:

5.1.1 Article 4(1)(b) CRR refers throughout to undertakings carrying out Relevant MiFID II Activities – such activities by their nature are only undertaken by EU entities and third country firms providing investment services or performing investment activities through the establishment of a branch in the EU. In common with CRR, IFR/IFD and other EU regulation, MiFID II does not generally apply on an extra-territorial basis to entities established outside the EU and which do not perform investment activities or provide investment services within the EU. We note that there is no reference in the language of Article 4(1)(b) CRR to undertakings conducting activities "equivalent" or "corresponding" to the Relevant MiFID II Activities – such language would have been included had it been the intention to take a broader, extra-territorial approach;

5.1.2 Article 4(1)(b) states explicitly that, for the purposes of points (b)(ii) and (b)(iii)[5] (which set out the group threshold tests, where an undertaking is part of a third-country group), it is the total assets of each branch of the third country group authorised in the EU (and by clear implication, therefore, not the assets of the undertaking as a whole) which are to be included in the combined total value of the assets of undertakings in the group. If it had been the intention that the total assets of all relevant third country undertakings should be caught, this provision would serve no purpose. Indeed, given the general approach of CRR not to be extra-territorial in nature, if it had been the intention of this provision to have the extra-territorial effect now put forward by the EBA, one would have expected CRR to say so explicitly;

5.1.3 The fact that the Level 1 text requires the group assets test only to include entities which individually have total assets of less than EUR 30bn supports this interpretation, and makes sense in the context of the definition only applying to firms operating in the EU – as this is the threshold above which a relevant EU undertaking would meet the test for authorisation as a credit institution on a standalone basis; the same threshold is not a trigger for credit institution authorisation for non-EU undertakings.

5.2 The presence of non-EU entities with assets derived from non-EU activities in a group is not a regulatory arbitrage device or a mechanism to circumvent the EUR 30bn assets threshold – on the contrary, the presence of such activities is simply a function of the business model and profile of the non-EU group. The Level 1 text included appropriate anti-avoidance provisions by allowing for a group test to avoid a group using multiple EU entities to stay below Class 1 test – as set out by Recital 39. We note that the Reclassification RTS goes significantly beyond this,

[5] We note that Article 8a (6)(b) empowers EBA to develop RTS for the methodology relevant to 4(b)(i) and (ii) only, and not (iii).

in a manner which in our view is not justified by the Level 1 text or by any reasonable policy justification in seeking also to consider the non-EU activities of non-EU entities, given such activities would not present systemic risk to the Union.

5.3 FIA EPTA notes that the legal interpretation set out above is consistent also with our understanding of the trilogue discussions at the time the when the Level 1 text of IFR / IFD was being agreed between the co-legislators. We are aware that the calculation of the threshold for conversion of Class 1 firms into credit institutions was discussed and specified as part of these negotiations. Our understanding is that there was clear agreement among the co-legislators that the test should encompass anti-avoidance provisions targeted at the risk of firms establishing multiple EU undertakings to remain below the authorisation threshold, and that the assets of branches of third country firms authorised in the Union which are part of the same third country group as an EU undertaking should also be included. To our understanding, it was never discussed, nor even suggested, that the assets of all non-EU affiliates in a third country group should be included in the calculation.

6 Other matters

6.1 There are various other issues of operational implementation and interpretation which militate powerfully against the proposal put forward in the RTS and in favour of the policy approach put forward by FIA EPTA.

Determining which non-EU entities are to be considered:

6.2 FIA EPTA fears additional complexity in the implementation as it remains unclear how a group should consider which entities within its group are in-scope for the calculation. Paragraph 3.2(8) of the Consultation Paper states that relevant undertakings need to include in their group calculations group entities that "carry out any of the relevant activities" which is defined as "activities referred to in points (3) and (6) of Section A of Annex 1 to Directive 2014/65/EU". However, this reference to the MiFID permissions of dealing on own account and underwriting or placing on a firm commitment basis does not provide sufficient clarity.

6.3 Non-EU Group entities which are regulated, or otherwise, may not have the same or equivalent regulatory permissions. Firms would therefore need to use their discretion as to which non-EU entities within their groups to include for the purposes of calculating the group threshold. Consequently, this ambiguity has potential to create an unlevel playing field where two different investment firms with similar global structures and group sizes could end up being regulated and supervised under two completely different regimes purely based on how they interpret their third-county affiliates' activities in relation to this RTS or on how their third-country affiliates' activities are characterised by their domestic regulator. Firms and national competent authorities could take different views on these matters, thereby undermining the level playing field that IFR/IFD is seeking to achieve.

Complexity of calculations:

6.4 Furthermore, even when such a determination is made, the foundation for the calculation also carries unfortunate consequences, as the value of the non-EU undertakings according to Article 3 of the Reclassification RTS should be done on the basis of the recent audited annual accounts prepared in accordance with IFRS, or if those are not available the total value of assets be determined on the basis of the annual accounts prepared in accordance with a Member State's applicable accounting standards. The EU calculating entity is required to calculate

monthly total assets on quarterly reference dates. These obligations would give rise to a number of practical difficulties:

(i) Depending on their place of incorporation or legal entity status (e.g. partnerships), the non-EU entities may not be obliged to publish audited annual accounts.

(ii) The calculating entity may not have sufficient knowledge of or access to its affiliates' accounts in order to prepare accounts for the purposes of the calculation, in particular as this is a rolling requirement.

(iii) Non-EU affiliates may be reluctant to provide accounting details that may be made available to regulatory authorities that do not have jurisdiction over them.

(iv) NCAs may not have the power to compel production of such non-EU accounts for verification/enforcement purposes, or at least not without facing significant administrative burdens.

6.5 In these circumstances the calculation obligation will very much be subject to the good faith of the calculating entity's non-EU affiliates. As with the lack of clarity around the definition of "relevant activities," we do not believe that the good faith calculations will enhance the level playing field, but rather that it will lead to a more complicated playing field because of differing procedures and practices in non-EU regimes of which the EU national competent authorities will have no oversight or control.

Ongoing monitoring of non-EU positions:

6.6 Under the current formulation of the RTS the competent NCAs will be put in a position of having to monitor and perhaps enforce compliance with these obligations in relation to the actions or omissions of non-EU entities that are not providing investment services or performing investment activities within the Union and are not subject to the jurisdiction of the competent authorities. Further complications arise in relation to the oversight of the calculation, as the draft RTS prescribes that the EU calculating entity will be responsible for calculating the total value of the assets of all relevant undertakings in the group. Where the group includes non-EU parent entities and non-EU subsidiaries, it is unclear how relevant NCAs will be able to verify and enforce this calculation obligation.

Accounting treatment:

6.7 As noted earlier, the proposed RTS requires calculations to be undertaken on the basis of audited annual accounts prepared in accordance with IFRS or applicable accounting standards of the Member State. Given that non-EU entities may not have prepared accounts in accordance with IFRS or accounting standards of an EU member state, they would need to convert accounts from local GAAP to IFRS. This will be a burdensome and complex process.

6.8 Similarly, a complex exercise of conducting intra-group consolidation as between EU and non-EU affiliates in the same non-EU group will need to be undertaken – generally such consolidation is only undertaken at relevant parent levels, and the EBA's proposal would likely require an entirely bespoke set of intra-group consolidation arrangements to be established solely for the purposes of conducting the calculations set out in the EBA RTS.

Each of these problems would be avoided by the proposal put forward by FIA EPTA:

6.9 We would reiterate that each of the above difficulties would be avoided by the proposal put forward by FIA EPTA, which:

(i) removes uncertainty about which entities need to be considered for the test;

(ii) focuses on assets of relevant EU entities / branches conducting Relevant MiFID II Activities and operating in the EU, in relation to which relevant accounts (to IFRS or EU Member State accounting standards) should be readily or more easily available; and

(iii) avoids the need for extensive monitoring of the nature and size of non-EU activities taking place elsewhere within a group.

7 Comments on specific questions in the EBA consultation

7.1 It will be evident from our comments above that FIA EPTA has concerns which go beyond the specific issues on which the EBA has sought input through the questions in the Consultation Paper. We have set out below, however, brief observations on the questions raised.

Question 1: Is there any further element (including any potential simplification) concerning the accounting standards to be used for the purposes of these draft RTS that should be considered in this article?

7.2 We do not have specific questions about the methodology, but highlight again the points made earlier in this note regarding the possible absence of audited annual accounts for third country affiliate undertakings, and the significant burdens that arise from requiring that any such accounts be adjusted to reflect IFRS or the accounting standards of a particular member state. To the extent the asset position of third country firms is required to be considered for the group assets test, FIA EPTA's view is that, where local law or regulation requires audited accounts of a non-EU undertaking to be produced, it should be permissible to rely on the accounts as prepared in accordance with applicable accounting standards of the country in which the firm is incorporated (e.g. GAAP standards for certain US entities), without adjusting to IFRS / EU member state requirements.

Question 2: This article is introduced to cover all possible cases envisaged in the definition of credit institution in point (1)(b) of paragraph 4(1) of the CRR (as amended by Article 62 of the IFR). Is there any other case that should be considered in clarifying the calculation methodology?

7.3 As a preliminary matter, FIA EPTA notes that Article 8a (6)(b) empowers EBA to develop RTS for the methodology relevant to 4(b)(i) and (ii) only, and not (iii).

7.4 FIA EPTA refers to the points made earlier in this response regarding the approach to the calculation of the group assets test. We have set out an alternative policy proposal which would need to be reflected in the drafting of Articles 6 to 8.

7.5 We also query why intra-group exposures are limited to those with other firms conducting Relevant MiFID II Activities. Whilst we understand the need to avoid double-counting in the group test, we suggest that there may be scope to take a broader approach to intra-group exposures to arrive at a better assessment of the actual size and risk profile of the relevant undertaking.

Question 3: Based on the provisions included in Articles 5, 6 and 7 of the draft RTS, do you anticipate any operational issues concerning the calculation of consolidated or combined assets? Please provide concrete examples.

7.6 We have already addressed these issues earlier in this response (including in section 6 in particular). We do not have further comments at this stage.