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COMMISSION STAFF WORKING DOCUMENT

Review of the prudential framework for investment firms

Accompanying the document

Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the prudential requirements of investment firms and amending Regulations (EU) No 575/2013, (EU) No 600/2014 and (EU) No 1093/2010

Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the prudential supervision of investment firms and amending Directives 2013/36/EU and2014/65/EU

{COM(2017) 790 final} - {COM(2017) 791 final}

1. INTRODUCTION

This Staff Working Document forms part of the review of the prudential treatment of investment firms, included in the 2017 Commission Work Programme as a REFIT-exercise[1]. The objective of the review is to ensure an appropriate application of capital, liquidity and other key prudential requirements for these firms. It is mandated by a series of Articles[2] in Regulation (EU) No 575/2013 (Capital Requirements Regulation, or CRR)[3]. Together with Directive 2013/36/EU (Capital Requirements Directive, or CRDIV)[4] the CRR constitutes the current prudential framework for investment firms. When these texts were agreed, co-legislators mandated the present review in recognition of the fact that the current framework, which is largely focused on credit institutions[5], is not fully suited to all investment firms.

As set out in the relevant Articles of the CRR which mandate the review, it is carried out in consultation with the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) and the national competent authorities represented in these European Supervisory Authorities (ESAs)[6]. Among the ESAs, the competence for the prudential framework for investment firms embedded in the CRR/CRDIV rests with the EBA. As a result, the review relies to a large extent notably on the work of the EBA, based on the successive calls for advice from the Commission[7]. ESMA and several of its members have been involved in the work of the EBA throughout but ESMA has not provided its own separate advice on the review.

According to the Better Regulation toolbox (tool #9), no Commission impact assessment is necessary whenever an EU agency has been mandated to carry out policy-design work and related analysis, to the extent that the Commission proposal does not substantially deviate from the agency's recommendations and the Commission services consider its assessment to be of sufficient quality. While the Regulatory Scrutiny Board examined a draft impact assessment for this initiative, it was ultimately concluded that a Staff Working Document was more appropriate given that the specific mandate of the review

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[1] See page 204 of the REFIT scoreboard at https://ec.europa.eu/info/sites/info/files/cwp_2017_refit_scoreboard_2016_en.pdf. The Commission's Regulatory Fitness and Performance (REFIT) programme aims to ensure that EUR legislation stays simple, proportionate and up-to-date, and delivers results for citizens and businesses effectively, efficiently and at minimum cost.

[2] Articles 493(2), 498(2), 508(2), 508(3) of the CRR

[3] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1–337) https://ec.europa.eu/info/law/banking-prudential-requirements-regulation-eu-no-575-2013/law-details_en

[4] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338–436) https://ec.europa.eu/info/law/banking-prudential-requirements-directive-2013-36-eu/law-details_en

[5] "Credit institution" and "bank" are used interchangeably throughout this staff working document

[6] See annex 3 for the procedural steps and stakeholder consultations which informed the review

[7] The Commission calls for advice and different steps and outputs of the EBA can be accessed at http://www.eba.europa.eu/regulation-and-policy/investment-firms

is based on the advice of the ESAs and their stakeholder consultation and technical work. The objective of this document is therefore rather to explain the ESA's advice, including the results of their analysis and consultation, while providing the Commission services' views on its conclusions, with a view to guide the Commission's decision-making.

Prudential requirements are an integral part of the regulatory framework for financial markets. They are designed to ensure that financial institutions have sufficient resources to remain financially viable and to perform their services through economic cycles or to enable their orderly wind-down without causing undue economic harm to their customers or to the stability of the markets they operate in. They govern the amount and quality of resources, notably in terms of capital and liquidity, as well as other risk management measures which financial institutions have to comply with in order to be allowed to offer their services. They differ for various institutions – banks, insurance companies, asset managers etc. They interact with other regulatory requirements which are also designed to protect markets and investors from the risks and externalities inherent in the business of financial institutions, such as rules to protect investors and their assets, to centrally clear trades with central counterparties (CCPs), and to post collateral with CCPs and other counterparties to guarantee trades. Typically, they are set at levels which are considered to achieve a balance between, on the one hand, ensuring the safety and soundness of the operations of financial institutions and, on the other, avoiding disproportionate or excessive costs which could hinder them from conducting their business in a viable way.

The review covers all investment firms including those identified as global or other systemically important institutions in accordance with Article 131 of CRDIV, which are however projected to remain fully subject to the CRR/CRDIV-framework, including the amendments proposed by the Commission thereto on 23 November 2016[8]. This is because these firms typically incur and underwrite risks on a significant scale throughout the Single Market. Their activities expose them to credit risk, mainly in the form of counterparty credit risk, as well as market risk for positions they take on own account, whether for their clients or themselves. They accordingly present a higher risk to financial stability, given their size and interconnectedness. There is therefore a broad consensus among authorities that they should remain subject to the CRR/CRDIV-framework. However, as explained below in sections 2.1.4 and 4, rather than continuing to rely on Article 131 of the CRDIV, a more appropriate way of identifying them is proposed in order to ensure a supervisory and regulatory level playing-field. This is also informed by the fact that, at present, these systemically important investment firms are largely concentrated in the UK. Several among them are currently in the process of migrating parts of their operations to the EU27. On this point, as explained in section 4.4, this Staff Working Document goes beyond the advice of the EBA on the review of investment firms but aligns with the view of the EBA in its opinion on issues related to

[8] In line with the second set of advice of the EBA of October 2016 (Opinion of the European Banking Authority on the First Part of the Call for Advice on Investment Firms http://tinyurl.com/z3e7fpl), the Commission proposed in November 2016 that investment firms identified as global or as other systemically important institutions (G-SIIs, O-SIIs) in accordance with Article 131 of the Capital Requirements Directive (CRD) should remain subject to the revised CRR. In March 2017 there were eight investment firms in this group, all based in the UK. The Commission also proposed that other investment firms could be unaffected by these changes. See: Commission proposals to revise the Capital Requirements Regulation and Directive of 23 November 2016 https://ec.europa.eu/info/law/banking-prudential-requirements-directive-2013-36-eu/upcoming_en

the decision of the UK to withdraw from the Union[9]. In this opinion the EBA confirms that systemic investment firms should remain in the CRR/CRDIV and become subject to supervision by the European Central Bank (ECB) in the context of the Single Supervisory Mechanism (SSM) for their operations in Member States participating in the Banking Union. This Staff Working Document therefore aligns with the substantial advice of the EBA on this point.

This Staff Working document is structured as follows. Section 2 provides an overview of the business models of investment firms and nature of the market they operate in. Section 3 explains the current prudential framework for investment firms and summarises the problems it represents, based on the extensive analysis of the EBA and ESMA notably in their 2015 report[10] and on the parallel work and analysis of the Commission services outlined in Annex 3 involving engagement with stakeholders on the problems and costs of the current framework. Section 4 sets out the objectives for the review and the EBA's policy advice for a new prudential regime for investment firms, presented in their final advice to the Commission in September 2017[11], and examines the separate but connected issue of systemic investment firms. Section 5 assesses the content and impact of the EBA advice for non-systemic firms in terms of whether it achieves the objectives for the review of a more appropriate and proportionate prudential framework for investment firms to underpin the safe functioning of investment firms and whether it effectively and efficiently balances this with the need to ensure investment firms can play their role in facilitating investment flows across the EU, boosting competition and improving investors' access to new opportunities and better ways of managing their risks, consistent with the aims of the Capital Markets Union to mobilise savings and investments to boost growth and jobs[12]. Section 6 concludes.

2. BUSINESS MODELS OF INVESTMENT FIRMS AND NATURE OF MARKET

Investment firms provide a range of services which give investors access to securities and derivatives markets (investment advice, portfolio management, brokerage, execution of orders etc.). Their main difference to credit institutions is that they do not take deposits or make loans, meaning they are far less exposed to credit risk and the liquidity risk of depositors withdrawing their money at short notice[13]. Their services concern

[9] Opinion of the European Banking Authority on issues related to the departure of the United Kingdom from the European Union (EBA/Op/2017/12) of 12 October 2017 http://www.eba.europa.eu/documents/10180/1756362/EBA+Opinion+on+Brexit+Issues+%28EBA-Op-2017-12%29.pdf

[10] EBA report on investment firms, response to Commission's call for advice of December 2014 (EBA/Op/2015/20) https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-20+Report+on+investment+firms.pdf

[11] Opinion of the European Banking Authority in response to the European Commission's Call for Advice on Investment Firms and Annex to the Opinion (EBA/Op/2017/11) http://www.eba.europa.eu/documents/10180/1976637/EBA+Advice+on+New+Prudential+Framework+on+Investment+Firms+%28EBA-Op-2017-11%29.pdf http://www.eba.europa.eu/documents/10180/1976637/Annex+to+the+EBA+Opinion+EBA-Op-2017-11.pdf

[12] Communication on the mid-term review of the Capital Markets Union action plan, June 2017 (COM(2017)292) https://ec.europa.eu/info/publications/mid-term-review-capital-markets-union-action-plan_en

[13] However, they can provide loans as an ancillary function as part of a transaction in financial instruments (Section B2, Annex I of MiFID)

financial instruments, which unlike deposits are not payable at par but fluctuate according to market movements.

In terms of numbers, investment firms represent a broad array of different types of firms, depending on whether they are focussed on providing one or two services mainly to retail customers or whether they offer a wide universe of services to a broad range of retail, professional and corporate clients. According to information compiled by the EBA, at the end of 2015 there were 6051 investment firms in the European Economic Area (EEA)[14]. They are present in all Member States. Most EEA investment firms are small or medium-sized. The EBA estimates that about eight investment firms control c.80% of assets of all investment firms in the EEA, corresponding to the eight EEA investment firms designated as other systemically important institutions[15]. Based on the EBA's information, around 85% of EEA investment firms limit their activities to investment advice, the reception and transmission of orders, portfolio management and the execution of orders. Nearly 40% of EEA investment firms are authorised exclusively to provide investment advice. Around 20% are authorised to carry out dealing on own account and underwriting, the services which currently entail the most stringent prudential requirements[16]. According to the EBA's data, while there are examples of large firms (in terms of gross annual income and gross balance sheet size) amongst the former category of firms whose licence is limited to a few investment services, the largest investment firms tend to be those performing a wider array of services[17]. Owing to its traditional status as an important hub for capital markets and investment activities, the UK has the largest number, with roughly half of all EEA investment firms, followed by Germany, France, the Netherlands and Spain.

The table compiled by the EBA and reproduced below provides a breakdown of the numbers of different types of investment firms across Member States, by reference to the 11 categories which the current CRR/CRDIV-framework divides them into (explained in section 3.1 below and presented in Annex 1).

Table 1 – Number of respective investment firms per Member State[18]

	Local CRD30 [1]	CRD 31(1) [2/3]	CRR 95(2) 1st cat. [4]	CRR 95(2) 2nd cat. [4]	CRR 95(1) [5/6/7]	CRR 96(1)(a) [8]	CRR 96(1)(b) [9]	Commodity CRR 493 & 498 [10]	Full auth. CRR 92 [11]	All MiFID
Austria	.	26	.	48	.	.	.	.	.	74
Belgium	.	3	.	15	9	.	.	.	11	39

[14] EBA report on investment firms, response to Commission's call for advice of December 2014 (EBA/Op/2015/20), Table 12: Population of investment firms, by category, by country, page 96. https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-20+Report+on+investment+firms.pdf

[15] See footnote 8 above

[16] EBA/Op/2015/20, Table 13, page 97.

[17] In the UK for example, the median size of a firm with a limited authorisation is 67 times smaller than a firm with a broad authorisation. In France the figure is 48 (EBA/Op/2015/20, Tables 7 and 11, pages 90-95).

[18] EBA/Op/2015/20, Table 12, page 96. The EBA notes that "the data displayed in this report are provided on a best effort basis by national competent authorities. For Belgium, France, Hungary, Italy and Sweden, the reported total number of MiFID firms differs from the sum of investment firms assigned to each category, as this categorisation cannot be aligned with the national regulatory regime."

Cyprus	.	12	6	.	83	6	.	.	54	161
Czech Republic	.	.	.	.	7	1	.	.	12	20
Germany	.	48	596	.	14	.	.	6	30	694
Denmark	.	1	32	.	.	.	.	.	8	41
Estonia	.	.	.	.	1	.	.	.	2	3
Spain	.	148	12	.	24	1	.	.	38	223
Finland	.	7	.	.	32	1	.	4	11	55
France	.	18	20	.	28	.	.	4	28	233
United Kingdom	2	1 328	.	1 172	553	46	.	85	172	3 358
Greece	.	11	.	11	27	.	.	.	11	60
Croatia	.	1	.	.	5	.	.	.	2	8
Hungary	.	.	.	2	7	.	.	3	10	19
Ireland	.	7	.	40	35	1	.	.	11	94
Italy	.	.	.	6	44	.	.	.	16	81
Liechtenstein	.	120	.	120	.	1	.	.	16	16
Lithuania	.	.	.	.	5	.	.	.	1	6
Luxembourg	.	11	.	52	24	.	.	.	8	96
Latvia	.	.	.	.	2	.	3	.	.	5
Malta	.	14	.	.	38	.	.	.	9	61
Netherlands	9	26	160	.	30	.	.	.	5	230
Norway	.	20	.	.	42	.	.	5	34	100
Poland	.	3	10	.	14	1	.	.	23	51
Portugal	.	10	.	.	12	.	.	.	2	24
Romania	.	.	.	.	11	.	.	.	17	28
Sweden	.	4	.	.	94	15	.	.	4	135
Slovenia	.	.	.	.	2	.	.	.	3	5
Slovakia	.	.	.	.	10	4	.	.	0	14
All	11	1 822	867	1 466	1 178	77	3	103	637	6 051

Table 2 below provides an overview of the key market characteristics per category of investment firm. It confirms that firms which provide a wide array of services and with full CRR authorisation (category 11) are on average much larger than the other categories. They include the eight largest investment firms referred to above and, together with other firms in this group, make up more than 90% of total assets despite constituting around 10% of the market for investment firms in numbers.

Table 2 – Market characteristics per investment firm category[19]

	Number of	**Mean size**	**Dominant markets by**	**Dominant markets by**

[19] Commission services analysis using data from the EBA report (EBA/Op/2015/20), Table 12, page 96

	firms in EEA	of firm (EUR mn)	number of firms	size of firms
Cat 1,2,3 - Local firms and firms that only provide reception/transmission and/or advice	1831	17.95	UK (72%), Spain (8%), Liechtenstein (7%), Germany (3%)	UK (68%), Netherlands (27%), Spain (2%)
Cat 4 - Perform, at least, execution of orders and/or portfolio management	2333	81.60	UK (51%), Germany (26%), Netherlands (7%), Liechtenstein (5%)	Netherlands (73%), UK (24%), Germany (1%)
Cat 5, 6, 7 - Not authorised to perform deals on own account and/or underwriting/placing with firm commitment	1178	N/A	UK (47%), Sweden (8%), Cyprus (7%), Italy (4%), Norway (4%)	N/A
Cat 8 - Only perform deals on own account to execute client orders	77	864.68	UK (60%), Sweden (19%), Cyprus (8%), Slovakia (5%)	UK (98%), Sweden (1%)
Cat 9 - Do not hold client funds, only perform deals on own account, no external clients	3	N/A	Latvia (100%)	Latvia (100%)
Cat 10 - Commodity derivatives investment firms not exempt under MiFID	103	366.00	UK (79%), Germany (6%), Norway (5%), Finland (4%), France (4%)	France (69%), UK (31%)
Cat 11 - Firms that do not fall under other categories	637	5414.21	UK (32%), Cyprus (10%), Spain (7%), Germany (6%), Norway (6%), France (5%), Poland (4%)	UK (86%), France (11%), Liechtenstein (2%)

3. THE CURRENT PRUDENTIAL REGIME

3.1. Regulatory context

The EU regulatory framework for investment firms consists of two main parts. First, the Markets in Financial Instruments Directive (MiFID)[20] and, as of January 2018 MiFID II/MiFIR[21], sets out the conditions for their authorisation and organisational and business

[20] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1–44)

[21] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349–496) and Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (OJ L 173, 12.6.2014, p. 84–148)

conduct requirements under which investment services can be provided to investors as well as other requirements governing the orderly functioning of financial markets. Under MiFID, investment firms can be licenced to perform between one and eight investment services[22].

Second, they are subject to the prudential framework under the CRR/CRDIV together with credit institutions. This is due to the fact that they can compete with credit institutions in performing these investment services, which credit institutions can offer to their customers under their banking licence[23]. Credit institutions are in turn subject to the key provisions of MiFID, aligning the conditions for the provision of investment services between investment firms and credit institutions both in terms of the investor protection and conduct provisions of MiFID as well as key prudential requirements of the CRR/CRDIV.

3.2. **Problems with the current prudential regime**

Over time, there have been a number of changes in the prudential regulation of credit institutions. In particular, the internationally agreed standards developed in the Basel Committee on Banking Supervision have made prudential requirements more detailed and complex. Most recently, these standards were transposed into EU law through the current CRR/CRDIV-package in 2013 in the wake of the global financial crisis, and in the form of the Commission's proposals to update these texts in November 2016[24].

Throughout these changes, the link between the prudential treatment of credit institutions and investment firms has been maintained and the changes have also impacted investment firms in the EU. However, considering that the two have different primary business models, the framework has always exempted some investment firms from some of the requirements which apply to credit institutions. As the framework has become more complex, further derogations for investment firms have been introduced.

Under the current CRR/CRDIV-framework, investment firms can be grouped into 11 categories primarily determined by the investment services they are authorised to undertake under MiFID, and whether they hold money and securities belonging to their clients[25]. This categorisation reflects multiple historic and implicit assumptions of the risks and prudential relevance of these services and functions and of how effectively the available risk-metrics developed principally for banks capture and address those risks. Consequently, investment firms which conduct a broad range of services are subject to the same requirements as credit institutions in terms of capital requirements for credit, market and operational risk, and potentially liquidity, leverage, remuneration and governance rules, while firms with limited authorisations (typically those which are considered less risky, i.e. investment advice, reception and transmission of orders) are largely exempt from most of these requirements.

[22] Annex 1, Section A of Directive 2004/39/EU. MiFID II will add the service of operating an organised trading facility to this list.

[23] Annex 1, Directive 2013/36/EU

[24] See: Commission proposals to revise the Capital Requirements Regulation and Directive of 23 November 2016 https://ec.europa.eu/info/law/banking-prudential-requirements-directive-2013-36-eu/upcoming_en

[25] See Annex 1

The starting point of the prudential framework for investment firms is thus largely based on the risks faced and posed credit institutions. The requirements are largely calibrated to secure the lending and deposit-taking functions of credit institutions through economic cycles. Therefore, it does not effectively capture the actual risks faced by the majority of EU investment firms who do not conduct these activities as their main business. In addition, its requirements are not well calibrated to the different business profile of most investment firms, and namely to the risks their activities can have for their customers and markets more broadly during the normal course of their operations and in case they fail and have to be wound-down.

Based on this, the current regime can be shown to be disproportionate and a source of excessive complexity and administrative and compliance costs for most investment firms. It does not fully reflect their core business models and risks posed by investment firms in an appropriate and proportionate way for their customers and for other market participants, highlighting a lack of risk-sensitivity. Moreover, several cases of different application of the rules by Member States are also observed.

3.2.1. Complexity and disproportionate nature

The underlying rationale of today's regime is that investment firms should apply the same rules as banks, with a progressively decreasing set of requirements for investment firms which only undertake certain activities. This results in the 11 categories which determine the requirements investment firms are subject to in terms of its main components such as own funds, leverage, liquidity, large exposures, reporting, capital buffers, remuneration and corporate governance.

This demonstrates the first element of the problem. Banks and investment firms are two qualitatively different institutions. While there is some overlap in the services they can provide, and larger investment firms can end up posing risks on a par with large banks, their primary business models are quite different: taking deposits and making loans in the case of banks, and performing various services giving investors access to securities and derivatives markets in the case of investment firms. Yet because the services they provide as their primary function overlap with some of those provided by banks as an ancillary function, investment firms today are, for reasons of historical and regulatory expediency, potentially subject to extensive prudential rules designed, and frequently updated, for the latter. This sets the stage for a partially arbitrary outcome in which some types of investment firms are subject to substantial capital requirements while others escape with comparatively little. The fact that some supervisors are compelled to "correct" for this anomalous situation by requiring specific types of investment firms to comply with additional capital add-ons to cover risks not addressed by the main requirements (so-called Pillar 2 powers) testifies to this.

In contrast to banks, whose prudential rules capture risks in lending and other banking-activities and broadly aim to protect depositors and financial stability based on the threat and likelihood that the risks which they are exposed to materialise, investment firms face and pose far fewer risks of this type. Rather, the risks they pose are more specifically related to potential undue and unexpected harm for their clients and the markets they operate in. Their prudential rules ought to be based on the activities they conduct which can give rise to these risks and not those of banks. For example, a starting point for assessing the risk faced and posed by an investment firm that invests clients' money on a discretionary basis (a portfolio manager) could be the amount of money invested, the

type and riskiness of the instruments which the firm invests in, or whether they act on behalf of retail or professional clients. For an investment firm which holds and safeguards client funds and assets, the assessment of risks could look at the amounts of funds and assets held whereas for a firm which executes client orders, it could be based on transaction volumes. These would constitute more relevant proxies for the potential risks of investment firms than the existing proxies designed for banks. Instead, the current regime starts from the assumption that investment firms share the same risks as banks, and then chips away at the applicable requirements as a second step. Yet this does not avoid many classes of investment firms from having to assess their risks through the prism of risks of banks. Based on the evidence compiled by the Commission as part of the discussions with stakeholders outlined in Annex 3, this can result in significant overall compliance costs in the tens and hundreds of thousands of euros, covering notably staff, legal and IT costs, and depending on the size and type of firm[26].

Moreover, the CRR/CRDIV is premised on ensuring adequate capital and liquidity to prevent institutions from defaulting on their obligations in virtually all foreseeable circumstances. While the CRR/CRDIV is proportionate to the volume and range of activities undertaken by institutions, its basic assumption is that the public interest is best served by avoiding their failure. This is notably premised on the central role banks perform in granting credit to households and businesses and in accepting deposits from the public; functions which, if disrupted, can severely impair financial stability. As illustrated above, most investment firms are small. The volume and range of their activities, distinct from deposit-taking and lending, also means they are mostly far less interconnected with the rest of the financial system than large banks. Their services are also largely substitutable, in the sense that few investment firms are central to the functioning of financial markets. In most cases, it should therefore be possible to wind them down in an orderly manner without triggering contagion across financial markets. As a result of the low systemic relevance of most investment firms, the underlying CRR/CRDIV premise of ensuring sufficient buffers of capital and liquidity to withstand significant losses may be misplaced and represent disproportionate costs for them. Rather, the default assumption for investment firms could be the opposite, that a focus on ensuring sufficient resources to manage an orderly wind-down is sufficient, and that cases where extra resources are needed to keep an investment firm alive for the sake of the public interest should be the exception.

This is also relevant with respect to the current CRR/CRDIV remuneration and governance regime. These rules aim to curb excessive risk-taking in order to prevent the failure of individual firms leading to contagion across the financial system and to better align the interests of staff members with the long-term interests of the firms they work for. However, since most investment firms have different risk-profiles compared to credit institutions, do not take deposits or grant loans, and could be wound-down with little risk of triggering contagion across financial markets, it is considered that the current rules do not capture the risks posed by investment firms in an appropriate and proportionate way. While it is assessed that large and systemic investment firms should have sufficient resources to comply with all CRD IV/CRR governance requirements, and should also

[26] This data is based on a sample of diverse investment firms who replied to the Commission's survey, sent to a group of investment firms, trade associations and law firms which were actively engaged in the discussions on the review, and a workshop attended by c.30 participants in May 2017 from among this group.

remain subject to all CRD IV/CRR remuneration rules[27], for smaller investment firms, on-going compliance and implementation costs related to certain remuneration and governance requirements are likely to exceed their prudential benefits, given their low risk to financial stability.

Therefore, while progressively decreasing the requirements for all but the largest and most systemic investment firms recognises that their activities differ from banks, covering banks and investment firms together to begin with in a prudential regime which has undergone considerable change in response to weaknesses and developments in the business models of banks represents a source of regulatory complexity and disproportionality for investment firms. The many exemptions which have been necessary to continue to accommodate investment firms into the framework, coupled with the lack of risk-categories in the framework tailored to their specific business models can mean some firms escape an effective objective treatment within the current regime, giving rise to regulatory lacunae and possible opportunities for regulatory arbitrage for firms. Together, these problems can give rise to cases of inadequate levels of capital in some firms, act as a barrier to entry for others, and can complicate oversight by supervisors who lack an effective toolkit to monitor investment firms' risks.

3.2.2. Lack of risk sensitivity

Besides the inherent overall complexity of how the regime applies to investment firms in the first place, the detailed requirements themselves which apply are often poorly correlated to their business. The current regime, which is based on the Basel accord, is largely focused on addressing the risks posed by large international banks and is calibrated accordingly[28].

As detailed above, the prudential requirements that investment firms are subject to are driven by the activities they undertake. Some assumptions are made regarding the riskiness of some, but not all, of these activities. The reasoning is therefore partial. As a result, the current regime imposes capital requirements on the basis of these activities, according partially to the main types of business models of investment firms, but does not fully address the actual risks posed. For example, the requirements which result from institutions' exposure to credit, market and operational risks correspond to some of the conceivable threats and externalities posed by an investment firm's business but not all, and often in an approximate way (say relative to the size of client portfolios managed by an investment firm). Credit risk, the component which accounts for most of the resulting capital required from banks, is largely irrelevant for most investment firms which do not lend. Consequently, operational risk assumes a disproportionately high significance for them. Since the risk-criteria of the CRR/CRDIV often do not accurately reflect many of the risks which investment firms subject to own funds requirements actually incur, considerable work is required to reconcile internal data associated with running the business with the requirements of the framework. In several cases, the work is outsourced at non-negligible on-going cost to consultants and law firms. Also, often the precise risk-weights and calibrations attached to specific exposures and transactions,

[27] Final EBA report on new prudential regime for investment firms (EBA/Op/2017/11), section on remuneration

[28] This point about the relevance of Basel is also often made by smaller banks. However, the proportionality of how CRR/CRDIV applies to them is not under review here. In any case, as banks, the applicable requirements correspond to their profile better to begin with than to investment firms.

drawn up largely with banks in mind but also undertaken by various investment firms, can result in disproportionate requirements for the latter if they are a key focus of their business. This can for instance be the case for some investment firms specialised in commodity derivatives, whose specific case is discussed below. In addition, because the existing regime is designed from a banking perspective, some investment firm risks are not addressed at all (e.g. possible specific risks, distinct from the provision of other services, arising from the operation of Organised Trading Facilities (OTFs) under the future MiFID II).

Further, a key determinant of which category a firm falls into is whether or not it holds client assets or money. However, the applicable requirements are not sensitive to the amount of assets or money held. Also, because the requirements add up according to the range of services provided, a firm performing a small volume of services across many investment services can be subject to some higher requirements than a firm with a high turnover in one service even if the latter may in fact pose more risk from a prudential and systemic perspective[29]. Moreover, as the treatment corresponding to the provision of some investment services is not explicitly addressed in the CRR/CRDIV, they can therefore trigger some higher requirements by default, but this is not necessarily justified[30].

Also, with the extension of MiFID to all derivatives markets in 2007, some specialised firms dealing in commodity derivatives were carved out, either entirely from MiFID and prudential rules, or from capital and large exposure rules in the prudential framework, and the determination of the appropriate prudential regime to be applied to them has been pushed back several times[31]. This has mostly been due to the revision of MiFID and the relevant exemptions for commodity firms therefrom, but also reflects the fact that the current prudential framework as such as well as its detailed requirements have been generally considered to be ill-suited for these firms. The business of many of these firms involving financial instruments tends to revolve around hedging the risks of their parent companies related to the physical production, transmission, storage or purchase of the underlying physical commodities. Depending on the firm and sector (energy, agriculture), their volume of hedging activity can be substantial, implying a possible major impact from capital requirements under the current framework. Other relevant EU regulatory provisions[32] have already taken the specificities of commodity firms into account but the determination of the prudential rules for firms which would fall under the current framework has simply been postponed until now. As a consequence, the prudential treatment of these types of firms has been marked by continuing uncertainty and some differences between Member States[33].

[29] Although internal practices of cross-subsidisation and -selling between services may conceivably hide and amplify risks as well.

[30] This is currently the case for instance with regard to the services of underwriting without a firm commitment basis or operating a multilateral trading facility (MTF). MiFID II will add the service of operating an organised trading facility (OTF) to the list of investment services, which will also lack an explicit corresponding treatment under CRDIV/CRR.

[31] These exemptions are set to be narrowed down by MiFID II, while the expiry of the exemptions from CRR is now set for January 2021.

[32] Namely EMIR and its margin rules for non-financial corporations and MiFIDII with its exemptions for commodity dealers.

[33] E.g. UK FCA regime for Energy Market Participants and Oil Market Participants

Moreover, the current framework on remuneration and governance does not appropriately capture the business model of investment firms and does not reflect their remuneration structure. A Commission review of the remuneration rules under CRD IV/CRR finalised in 2016[34] revealed that the deferral and pay-out in instruments requirements are generally not efficient in the case of small and non-complex credit institutions and investment firms. The application of the maximum ratio rule could lead to an increase of the firm's fixed cost base, which may be a problem since revenues of investment firms, unlike in the case of credit institutions, are mainly generated by commissions and fees, and are therefore highly volatile. In such cases, an increased fixed pay resulting from the application of the maximum ratio rule could impact investment firms' ability to remain profitable in times of economic downturn or reduced revenues[35]. The lack of flexibility of the rules on remuneration and governance results in a suboptimal level of supervision as it compels supervisors to enforce requirements vis-à-vis investment firms, in situations where this might not be warranted from a prudential supervision perspective.

Overall, the inappropriate and approximate nature of many of the current rules and their lack of sensitivity to the risks actually posed by investment firms mean that some of the risks in their operations referred to above are currently not covered by appropriate and proportionate prudential requirements. Newcomers can also be discouraged either by the overall lack of clarity how to comply with the current framework, the applicability of multiple requirements which are ill-suited for their business plans, the higher requirements which apply by default to some services which are not explicitly considered in the CRR/CRDIV or a combination of all of these. These problems can result in a barrier to entry for new providers of investment services, add to cases of inadequate levels of capital in some firms, and complicate oversight by supervisors.

3.2.3. Differences in application across Member States

In addition to the in-built complexity and lack of risk-sensitivity of the current regime, there is the added complexity of differing national transpositions and use of options in the framework. One such option is the possibility for national competent authorities to apply capital requirements from the old CAD rather than the CRR to some firms authorised only to provide the execution of orders and portfolio management[36]. Furthermore, MiFID was designed for reasons of investor protection and the orderly and transparent functioning of markets. The way in which the categorisation of investment services reads across into prudential requirements was not considered in a coherent way as they were developed, but separately. In addition there may not be a uniform application of the designation of different investment services. For example, in some Member States, investment firms are required to seek authorisation for closely-linked services (e.g. execution of client orders and reception and transmission of client orders, or execution of client orders and dealing on own account when the firm trades in its own name) but not in others. This issue of differences in national interpretations between types of investment services under MiFID is itself not under review here. Indeed whether

[34] Report from the Commission to the European Parliament and the Council: Assessment of the remuneration rules under Directive 2013/36/EU and Regulation (EU) No 575/2013COM(2016) 510 final

[35] Final EBA report on new prudential regime for investment firms (EBA/Op/2017/11), section on remuneration

[36] Article 95(2), third subparagraph, of the CRR

investment firms' ordinary business falls under one or two licensing requirements in different Member States does not necessarily raise any major regulatory or level-playing field issues under MiFID. On its own, these differences would not materially affect their business model or choice of where to incorporate. However, because the designation of these services under MiFID determines the application of the relevant CRR/CRDIV rules, this means that prudential requirements may not be applied in a harmonised manner and the costs these entail may be different in each Member State.

One example of this is the fact that the designation of investment firms in the CRR/CRDIV influences the amount of initial capital that is required for a firm to be authorised. By default, the amount of initial capital held by an investment firm should be EUR 730 000 (Article 29 CRDIV). This is reduced to EUR 125 000 in cases where a firm does not deal on its own account or underwrite on a firm commitment basis while still holding client money or securities and, if Member States choose, to EUR 50 000 if such a firm is not authorised to hold client money or securities. In some cases, Member States have also adopted entirely different initial capital requirements, partly due to the fact that the levels in CRDIV have not been amended since 1993. The problem is also compounded by the fact that neither MiFID nor the CRR contain a precise definition of holding client assets. Therefore, different determinations of whether client assets are "held" under accounting or prudential norms, notwithstanding requirements to ensure they are properly segregated from the firm's own assets, can mean that the application of these rules may differ across Member States.

Moreover, there are some inconsistencies in the national measures transposing CRD IV. These have usually kept the rules on credit institutions and investment firms separated in two different legal texts; therefore, investment firms continued to have their dedicated regime, following the CAD model at EU level in the pre financial crisis period. However, provisions applicable to “institutions” in CRDIV (i.e. both credit institutions and investment firms) did not receive a mirroring transposition for investment firms. Additionally, such mirroring provisions have sometimes been adopted much later than those on credit institutions, Member States arguing that CAD rules applied nonetheless. Further, initial capital requirements for local firms (Article 30 CRD IV) have not been transposed in most Member States, the justification provided being that local firms do not operate in those Member States. Also, most Member States did not see the need to transpose specific rules on the initial capital for particular types of investment firms (Article 29 CRD IV), as they do not allow investment firms executing investors’ orders for financial instruments to hold such instruments for their own account, for example. In contrast, at least one Member State has applied CRR own funds requirements to firms which are excluded from the CRR definition of "investment firms", considering that the exemptions accorded in the CRR for these firms can create an un-level playing-field.

Finally, as a result of the lack of risk-sensitivity in the current framework examined above, some firms can end up with very large requirements imposed on them by national supervisory practice (so-called Pillar 2 requirements). In other words, absent an effective primary means of defining capital requirements (Pillar 1), the tool in the CRR/CRDIV-kit which is intended as the fall-back (Pillar 2) becomes that primary mechanism. This is subject to national supervisory judgment and thus may lead to undue differences in the required prudential stance in similar circumstances across borders. According to information gathered by the EBA, for several firms Pillar 2 requirements can exceed those of Pillar 1 by 100%. This observation of how national discretion is applied

confirms that the current prudential regime fails to cover the risks of investment firms in an appropriate and risk-sensitive manner.

3.2.4. Systemic investment firms: risks of regulatory and supervisory arbitrage

The sections above demonstrate that the current framework is unsuitable for the vast majority of investment firms. However, as advised by the EBA and proposed by the Commission as part of its amendments to the CRR/CRDIV in November 2016[37], this is not the case for investment firms identified as global or other systemically important institutions (G-SIIs/O-SIIs). Rather, their systemic relevance, including the nature and reach of their activities, merits their continued application of the existing framework, including the amendments proposed thereto. As explained in the introduction, this is considered to be a fully proportionate framework for these firms due to the significant scale and size of the risks which they face and pose, which should not be undermined.

Currently, investment firms identified as systemic (i.e. O-SIIs) are concentrated in the UK, from where they provide wholesale market and investment banking services across the EU and beyond. These firms are typically subsidiaries of US, Swiss or Japanese banking groups/broker-dealers. They incur and underwrite risks on a significant scale. Their activities expose them to credit risk, mainly in the form of counterparty credit risk, as well as market risk for positions they take on own account, client related or not. They accordingly present a higher risk to financial stability, given their size and interconnectedness. Moreover, they provide services throughout the internal market, which presents an additional challenge for supervision organised along national lines.

This introduces two linked challenges. First, as steps are taken to address the problems identified in the sections above for the vast majority of investment firms, it should be ensured that new opportunities for regulatory arbitrage are not created which could allow investment firms which should remain subject to the rules of the CRR/CRDIV to escape its scope. For example, this could be the case if a systemic investment firm were to split itself into smaller sub-entities in an effort to avoid the CRR/CRDIV and instead benefit from any adjustments or simplifications introduced for non-systemic investment firms. This type of regulatory arbitrage could cause harmful disparities in the prudential treatment of these firms, which would still constitute a systemic entity on a group-basis and should remain subject to consolidated application and supervision under the CRR/CRDIV. Otherwise, this could in turn threaten financial stability and the integrity and functioning of the Single Market. Second, amid the intention of the UK to withdraw from the EU, these firms are likely to decide to relocate part of their activities to the EU. This raises an issue of prudential supervision. Even though these firms provide cross-border investment banking services on a significant scale and as such should remain subject to CRR/CRDIV, their authorisation and prudential supervision would be carried out by national competent authorities, not the Single Supervisory Mechanism within the European Central Bank[38] as would be the case for significant credit institutions in the

[37] See footnote 8

[38] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63–89)

Banking Union[39]. This may lead to several shortcomings. National supervisors which currently supervise large credit institutions or investment banks may lack the expertise and overall perspective that is essential to effectively address the prudential risks associated with these big cross-border firms. There is also a risk of harmful supervisory arbitrage. The potential prospect of a "race to the bottom" could notably concern the degree to which firms would be allowed to outsource relocated activity back to the parent company located in a third country as well as national authorities' stance on waiving prudential requirements on a solo basis and on designating firms as O-SIIs (allowing them to operate outside the CRR/CRDIV under the future bespoke regime for investment firms)[40]. This could lead to inconsistent supervision between credit institutions and systemic investment firms, undermining the level playing field for these firms across the EU as well as between systemic investment firms located in different Member States, and thereby threaten financial stability and the integrity and functioning of the Single Market.

These risks exist regardless of whether the relocation of activities would be to Member States which participate in the Banking Union (Euro Area) or to other Member States. However, based on anecdotal information, at this stage the indications are that the preferred locations for these firms' EU27-operations are in financial centres in Euro Area Member States (Germany, Ireland, Netherlands, Luxembourg, France). Regarding the scale of the activities which are expected to be relocated to these Member States, there are some indications to suggest that over time this will constitute a sizeable share.[41]

The possible relocation of other UK-investment firms, while potentially significant in terms of numbers of firms, does not represent a challenge on a par with the situation regarding systemic investment firms. The possibility for these firms, which are considerably smaller in size and generally have simpler business models and less cross-border reach, to generate risks to the same degree is far less, implying that their potential relocation to EU27 Member States does not represent the same risks of regulatory arbitrage, financial stability and fragmentation for the Single Market as systemic firms. Indeed, considering the assessment in the sections above that the CRR/CRDIV is not appropriate and proportionate for all non-systemic investment firms, the prudential treatment of their possible relocated operations in the EU27 should reflect this and they should not therefore be forced to apply the CRR/CRDIV-rules. Finally, in contrast to the anecdotal information regarding systemic investment firms' actual relocation plans, little is known at this stage about these plans for smaller UK-based firms.

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[39] In the Euro Area, prudential supervision of credit institutions is conducted by the ECB and national competent authorities (NCAs) – within the framework of the Single Supervisory Mechanism (SSM). The allocation of responsibilities between the ECB and NCAs depends on the significance of the supervised entities. If a credit institution meets certain significance criteria for the Euro Area as a whole, it will be supervised by the ECB (unless the ECB decides there are particular circumstances that would justify a different allocation of responsibilities). However, investment firms are not be supervised by the ECB, and are only included in the supervision of banking groups which include an investment firm on a consolidated basis.

[40] ESMA has announced an effort to quell any race to the bottom and to coordinate NCAs' authorisation practices for relocated investment firms but the remit of its members does not always effectively extend to prudential rules. ESMA opinion 31 May 2017 – General Principles to Support Supervisory Convergence in the Context of the UK withdrawing from the EU

[41] For example, research published by Bruegel estimates that "35 percent of London wholesale banking is related to EU27-based clients, varying from about one fifth for UK-headquartered banks to a third for US-headquartered banks and half for EU27-headquartered banks. Thus, about €1.8 trillion (or 17 percent) of all UK banking assets might be on the move as a direct consequence of Brexit."

4. REVIEWING THE PRUDENTIAL REGIME

4.1. Role and purpose of prudential requirements

A starting point for reviewing the current framework is an understanding of the purpose served by prudential requirements for investment firms. In general, suitable and sufficient prudential requirements for financial institutions are considered to be a necessary part of the regulatory conditions for them to provide their services. In the case of investment firms, their activities are varied but hinge on seeking returns from taking risks for their clients and/or for themselves by investing in different financial instruments. The potential returns on offer of investing in different financial instruments can be substantial, potentially incentivising investors, shareholders and creditors in investment firms to overlook cases of excessive risk-taking or management failures by the firm. Pure market discipline by these stakeholders may not always be enough to ensure that decisions taken by the firm are in their best interest or in the wider public interest of maintaining financial stability. If unchecked by suitable prudential arrangements, the possibility of problems for their clients and for markets more broadly increases if the risks inherent in the investments or in other parts of the operations of investment firms materialise. These problems can occur both during the life of an investment firm and if it needs to be wound down.

If firms act exclusively as agents for their clients and for example limit their services to investment advice or the management of their portfolios, the risks inherent in the financial instruments mostly reside with their clients, meaning the firm's own risks from performing these services are limited. However, sufficient resources and arrangements are still required to underpin the functioning of these firms in an orderly way and ensure that their incentives align with the best interests of their clients. If firms act also as principals to the trades, they assume greater risks themselves[42]. Depending on the activities they undertake, this can extend to them holding their clients' money or assets and taking sizeable positions on their behalf in different market segments. Some firms can also offer products with a guarantee on all or a part of their clients' initial investment, amplifying the market and liquidity risks they are exposed to, which may not be fully covered by the fees charged for the service. For the most part, the core activities of investment firms are distinct from "shadow banking"-activities which typically involve credit intermediation by way of maturity and/or liquidity transformation, credit risk transfer and raising funds with deposit-like characteristics[43]. Yet larger investment firms can also be active in parts of this market, for instance in securities lending and repurchase transactions.

As with other financial institutions, it is difficult to accurately foresee in advance the exact ways in which an investment firm's actions could cause undue harm for their customers or for the markets they operate in and to assign capital, liquidity and other prudential requirements accordingly. Nonetheless, these requirements should be

[42] This distinction rests on the fact that firms that deal on own account as principals expose their balance sheet directly to risks in trading financial instruments, whether or not for hedging purposes, with limited overnight positions, or through the use of leverage (borrowing funds to increase the volume of transactions). Consequently, they can pose an elevated risk to the functioning of markets as themselves, in contrast to agent-only firms which are not party to the transactions themselves.

[43] See Commission Communication on Shadow Banking – Addressing New Sources of Risk in the Financial Sector of 4 September 2013 (COM(2013)614)

calibrated in a proportionate and appropriate way to how a firm's services expose customers, the firms themselves and their wider market environment to these risks. The CRR/CRDIV requirements have been refined over time based on considerable empirical experience with how bank-risks have materialised. They embed far less detailed recognition of how this has played out for investment firms, mostly due to the fact that the requirements themselves don't target their risks very well to begin with. As outlined in section 2, the result is that their application to investment firms is complex, risk-insensitive and subject to considerable fragmentation across Member States.

4.2. **Objectives of the review**

As financial intermediaries facilitating investor access to securities and derivatives markets, investment firms play a useful socio-economic role in channelling capital and savings toward productive uses across the EU. Therefore, on a general level the review of the prudential rules which apply to these firms forms part of the Commission's initiatives to ensure a strong and fair Single Market with a well-functioning and stable financial system and a Capital Markets Union which mobilises investments and boosts growth and jobs.

More specifically the review is aimed at assessing and addressing the problems outlined in section 3.2 above. Overcoming these implies setting the objectives below:

- *More appropriate, risk-sensitive prudential requirements*: the requirements should cover the risks actually posed and incurred by investment firms across all types of business models in a more tailored and comprehensive way than the current framework. For investment firms in aggregate, capital levels should not necessarily change significantly, but the distribution of capital across firms should correspond better to actual risks. An appropriate regime would avoid misaligning the capital and the actual risks of the firms, in order to ensure that any externalities and possible impacts for investment firms' customers and the markets in which they operate are adequately addressed without overburdening firms with disproportionate requirements. The requirements on remuneration and governance should correspond to the risks posed by the activities of investment firms and be adjusted to their business models and remuneration structures, making the rules easier to comply with and oversee.
- *A framework that accommodates investment firms for the business they conduct and avoids regulatory arbitrage*: the framework should avoid the situation where the identification of investment firms, and the subsequent prudential requirements applied to them, is subject to an overly complex, or insufficiently clear process, which gives rise to the potential for regulatory arbitrage, including in the context of Brexit and potential decisions by UK-firms to relocate parts of their activities to the EU27. The framework should be clear as to which requirements apply to which firms and should provide transparency as to how these requirements are derived, thereby alleviating overall compliance costs. The prudential regulatory conditions for investment firms to conduct their business should not constitute excessive or disproportionate hurdles to market entry (on top of the conduct of business and organisational requirements of MiFID).
- *A streamlined regulatory and supervisory toolkit:* the framework should facilitate effective supervisory oversight by competent authorities regarding the actual risks posed and incurred by investment firms in order to boost the orderly and

efficient functioning of these markets, avoiding excessive or redundant supervisory requirements and any regulatory blind-spots.

These objectives are linked and overlap to some extent. They are all relevant for addressing the problems identified in section 3.2 in a comprehensive manner but table 3 below illustrates which problem they most notably relate to.

Problem	Objective
Complex and disproportionate regime	A framework that accommodates investment firms for the business they conduct and avoids regulatory arbitrage
Lack of risk-sensitivity	More appropriate, risk-sensitive requirements
Differences in application by Member States	A streamlined regulatory and supervisory toolkit

4.3. **Summary of EBA advice on new prudential regime**

The review mandated by Articles 493(2), 498(2), 508(2), 508(3) of the CRR requires the Commission to consult the EBA and ESMA. Accordingly, a first call for advice to them was sent by the Commission in December 2014. In response, a report by the EBA and ESMA was published in December 2015 evaluating the functioning of the current regime and recommending a revised prudential framework for all investment firms which are not systemic and which should remain in the CRR/CRDIV[44]. A second call for advice by the Commission on the content of a revised prudential regime was sent in June 2016. The final advice of the EBA, developed as a result of this process and including a discussion paper published for consultation in November 2016[45], involves the design of a new bespoke prudential regime for non-systemic investment firms distinct from the existing CRR/CRDIV-framework[46].

The starting point of the EBA is to identify the key risks which all non-systemic investment firms incur and pose as part of their daily business and in case they fail as opposed to the existing framework which is aimed more towards the risks faced and posed by credit institutions. As such, it replaces many of the risk-metrics and concepts of the existing framework which are designed for banks and which do not capture the business of many investment firms. However, rather than invent new risk-metrics and concepts in areas which are already captured by the existing framework, the EBA advises to retain these for investment firms, albeit simplified in several respects. The bespoke regime would then apply capital and other prudential requirements to investment firms depending on whether or not, and the degree to which, their activities and business profile represented the given risk-metrics and concepts.

[44] EBA/Op/2015/20

[45] EBA/DP/2016/02 Discussion Paper, Designing a new prudential regime for investment firms https://www.eba.europa.eu/documents/10180/1647446/Discussion+Paper+on+a+new+prudential+regime+for+Investment+Firms+%28EBA-DP-2016-02%29.pdf/cf75b87e-2db3-47a3-b1f3-8a30fa6962da

[46] EBA/Op/2017/11

The EBA's proposals set prudential requirements in order to mitigate the risks which the activities of investment firms may pose towards their customers, the markets more generally, as well as for the orderly functioning of the firm itself. They are calibrated in recognition of the fact that, in most cases, investment firms can be wound down without triggering contagion across financial markets. Capital, liquidity and other prudential requirements should therefore not exceed their purpose nor increase across the board for all firms, but rather be better targeted at the risks actually posed by different types of investment firms.

4.3.1. Categorisation

The EBA proposals entail a new categorisation of investment firms. Rather than 11 categories, there would be three main ones. As per their initial recommendations, systemic investment firms constitute Class 1 and would remain in the CRR/CRDIV (see section 4.4 below). Class 2 firms are those which either deal on own account and incur market and counterparty credit risk, safeguard and administer client asset, or hold client money or are above the following size-thresholds (assets under management under both discretionary portfolio management and non-discretionary (advisory) arrangements higher than EUR 1.2bn; client orders handled of at least EUR 100mn/day for cash trades and/or at least EUR 1bn/day for derivatives; balance sheet total higher than EUR 100mn; total gross revenues higher than EUR 30mn. They are required calculate their capital requirements in relation to the new K-factors (see next section). Class 3 firms are those which don't conduct the above activities and which are below all the above thresholds. They are required to calculate their capital requirements in relation to the existing CRR provisions for fixed overheads or as equal to revised levels of initial capital, whichever is higher. Class 3 firms are not required to meet a capital requirement set in relation to the K-factors. This focuses their requirements solely on facilitating their orderly wind-down.

4.3.2. Capital requirements

For all non-systemic investment firms, the EBA bases their capital requirements on a new set of factors which measure their risk to customers, to markets and to the firms themselves. The result of this approach is a capital regime based on a number of so-called "K-factors".

Risks to customers are caught by the following new K-factors: client assets under management and ongoing advice, assets safeguarded and administered, client money held, and customer orders handled. For risks to market, the applicable K-factor captures a firm's net position risk, based on existing CRR requirements for market risk, or where permitted by the supervisor for specific types of investment firms, one based on margins posted with a firm's clearing member. This allows investment firms to choose to apply either the standardised approach under CRR (i.e. simplified standardised approach in CRR2) if their assets are below EUR 300 million or the revised standardised approach under the CRR2 as well as the option to use internal models. In the latter cases, the resulting capital requirement can be decreased to 65%, making permanent the possibility under CRR2 to apply this on a temporary basis for three years, in order to take account of investment firms' overall lower prudential relevance. Finally, risks to firm from the default of a trading counterparty or from concentration risk are caught, respectively,

based on simplified CRR requirements for counterparty credit risk[47] and large exposure risk, while the operational risk from intra-day trading is caught by reference to a new risk-metric for daily trading flow.

Table 4 – K-factors for determining capital requirements for investment firms

Risk type	K-factors	New or based on CRR?	Metric	Rationale
Risk to Customer (RtC)	**K-AUM**	New	Assets under management	The risk of harm to clients from incorrect discretionary management of customer portfolios or poor execution, providing customer reassurance in terms of the continuity of service of ongoing portfolio management and advice
	K-CMH	New	Client money held	The risk of harm where an investment firm holds the money of its customers, regardless of whether they are on its own balance sheet or segregated in other accounts.
	K-ASA	New	Assets safeguarded and administered	The risk of safeguarding and administering customer assets, and ensures that investment firms hold capital in proportion to such balances, regardless of whether they are on its own balance sheet or segregated in other accounts.
	K-COH	New	Customer orders handled	The risk to clients of a firm which executes their orders in the name of the client, and not in the name of the firm itself, e.g. as part of 'execution-only' services and in the reception and transmission of orders.
Risk to Market (RtM)	**K-NPR**	CRR	Net position risk	The risk of trading exposures in financial instruments, FX and commodities based on the CRR
	Or			
	K-CMG	New	Clearing member guarantee	The margin posted with a clearing member against trading risks
Risk to Firm (RtF)	**K-TCD**	CRR	Trading counterparty default	The risk to an investment firm of counterparties failing to fulfil their obligations, multiplying exposures

[47] However, the firm could opt to apply CRR-methods for counterparty credit risk instead, for instance if it is part of a banking group.

				by risk factors based on the CRR, into account the mitigating effects of effective netting and the exchange of collateral.
	K-CON	CRR	Concentration risk	Concentration risk in relation to individual or highly connected private sector counterparties with whom firms have exposures above 25% of their capital and resulting in capital add-ons in line with the CRR.
	K-DTF	New	Daily trading flow	The operational risks in large volumes of intra-day trades based on the gross value of settled cash trades and notional value of derivatives.

The overall capital requirement is the sum of the above K-factors. This is derived by multiplying the volume of activity referred to by the new K-factors for K-AUM, K-CMH, K-ASA, K-COH, and K-DTF by the coefficients indicated in Table 5 for a given K-factor[48]. The volumes of K-CMH, K-ASA, K-COH and K-DTF are calculated on the basis of a rolling average from the previous three months, while for K-AUM it is based on the previous year.

Table 5 – Coefficients for each new K-factor (besides K-CMG)

K-factor	Coefficient
K-AUM	0.02%
K-ASA	0.04%
K-CMH	0.45%
K-COH & K-DTF cash/derivatives	0.1/0.01%

For those risks which rely on existing rules the capital requirement is set either with reference to or by a modified application of the respective CRR-provisions. K-NPR is set with reference to the CRR while K-TCD and K-CON are set by a modified application of the respective CRR-provisions.

The overall capital requirement from applying K-factors would be the sum of the following:

[48] The EBA developed the calibration of the coefficients for each K-factor individually based on the data it collected as a flexible way of ensuring the targeted outcome of the review, namely that overall capital requirements for investment firms across the EU should not increase significantly and that there should be a rebalance in the way capital applies in favour of Pillar 1 over Pillar 2. The starting point is the calculation of the ratio of the fixed overheads requirement (FOR) to the different metrics used for each K-factor, as reported by firms. These ratios are then used to set the coefficient for each K-factor, at levels that would correspond largely to the objectives of ensuring that capital is not increased substantially across the board and that the majority of smaller firms continue to be subject to the simpler FOR requirement rather than to the K-factor approach.

Capital requirement = (a*K-AUM + b*K-CMH + c*K-ASA + d*K-COH + (K-NPR or K-CMG where permitted) + K-TCD + K-CON + e*K-DTF

where a, b, c, d and e are coefficients in Table 5 and where the amount of a K-factor is simply zero if a firm does not undertake the relevant activity.

Finally, the capital instruments which qualify as own funds for investment firms to meet their capital requirements consist of the same items as under CRR/CRDIV. For this purpose, Common Equity Tier 1 (CET1) capital CET1 should constitute at least 56% of regulatory capital, while Additional Tier 1 (AT1) is eligible up to 44% and Tier 2 capital up to 25% of regulatory capital.

4.3.3. Initial capital

The EBA proposes to revise the levels of initial capital as follows. The initial capital of an investment firm that is authorised to provide the investment services or to perform the investment activities of dealing on own account, underwriting or placing on a firm commitment basis, or operating a multilateral trading facility (MTF) or organised trading facility (OTF) should be EUR 750 000. An investment firm that is not authorised to provide these investment services and which does not hold client money or securities should have initial capital of EUR 75 000. Finally, all other investment firm should have initial capital of EUR 150 000. These amounts should be met by firms on a permanent basis.

4.3.4. Liquidity

The EBA proposes that liquidity requirements apply, in some cases for the first time, to both Class 2 and 3 firms. Specifically, both should demonstrate adequate internal procedures to manage their liquidity needs and are required to hold a minimum amount of liquid assets equal to one third of their fixed overheads requirement to cover these. The list of liquid assets and applicable haircuts is aligned with the Liquidity Coverage Ratio (LCR) under the CRR[49] and supplemented with cash at external banks (excluding any client money). For Class 3 firms, this is further supplemented with receivables from trade debtors and fees/commissions from their services within 30 days, provided these don't exceed one-third of the minimum liquidity requirement, do not count towards any additional liquidity requirements imposed by the competent authority, and that they are subject to a haircut of 50%. In exceptional circumstances, investment firms can fall below the required threshold by monetising their liquid assets to cover liquidity needs, provided they notify their competent authority immediately. All financial guarantees provided to customers, which can give rise to increased liquidity needs if triggered, reduce the amount of available liquid assets by at least 1.6% of the total value of such guarantees.

4.3.5. Concentration risk

The EBA proposes that all investment firms are required to monitor and control their concentration risk, including in relation to their customers. However, only Class 2 firms

[49] Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for credit institutions (OJ L 11, 17.1.2015, p. 1–36)

are required to report to competent authorities on their concentration risks for instance in terms of the risk of default of their counterparties, where they hold client money, securities and their own cash, and concentration risk from their earnings. Those firms that deal on own account or execute client orders in their own name should not exceed an exposure to a single or to connected counterparties equal to 25% of their regulatory capital, subject to specific derogations for exposures to credit institutions or other investment firms and with broadly aligned exemptions in terms of exposures to central banks, governments, central counterparties etc. These limits may only be exceeded if additional capital requirements under K-CON are met, calculated as a multiple of the amount of any K-NPR and K-TCD attributed to the relevant exposure and according to the relative size of the excess.

4.3.6. Treatment of groups

The EBA proposes that investment firms which are part of a banking group should also apply the new rules on an individual basis. A waiver is provided for Class 3 firms which are part of a banking group headquartered in the same Member State, considering that the consolidated application of the CRR/CRDIV to the group should sufficiently cover their risks. For groups containing only investment firms, the EBA retains the existing option under CRR to ensure sufficient capital at the top-company level and makes this the norm. However, competent authorities can also require groups of firms to apply the requirements on a group-basis, for instance in circumstances where a group of investment firms are deliberately structured to fall below the thresholds for being a Class 2 firm or are highly interconnected and applying capital to the group as a whole would better reflect its risks.

4.3.7. Supervisory reporting and public disclosure

The EBA recommends that investment firms are required to report to their competent authorities on their compliance with the prudential framework, in accordance with detailed requirements to be articulated in Level 2 implementing measures. Class 2 firms which are subject to the K-factors have more granular reporting requirements than those subject to the capital requirement either in terms of permanent minimum capital or fixed overheads. These firms shall publicly disclose their levels of capital and their capital requirements whereas small and non-interconnected firms shall not have public disclosure requirements.

4.3.8. Supervisory review and evaluation (Pillar 2)

Based on the internal capital adequacy assessments of both Class 2 and 3 firms, the EBA recommends that competent authorities should have powers to review and evaluate the prudential situation of investment firms and, where necessary, to exercise powers to require changes in areas such as internal governance and controls, risk management processes and procedures and, where needed, setting additional requirements, including in particular in relation to capital and liquidity requirements.

4.3.9. Corporate governance and remuneration

With regard to corporate governance and remuneration requirements, the EBA recommendations are based on the assessment that MiFID II overall offers sufficient guarantees for Class 3 investment firms. For Class 1 investment firms the CRR/CRDIV regime, including the maximum ratio rule, is considered fully appropriate. For Class 2

firms, given their risk profile, the EBA assessment is that some CRD-like provisions could be an appropriate add-on to MiFID II requirements. With regard to corporate governance, these would include risk management arrangements and country-by-country disclosure. Specialised management body committees are recommended only for significant Class 2 investment firms. With regard to remuneration, the additional provisions should be in the EBA's assessment similar to those in CRD IV, UCITS[50] and AIFMD[51] Directives. However, the EBA does not provide a concrete recommendation on whether the maximum ratio rule should be maintained for Class 2 investment firms. On the one hand, the EBA draws the attention to the fact that the maximum ratio rule can be an effective tool to limit the incentives for short-term risk taking, especially if the deferral and pay out in instruments requirements are not applied. On the other hand, the EBA points out to the impact of the maximum ratio on the fixed costs of investment firms and their ability to remain profitable in times of economic downturn. The collection of data and aggregate disclosure of high-earners is recommended. Finally, EBA proposes some simplification of the pay out in instrument rules for Class 2 firms and provides estimates for the number and market share of investment firms which could be excluded from the application of the pay out in instruments and deferral rules should derogations for smaller Class 2 investment firms be considered.

4.3.10. Transitional provisions

To mitigate the effects of possible increases in capital requirements, the EBA proposes that these can be limited to twice the level of the capital requirements under the current regime for 3 years after entry into force of the new regime. For new firms which are not subject to the current regime, the capital requirements can be limited to twice the level of the fixed overheads requirement, while those subject only to initial capital today can apply a cap equal to twice this level. Increases in initial capital can also be met incrementally over a period of five years. Firms that transition from Class 3 to Class 2 would have to apply the K-factor requirement immediately, except for the K-AUM and K-COH where firms should be allowed 3 months from the date they exceed the categorisation thresholds before being reclassified to Class 2. Meanwhile a Class 2 firm should meet the criteria for being in Class 3 for at least 6 months before being confirmed as belonging to Class 3. Finally, investment firms specialised in commodity derivatives which fall within the scope of MiFID II should be granted a phase-in period before becoming fully subject to the prudential regime together with all other investment firms.

4.4. **Systemic investment firms**

The EBA proposes to develop detailed Level 2 regulation for the identification of Class 1 systemic investment firms. However, amid the backdrop of UK-based systemic investment firms relocating to the EU27 and the recommendations of the EBA[52] and

[50] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), amended by Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014

[51] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers

[52] Opinion of the European Banking Authority on issues related to the departure of the United Kingdom from the European Union (EBA/Op/2017/12) of 12 October 2017 http://www.eba.europa.eu/documents/10180/1756362/EBA+Opinion+on+Brexit+Issues+%28EBA-Op-2017-12%29.pdf

ESMA[53] to ensure a regulatory level playing field between credit institutions and systemic investment firms, rather than postpone the decision until the process reaches the Level 2 stage, it is considered that this is more appropriately done at Level 1. This section describes the options for doing so and therefore goes beyond the EBA's advice in its opinion on the review of investment firms and delivers on its opinion on issues related to the decision of the UK to withdraw from the Union.

There are two main options to avoid regulatory loopholes which could allow systemic investment firms which should remain subject to the CRR/CRDIV to escape its scope and to help ensure that the relocated activities of UK-based systemic firms are brought under effective supervision to ensure a level playing field[54]. First, the criteria for being identified as a global or other systemically important institution (G-SII/O-SII) which should continue to fall under CRR/CRDIV could be tightened to ensure systemic firms are effectively caught and Member States' discretion to designate them is reduced. Second, the definition of "credit institution" in the CRR/CRDIV could be amended to also cover these systemic investment firms based on the nature and size of investment services they provide and thereby lock them into the CRR/CRDIV and bring them under the scope of the SSM.

Both of these options have advantages and disadvantages. The first would have the advantage of making the G-SII/O-SII criteria more tailored for investment firms. On the other hand, it could involve an extensive and lengthy examination of the criteria, with little work and consensus achieved so far on what these changes should consist of. It would also involve revisiting provisions which were difficult to agree in the current framework. Even if the changes did not affect the designation of banks and were limited to investment firms, tightening the O-SII criteria to minimise some more subjective and discretionary elements could be controversial for many Member States keen to retain the flexibility of the current framework. The current level of discretion was a conscious choice by the legislators considering that the O-SII framework was conceived as a macroprudential tool.

The second option, amending the CRR definition of credit institution to capture systemic investment firms, has the advantage of sidestepping a lengthy examination of the O-SII criteria. It essentially concerns amending one definition and is thereby more straightforward. This would equate systemic investment firms with credit institutions in a permanent sense, helping to minimise the scope for any regulatory arbitrage which the tinkering of the O-SII criteria could leave open. This could be done by adding to the current definition of credit institutions those investment firms that provide the most risky and systemically critical investment services on a significant scale, namely undertakings that (1) deal on own account and underwrite on firm commitment basis; and (2) exceed certain size thresholds in terms of e.g. total assets at individual or group level. This would be coherent with the recommendation of the EBA, referred to in section 3.2 above,

[53] ESMA opinion 31 May 2017 – General Principles to Support Supervisory Convergence in the Context of the UK withdrawing from the EU

[54] A third option, amending the scope of the SSM Regulation is not considered here. The Commission report reviewing the SSM Regulation (forthcoming, add reference) did not find any major issues in the application of that Regulation that would need to be addressed. Opening it up for the issue discussed here alone is not considered an effective and efficient way of proceeding, considering that the SSM Regulation can only be amended by unanimity and it could risk opening up other aspects of the functioning of the SSM that were controversial at the time of its negotiation.

to exclude investment firms which perform these activities from falling in the lighter category of Class 3, ensuring they fall under the more stringent Class 2 instead. In this case, if their size reaches a critical threshold, they are then 'elevated' into Class 1.

In addition, this option would also have a read-across to other pieces of EU legislation which refer to the CRR/CRDIV-definition of 'credit institution', notably the Directive on Deposit Guarantee Schemes[55] and the Bank Recovery and Resolution Directive[56]. The change in the definition would also have implications for the SSM Regulation and thereby imply not only that systemic investment firms would remain subject to the CRR/CRDIV, but also that their prudential supervision is ensured by the SSM to the extent that they are established in Member States participating in the Banking Union. This would further consolidate the aim of ensuring that systemic investment firms do not escape the requirements of the CRR/CRDIV, avoiding the regulatory arbitrage and risks for financial stability and the fragmentation of the Single Market which this would entail, by vesting key decisions over the authorisation and supervision of these firms with the ECB and creating a level playing field with the centralised supervision of credit institutions, subject to the same rulebook.

By extension, this would also then apply to the Regulation setting up the Single Resolution Mechanism (SRM)[57]. Otherwise, the responsibility between the national and the EU-level for supervision and resolution would not be aligned. This would also mean that the contributions of these investment firms to resolution funds would no longer be made to national funds set up pursuant to the Bank Recovery and Resolution Directive (BRRD)[58] but to the Single Resolution Fund (SRF) under the SRM. This could create some redistribution in the contributions of institutions to the SRF, but conceptually this would be no different than when credit institutions already subject to contributions to the SRF grow or shrink in size[59]. However, in some cases different business models will continue to be treated differently. For example, whether or not they were to fall under the Directive on deposit guarantee schemes (DGS), including in terms of having to contribute to DGS funds, would depend on whether they began to accept deposits.

One difficulty with this approach is to determine the right size-threshold in order to ensure the population of investment firms which is caught is neither too large nor too

[55] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (OJ L 173, 12.6.2014, p. 149–178)

[56] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190)

[57] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014, p. 1–90)

[58] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190)

[59] The target level of the SRF is set in relation to a percentage of deposits covered under Deposit Guarantee Schemes in participating Member States, with individual institutions contributions a function of their share of the total liabilities of all institutions in these Member States.

small. A hard threshold can also cause possible cliff-effects for firms as they grow/shrink in size, although this can be mitigated by setting the threshold based on an average of assets over time.

Therefore, amending the CRR definition of credit institution to capture systemic investment firms is considered the best option for minimising the scope for regulatory arbitrage and potential risks for financial stability and the fragmentation of the Single Market which the creation of a new regime for non-systemic investment firms could entail. As discussed, this would firmly subject systemic investment firms into the CRR/CRDIV which is considered to be the appropriate and proportionate regime for them. For these firms little would change as they would continue to apply the current framework. This option would also imply, for Member States participating in the Banking Union, their prudential supervision by the ECB. Furthermore, by limiting the necessary changes to the definition of credit institution rather than more far-reaching changes, it is an efficient way of achieving this outcome.

5. ASSESSING THE IMPACT OF THE NEW REGIME

5.1. Changes implied by the EBA advice

The EBA advice would rely on three main tools and result in a number of changes. First, it would set up a dedicated and harmonised new prudential framework for non-systemic investment firms separate from the CRR/CRDIV. Second, it would introduce a new categorisation of investment firms based on the size and type of their activities. Third, it would revise the scope and content of prudential requirements that would apply to investment firms depending on their categorisation and profile, targeting the business models of investment firms both with the new K-factors for setting tailored capital requirements and in other areas such as liquidity and concentration risk where existing provision for risks already targeted by the current framework would be adjusted.

These tools and associated changes as well as how they would help achieve the objectives of the review outlined in section 4.2 above (more appropriate, risk-sensitive prudential requirements; a framework that accommodates investment firms better for the business they conduct and avoids regulatory arbitrage; and a streamlined regulatory and supervisory toolkit) are summarised in table 6 below. For example, greater harmonisation notably serves to streamline the regulatory and supervisory toolkit. The simpler categorisation also helps in this respect but also to avoid regulatory arbitrage, for instance in terms of ensuring that systemic firms alone remain in the CRR/CRDIV while opportunities and incentives for other firms to adjust their business in order to secure specific prudential treatment are minimised. Finally, the revised scope and content and the tailoring of the requirements to investment firms improves its appropriateness and overall risk-sensitivity.

Table 6 – Outline of key changes and contribution to achieving objectives

	CRR/CRDIV	**EBA proposals**		**Appropriate and risk-sensitive rules**	**Accommodate firms better, less scope for arbitrage**	**Streamlined toolkit**
Level of harmonisation	Medium	High				✓

Categories	11	3 main categories			✓	
Scope and content of requirements	Largely bank-centric	New K-factors + modified CRR		✓		

5.2. **Main impacts**

The following sections examine the main impacts of the changes proposed by the EBA in terms of capital and liquidity requirements, compliance costs and wider effects. In terms of quantitative impacts, the EBA's aim was to calibrate its proposals in line with the objectives outlined in section 4.2. Namely overall capital requirements across the population of investment firms should not change significantly, but they should be better targeted at the actual risks faced and posed by different kinds of firms. Second, most investment firms which are small and non-interconnected should continue to be subject to lighter requirements, notably in relation to their capital.

5.2.1. Capital requirements

Based on the sample of firms it obtained data from (c.1200 firms or c.20% of EEA investment firms), the EBA assesses that under the new regime approximately two-thirds would be Class 2 firms and one-third would be Class 3 firms. However, the EBA admits that its data is biased towards Class 2 firms since smaller firms (prospective Class 3 firms) contributed less data. Therefore, the share of firms in each category is likely to be different in practice.

For firms in Class 3, their capital requirements would, where higher than their initial capital, be set in terms of their fixed overheads requirements, calculated in accordance with Commission Delegated Regulation (EU) 2015/488[60]. For around 1800 firms that only provide reception and transmission of orders and/or investment advice, based on EBA data from 2015[61], this would mean becoming subject to the fixed overheads requirement for the first time (and to the K-factors if they exceeded the relevant thresholds of assets under advice of EUR 1,2bn or annual income of EUR 30mn or balance sheet size of EUR 100mn). However, the EBA's data gathering from c.1200 firms indicates that most firms ought to comfortably meet the new requirements based on their existing levels of own funds. Based on the fact that the fixed overheads requirement mostly relies on common expenses associated with running an investment firm, this finding could be extrapolated with a reasonable degree of confidence to most firms which currently do not have a specific regulatory requirement to hold own funds. Nonetheless, the EBA proposes to revise the content of the fixed overheads requirement in a Level 2 measure, in order to account for the specificities of some firms whose business models and associated overheads might not be sufficiently reflected in the present rules (e.g. commodity dealers subject to MiFID II for the first time). Little concrete change is expected for firms which are already subject to the fixed overheads requirement and which would fulfil the criteria for Class 3.

[60] Commission Delegated Regulation (EU) 2015/488 of 4 September 2014 amending Delegated Regulation (EU) No 241/2014 as regards own funds requirements for firms based on fixed overheads (OJ L 78, 24.3.2015, p. 1–4)

[61] Table 12 in EBA/Op/2015/20

For investment firms in Class 2, whose capital would be set by the K-factors which capture some risks for the first time, the impacts can be expected to be more substantial. However, the EBA's assessment is that these impacts would be concentrated in a relatively small number of individual firms, not for all or some types of investment firms more generally. This is explained on the one hand by the fact that the K-factors for K-AUM, K-COH, K-ASA and K-CMH would capture the corresponding activities for the first time and accordingly increase capital requirements for some firms which conduct these activities on a significant scale. On the other, two K-factors which are based on requirements in the CRR (K-TCD and K-NPR) would also be responsible for increasing capital requirements for some firms which incur these risks[62].

The data analysis of the EBA, presented in summary form in Annex 2, illustrates that the most impacted business models[63] in terms of higher capital requirements include investment advisors, execution brokers, firms which place securities and portfolio managers. The results mask individual impacts for firms, meaning that the increase across the population as a whole for that business model can in some cases be attributed to a small number of firms. For others such as trading firms and custodians, requirements as a whole would decrease, but for individual firms in these groups this would depend on whether they were subject to the either the fixed overheads requirement, the permanent minimum capital or to the K-factors . The decrease for trading firms under the K-factors can for example be due to the fact that they would no longer need to calculate capital requirements for operational risk under the EBA proposals.

On aggregate, for investment firms across the board, the EBA assesses that requirements would increase 10% compared to Pillar 1 requirements today, and decrease 16% compared to total requirements applied as a result of Pillar 2 add-ons. In terms of available own funds, the EBA finds that most firms ought to have sufficient capital to comfortably meet the new requirements. On aggregate, around 7% in their data from c.1200 firms exhibit a shortfall, mostly concentrated in a small number of investment advisors, trading firms, and multiservice firms. As mentioned, for firms in this group whose increases would be over twice their current requirements, a cap for three years could be granted.

The EBA's proposals for calibrating the requirements are on the basis of EU-wide aggregates. Consequently, in some Member States the national aggregate level of capital for investment firms may increase or decrease. In some cases where some Member States have several investment firms with a particular business model (e.g. proprietary trading firms in the Netherlands who trade through clearing members), consideration is also being given to allowing capital to be set according to existing practices (i.e. K-factor for clearing member guarantee explained in section 3.1).

5.2.2. Liquidity requirements

A similar story applies in relation to the EBA's proposed liquidity requirements. They find that, based on their data from over 1200 firms, more than 80% of firms meet the

[62] However, the EBA assesses that this may be overestimated based on firms having reported non-trading book positions in the EBA's data collection which the future regime would not apply to.

[63] The EBA stresses that the business model categorisation is subject to a high degree of subjective assessment regarding firms' principal profile.

proposed level set at a third of the fixed overheads requirements with cash or highly liquid assets. Around 70% of firms have over three times the amount available. Less than 10% of the firms in their data set would fail to meet the requirements if they were applied today. While the EBA's data exercise did not subject the liquid assets of investment firms to the haircuts they propose to apply pursuant to the LCR, it is observed that most firms would meet the requirements in cash to which no haircut applies.

5.2.3. Compliance and administrative costs

Besides the direct costs associated with the new requirements for some firms in terms of capital requirements, one-off indirect costs can be expected from the need for firms to revamp risk management systems, update compliance departments and revise contracts with law firms and other providers of services currently used to facilitate compliance. Some stakeholders consider these to represent sunk costs from the present regime, potentially exposing individual firms to EUR tens of thousands, based on the approximate costs identified in the work of the Commission regarding the costs of the current regime[64].

In terms of the benefits of the changes, the migration of investment firms to a prudential regime more tailored to their risks ought to considerably benefit them. Setting capital and other prudential requirements, including remuneration and governance, in proportionate fashion to investment firms for the first time alleviates the significant costs which firms incur as a result of the bank-centric requirements of the current regime. The complicated task of matching and reconciling business data to an ill-fitted regulatory framework and reporting regime would end, bringing down compliance costs in the process. For example, streamlining the current onerous reporting framework can be expected to result in a reduction of administrative burdens and compliance costs for all investment firms. How these reductions in compliance costs would relate and compare to changes in capital requirements for different types of firms is not known at this stage but should feature in the monitoring and evaluation of the framework. Their operating conditions ought to improve as a result, freeing capital from mislaid and unproductive regulatory purposes for more productive uses, including for innovative firms seeking to grow through digital means. Finally, remuneration policies and practices should be more appropriate to their business cycles and revenue streams.

5.2.4. Impacts beyond investment firms

In terms of their customers and counterparties, the increased resilience and risk-readiness of investment firms should reassure them that they will not be unduly impacted by the risks and possible problems incurred by firms. Through the application of rules which are more tailored to their business, customers of investment firms should be better protected from the risks incurred by firms, including in the event that they fail. This should help reduce economic losses in drawn-out insolvency proceedings or reliance on investor compensation schemes, avoiding consequent impacts on other firms to top-up these schemes to handle pay-outs. Overall confidence, investor sentiment and market stability

[64] This data is based on a sample of diverse investment firms who replied to the Commission's survey, sent to a group of investment firms, trade associations and law firms which were actively engaged in the discussions on the review, and a workshop attended by c.30 participants in May 2017 from among this group.

should also benefit, with positive knock-on effects for the needs of the users of investment firms, including those seeking to access finance in securities markets.

Supervisors would also have a more appropriate framework of rules to carry out their oversight. Redundant regulatory and supervisory information could be scrapped while decreasing the possibility of actual risks going undetected. A more tailored set of risk-measures, required ratios of capital, liquidity and other indicators, and the relevant associated reporting by firms, as well as remuneration and governance requirements, would help supervisors perform their role in a more focused and targeted way, boosting the orderly and efficient functioning of financial markets. At the same time, the proposed powers for supervisors would not limit their ability to impose additional prudential requirements on firms where necessary, including as part of macro-prudential oversight.

In tandem, the functioning of the Single Market and the development of the Capital Markets Union should be boosted. This includes facilitating access to finance for SMEs which are not banks or investment firms themselves. A more suitable prudential framework should help free up capital from unproductive regulatory purposes and allow investment firms to offer better services to their customers, including SMEs, boosting competition and improving investors' access to new opportunities and better ways of managing their risks. This should contribute to helping investment firms act as intermediaries in mobilising investments from savers across the EU and thereby facilitating non-bank sources of finance for European economic actors.

5.3. **Assessment of the EBA proposals in terms of the objectives of the review**

This section examines how the EBA's proposals align with the objectives of the review for: more appropriate, risk-sensitive prudential requirements; a framework that accommodates investment firms better for the business they conduct and avoids regulatory arbitrage; and a streamlined regulatory and supervisory toolkit.

The EBA's proposals would remove investment firms from the complex and disproportionate application of the CRR/CRDIV framework, which was designed to capture the risks of banks, and base their prudential requirements on the specific and most relevant risks they pose for customers and markets. It would allow capturing risks in investment firms' business models which have thus far gone unaddressed for the first time, thereby improving risk-sensitivity and supervisory oversight. For instance requirements for firms in Class 2 would be scaled appropriately for firms depending on whether and what amount of client money and securities they hold, administer or handle. Together, this would serve the objective of the review to design more risk sensitive prudential requirements.

The EBA proposals would also carry over some requirements which are already specific to investment firms in the existing framework and which continue to serve a purpose, e.g. fixed overheads requirement for smaller firms. Having initially considered an option to conceive of investment firms' risks from trading in a different way from the CRR-provisions on market risk[65], the EBA advice would also support a level playing field between banks and investment firms where the risks faced by each are similar (e.g. market risk arising from trading activities). In this respect, it relies on concepts that are

[65] The EBA's November 2016 discussion paper proposed capital requirements be set relative to trading volume.

familiar to firms both from their existing regulatory requirements and market practice (e.g. possibility to rely on margins posted with clearing members to cover trading risk), but applies existing requirements in a slightly simpler manner than the existing regime and the revisions it is currently undergoing. It would also allow for some specific consideration e.g. for investment firms specialised in commodities for their trades conducted for hedging purposes for the group and the resulting intra-group exposures. Furthermore, rather than rethinking other prudential concepts like liquidity and large exposures rules anew, it completes the framework through a simplified application of the existing CRR provisions. These factors all contribute to the proportionality objectives of the review, both for investment firms themselves and in order not to create competitive distortions vis-à-vis other players in the market, notably credit institutions.

The requirements would be sensitive and would adjust as firms' risks grow in accordance with the business they undertake, unlike today where they shift abruptly as a firm moves into a new category if it adds a new investment service to its profile. With its fixed set of criteria for distinguishing Class 2 and 3 firms, the EBA's revised categorisation is more predictable and balances greater certainty for firms with greater risk-sensitivity. It would reduce the scope for regulatory arbitrage by firms between the current categories of treatment and between Member States. By capturing their business in a more blunt and direct way than the existing regime, investment firms would be less able to secure a significantly different prudential treatment by adjusting specific aspects of their business models.

Altogether, this represents a significant simplification in the way their capital is set, both from the perspective of supervisors and firms. It would make the process of complying with capital requirements far more linked to the business models of firms. It should therefore help achieve the objective of better accommodating investment firms for the actual business they conduct and should facilitate market entry. This notably also contributes to the REFIT-aims of the review, namely to ensure that legislation is simple, proportionate and up-to-date, and delivers on its aims effectively and efficiently.

In terms of governance and remuneration rules, relying on MiFID II for Class 3 firms and going beyond these rules only for Class 2 firms seems proportionate. The EBA recommendations for the additional corporate governance requirements comparable to CRDIV rules[66] are not considered to be excessive. With regard to remuneration, the general remuneration principles in CRD IV/CRR[67] also seem appropriate for Class 2 firms in order to promote sound and effective risk management and not to encourage excessive risk-taking. Concerning the requirements for deferral and pay-out in instruments, it has been assessed that these are not efficient in the case of small and non-complex credit institutions and investment firms, and of staff with low levels of variable remuneration[68]. On that basis, in November 2016[69] the Commission already proposed to amend the CRDIV to exempt small institutions (defined on the basis of their balance sheet) and persons with low levels of variable remuneration from these two requirements. Given that Class 2 investment firms are generally much smaller in terms of the balance sheet than credit institutions and Class 1 investment firms, a threshold set at a lower level

[66] Based on Articles 76(1) and (2) and 89 of CRDIV
[67] Art 92 CRDIV
[68] Report from the Commission "Assessment of the remuneration rules under Directive 2013/36/EU and Regulation (EU) No 575/2013 (COM (2016) 510 final).
[69] COM(2016) 854 final, Article 94(3).

would be more appropriate. With regard to the maximum ratio rule, the observations made by the EBA on its impacts on the cost flexibility and profitability of Class 2 investment firms in times of reduced revenues have led to questions as to the appropriateness of the rule for such firms.

Compliance costs should decrease across all types of firms as they would be relieved of all awkward CRR-calculations to determine their capital and instead perform these in a more straightforward way based on how their business operates. The reduction should be greatest for Class 3 firms, who would have the simplest requirements. Among the main beneficiaries are investment firms which are SMEs[70]. A more proportionate and appropriate prudential framework for investment firms should help improve the conditions for conducting their business and barriers to entry should decrease. For example, streamlining the current onerous reporting framework can be expected to result in a reduction of administrative burdens and compliance costs for SME-firms, including for innovative firms seeking to grow through digital means. Likewise, compliance would be simplified for all Class 2 firms which don't trade financial instruments, who would simply multiply the volumes of their easily and readily measurable business lines by a given coefficient to determine their capital. Initial one-off costs in adapting to the new rules should rapidly smooth out over time as the regime beds down. Relative to investment firms that don't trade on own account, the greater complexity for some trading firms to apply CRR-requirements for market risk alongside simplified versions of existing CRR-rules should be offset by the fact that in most cases these requirements already apply today.

In terms of impacts on levels of capital, if aggregate requirements are not expected to increase significantly across the board in line with one of the objectives of the review, the EBA's proposals for calibrating the requirements seem like a fair and balanced compromise. The impacts for types of firms who would see their capital increase would be relatively smaller than under possible alternative calibrations with lower thresholds to qualify for Class 3 status and/or higher K-factor coefficients which were discussed as part of the review, and in a way which would be more proportionate in attempting to achieve the objectives of the review to increase prudential safety where necessary but without overburdening specific firms or the sector overall with significant capital increases. The EBA's proposals to phase-in the regime in case of significant increases for some firms are also useful in this respect.

Furthermore, the EBA's recommendations have been developed with input from stakeholders. Investment firms represent various business models and their views tend to focus on aspects of the proposals specific to them. This complicates cross-cutting comparisons of the relative weight of stakeholder-positions. Overall however, the large majority of stakeholders welcome a tailored prudential framework more suitable for their business models. They stress that their systemic relevance is limited, that they do not pose risks akin to credit institutions e.g. for depositors, and that capital requirements should focus on ensuring they can be wound down in an orderly way. In terms of specific requirements which apply to their particular business model, investment firms which

[70] As defined in the Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (OJ L 124, 20.5.2003, p. 36–41), i.e. enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million.

conduct agency-only services and do not enter into transactions in financial instruments using their own balance sheet generally criticise proposals for linking capital requirements to the volume of client portfolios and orders they handle or manage in a linear way. Many firms which trade on own account agree that the provisions of the existing framework for capturing market risk have some merit in light of the risks they incur and pose but welcome further simplification and downward-adjustments compared to the rules applicable to banks. Concerns have also been expressed by commodity firms, for instance regarding the zero-threshold for trading activities for Class 2 and their de facto exclusion from the lighter regime for Class 3 firms.

The EBA is understood to have taken these views into account in the calibration of the proposed new risk-metrics, the possibility to phase-in and cap higher requirements, the adjustments for commodity firms, the commitment to revisit the way fixed overheads are calculated, and a general review clause on the calibration in due course. Alternatively, the EBA could have opted to propose higher thresholds or fewer criteria for investment firms to fall into Class 2 and/or lower coefficients for the K-factors for firms in Class 2. These would have led to more firms being able to benefit from the lighter requirements for Class 3 firms, and to lower capital requirements for Class 2 firms. However, this would probably have meant a decrease of overall capital across the population of investment firms and capital levels for Class 2 firms which are insufficiently calibrated to the risks they incur and pose. While sensitive to the proportionality-objectives of the review, this would have compromised the objective of ensuring that capital is properly risk-sensitive.

Finally, as noted in section 4.4, the only critical area where it is considered better to go beyond the EBA's advice on the investment firms' review regards the method for classifying systemic investment firms. Rather than postpone decisions for identifying them to Level 2, it is preferred to recategorise them as credit institutions in Level 1 and thus deliver on the EBA's opinion on issues related to the decision of the UK to withdraw from the Union. The supervision of large and complex investment firms under the remit of supervisors responsible for credit institutions, including direct supervision by the ECB for significant institution, would minimise the scope for regulatory arbitrage and potential risks for financial stability or the integrity of the Single Market in a number of ways. First, it would level the playing field in terms of authorisation and supervision of large investment firms and large credit institutions. Second, it would strengthen the supervision of wholesale market activities, as it would enable prudential supervisors to have a more comprehensive overview of the group of institutions providing those services. Finally, it would make supervision more consistent across groups, as the consolidating supervisor would also have powers over large individual investment firms within the group.

6. CONCLUSION

Overall, compared to the status quo, the EBA recommendations are considered to be an appropriate and proportionate means of achieving the objectives of the review in an effective and efficient manner. More generally, the EBA advice is a clear positive step towards a prudential framework for investment firms which can both underpin the safe functioning of investment firms on a sound financial basis while not hindering their commercial prospects. As such, it should support the aims of the review in a balanced fashion, on the one hand helping to ensure that the risks of investment firms for

customers and markets are addressed in a more targeted way both in their ongoing operations and in case they need to be wound down and, on the other, that they can fully perform their role in facilitating investment flows across the EU, consistent with the aims of the Capital Markets Union to mobilise savings and investments to boost growth and jobs.

ANNEX 1 – SYNOPTIC TABLE OF INVESTMENT FIRMS IN CRR/CRDIV[71]

	Categories	Initial capital	Own funds	Large exposures	Liquidity	Leverage	Buffers	Reporting	Remuneration and governance
1	Local firms (CRR 4(1)(4))	€50k (CRD 30)	N/A	N/A	N/A	N/A	N/A	National rules	MiFID II
2	Firms falling under CRR 4(1)(2)(c) that only provide reception/transmission and/or investment advice	€50k (CRD 31(1))	N/A	N/A	N/A	N/A	N/A	National rules	MiFID II
3	Firms falling under CRR 4(1)(2)(c) that only provide reception/transmission and/or investment advice and are registered under the Insurance Mediation Directive (IMD)	€25k (CRD 31(2))	N/A	N/A	N/A	N/A	N/A	National rules	MiFID II
4	Firms falling under CRR 4(1)(2)(c) that perform, at least, execution of orders and/or portfolio management	€50k (CRD 31(1))	CRR 95(2)	N/A	N/A	N/A	N/A	COREP (COM regulation Art 7)[72] if 95(2)2nd subpara applies;	MiFID II

[71] The information in the table is based on Table 2 in EBA/Op/2015/20 and refers to some of the key Articles of the main provisions of the CRR/CRDIV which apply to firms' treatment on an individual basis. It does not give a complete overview of applicable requirements. A different treatment can apply on a consolidated basis.

[72] Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council (OJ L 191, 28.6.2014, p. 1–1861)

								national rules if 95(2) 3rd subpara applies	
5	Investment firms not authorised to perform deals on own account and/or underwriting/placing with firm commitment that do not hold client funds/securities	€50k (CRD (29(3))	CRR 95(1)	N/A	N/A	N/A	N/A	COREP (COM regulation Art 7)	MiFID II & CRD IV/CRR
6	Investment firms not authorised to perform deals on own account and/or underwriting/placing with firm commitment but hold client funds/securities	€125k (CRD 29(1))	CRR 95(1)	N/A	N/A	N/A	N/A	COREP (COM regulation Art 7)	MiFID II & CRD IV/CRR
7	Investment firms that operate an MTF	€730k (CRD 28(2))	CRR 95(1)	N/A	N/A	N/A	N/A	COREP (COM regulation Art 7)	MiFID II & CRD IV/CRR
8	Investment firms that only perform deals on own account to execute client orders	€730k (CRD 28(2))	CRR 96(1)(a)	N/A	CRR 6(4), or national exemption pending review	N/A	CRD 128, or national exemption under 129(2) and 130(2) from CCB and CyCB[73]	COREP (COM regulation Art 7)	MiFID II & CRD IV/CRR
9	Investment firms that do not hold client funds/securities, only perform deals on own account, and have no external clients	€730k (CRD 28(2))	CRR 96(1)(b)	N/A	CRR 6(4), or national exemption pending	N/A	CRD 128, or national exemption under 129(2)	COREP (COM regulation Art 7)	MiFID II & CRD IV/CRR

[73] CCB – Capital conservation buffer; CyCB – Countercyclical capital buffer

					review		and 130(2) from CCB and CyCB		
10	Commodity derivatives investment firms that are not exempt under the MiFID	€50k to 730k (CRD 28 or 29)	CRR 498	CRR 493	CRR 6(4), or national exemption pending review	CRR 6(5)	CRD 128, or national exemption under 129(2) and 130(2) from CCB and CyCB	National rules	MiFID II & CRD IV/CRR
11	Investment firms that do not fall under the other categories	€730k (CRD 28(2))	CRR 92	CRR 387	CRR 6(4), or national exemption pending review	CRR 6(5)	CRD 128, or national exemption under 129(2) and 130(2) from CCB and CyCB	COREP (COM regulation Art 5)	MiFID II & CRD IV/CRR

ANNEX II – EBA advice: main impacts

Table 1 – Changes in capital requirements per business model[74]

Business models	Nb. Firms	% Changes vs Current Pillar 1 requirement		Business models	Nb. Firms	% Changes vs Current Pillar 1 requirement
Custodians	**17**	**-11%**		**Portfolio managers**	**533**	**19%**
FOR	7	-16%		FOR	237	0%
PMC	6	-63%		PMC	163	-12%
K_Factors	4	26%		K_Factors	133	31%
Execution brokers	**92**	**47%**		**Trading firms**	**69**	**-13%**
FOR	33	47%		FOR	16	29%
PMC	37	8%		PMC	21	-27%
K_Factors	22	48%		K_Factors	32	-14%

[74] Business models are illustrative and grouped by the EBA on a judgemental basis. The total number of firms is based on the sample from which the EBA obtained data. For advisory firms, increases are due inter alia to currently several (large) advisors being subject to initial capital only and the new K-factor proportional to the assets under advisory arrangements.

Investment advisors	**87**	**308%**		**Multiservice firms**	**93**	**5%**
FOR	37	365%		FOR	17	-16%
PMC	32	-7%		PMC	29	-38%
K_Factors	18	306%		K_Factors	47	14%
MTF	**8**	**0%**		**Wholesale market brokers**	**9**	**8%**
FOR	6	0%		FOR	6	4%
PMC	1	3%		PMC	1	3%
K_Factors	1	0%		K_Factors	2	12%
Placing firms	**12**	**29%**		**Total**	**920**	**10%**
FOR	3	31%				
PMC	6	10%				
K_Factors	3	42%				

Table 2 – shortfall with respect to current own funds[75]

	Firms in sample	Firms with shortfall	Total shortfall (€)	Average shortfall (€)
Custodians	**17**	**0**	**-**	**-**
FOR	7	0	-	-
PMC	6	0	-	-
K_Factors	4	0	-	-
Execution brokers	**92**	**11**	**18,640,454**	**1,694,587**
FOR	33	4	5,344,868	1,336,217
PMC	37	2	-	-
K_Factors	22	5	13,295,587	2,659,117
Investment advice	**87**	**11**	**83,143,620**	**7,558,511**
FOR	37	3	442,190	147,397

[75] 'Shortfall' is meant as the difference between the capital requirements under the new framework and the own funds currently available. These values are calculated only for investment firms having a shortfall; firms with excess of own funds with respect to the capital requirements are not included in this calculation

PMC	32	0	-	-
K_Factors	18	8	82,701,430	10,337,679
MTF	**8**	**0**	**-**	**-**
FOR	6	0	-	-
PMC	1	0	-	-
K_factors	1	0	-	-
Placing firms	**12**	**0**	**-**	**-**
FOR	3	0	-	-
PMC	6	0	-	-
K_Factors	3	0	-	-
Portfolio managers	**533**	**32**	**85,478,895**	**2,971,215**
FOR	237	6	6,124,632	1,020,772
PMC	163	3	-	-
K_Factors	133	23	79,354,263	3,450,185
Trading firms	**69**	**3**	**23,548,244**	**7,849,415**
FOR	16	1	2,216,000	2,216,000

PMC	21	0	-	-
K_Factors	32	2	21,332,244	10,666,122
Multiservice firms	**93**	**3**	**104,609,856**	**34,869,952**
FOR	17	0	-	-
PMC	29	1	-	-
K_Factors	47	2	104,609,856	53,304,928
Wholesale market brokers	**9**	**1**	**2,934,351**	**2,934,351**
FOR	6	0	-	-
PMC	1	0	-	-
K_Factors	2	1	2,934,351	2,934,351
Total	**920**	**61**	**318,355,420**	**5,218,941**

ANNEX III – PROCEDURAL STEPS AND STAKEHOLDER CONSULTATION

I. Introduction

The review has been carried out with the comprehensive advice of the EBA, in consultation with ESMA, as required by the relevant Articles in Regulation (EU) No 575(2013) which constitute the legal basis for the review (notably Article 508(2) and (3)). It was also conducted in close consultation with industry stakeholders throughout the process. These steps are outlined in detail below.

In terms of the main milestones, following a first Call for Advice by the Commission in December 2014, the EBA published a first report on the current prudential framework for investment firms together with proposals for changes in December 2015. This constitutes a comprehensive and publicly available analysis of the status quo, with data on numbers and types of investment firms in Member States. This analysis helped broaden the reach of the review to stakeholders who may not be directly impacted by the rules to engage in the subsequent discussion.

On 4 November 2016, the EBA published a discussion paper for consultation focusing on a potential new prudential regime for investment firms. The discussion paper was open for comments for 3 months (until 4 February 2017). Its work was also supported by a detailed data-gathering exercise from investment firms by national competent authorities on behalf of the EBA. This helped substantiate and verify stakeholders' input with granular data.

Given the detailed public consultation and data collection undertaken by the EBA, it was agreed that the Commission would not run a general public consultation in parallel. Instead the Commission services engaged in targeted consultation with stakeholders in order to gather views on the main elements of the review. This included a roundtable with industry stakeholders (investment firms, investors, law firms, consultants) on 27 January 2017 on the proposed future regime, a workshop on the costs of the current regime on 30 May 2017 and a workshop on the EBA's draft final recommendations on 17 July. The review was discussed with Member States in the Financial Services Committee in March and October 2017 and in the Experts Group on Banking, Payments and Insurance in June and September 2017.

These targeted consultations and meetings helped further substantiate the analysis of the current regime and of the available policy alternatives in line with Better Regulation guidelines. This enabled developing a robust analysis and consensus behind the proposals developed on the basis of the EBA's work.

The Commission also considered input received previously in the wide-ranging Call for Evidence on the efficiency, consistency and coherence of the overall EU regulatory framework for financial services in which several respondents pointed to various issues relevant for the review[76].

The EBA outlined its final recommendations together with an indication of the proposed calibration of the new regime in July 2017. The final report was delivered on 29 September 2017.

II. Overview

- December 2014 – First call for advice from the Commission to EBA
- September 2015 –Commission Call for Evidence on the EU regulatory framework for financial services.
- December 2015 – First report by EBA evaluating the status quo and suggesting changes
- December 2015 – Commission's Stakeholders Meeting - Fact-finding on remuneration under CRD IV
- April 2016 – Commission request for further clarifications on EBA December 2015 Opinion on the application of proportionality to CRD IV remuneration provisions[77].
- June 2016 – Second call for advice to EBA
- June 2016 – Agreement by co-legislators on the extension of CRR-exemptions for commodity dealers until 2021
- July 2016 – Launch of first data gathering by EBA
- July 2016 – Commission Report on the assessment of the remuneration rules under CRDIV/CRR (COM(2016) 510 final)
- October 2016 – First reply from EBA to second call for advice on systemic investment firms to be kept under full CRR/CRDIV
- November 2016 – Publication of EBA discussion paper
- November 2016 – Commission proposals revising CRR/CRDIV, including waivers therefrom for all non-systemic investment firms
- November 2016 - EBA response to the Commission request for further clarifications on EBA Opinion on the application of proportionality to CRD IV remuneration provisions, with regard to credit institutions
- December 2016 – Launch of second data gathering by EBA
- January 2017 – Commission workshop on overall direction of EBA proposals

[76] See e.g. various replies submitted in the Commission's Call for Evidence of 2015 http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm

[77] https://www.eba.europa.eu/documents/10180/1667706/EBA+Opinion+on+the+application+of+the+principle+of+proportionality+to+the+remuneration+provisions+in+Dir+2013+36+EU+%28EBA-2016-Op-20%29.pdf

- March 2017 – Publication of inception impact assessment on Europa
- May 2017 – Commission workshop on costs of the current regime
- July 2017 – First publication of EBA final recommendations, EBA consultation on calibration proposals, Commission workshop on EBA proposals, and EBA data gathering for outstanding calibrations
- September 2017 – Final EBA report