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Finance for Europe

Association for Financial Markets in Europe

Consultation response

EBA consultation on draft Regulatory Technical Standards ('RTS') on the reclassification of investment firms as credit institutions in accordance with Article 8a (6)(b) of Directive 2013/36/EU

16 July 2021

The Association for Financial Markets in Europe (AFME[1]) welcomes the opportunity to respond to the EBA's second consultation on draft RTS on the calculation for the threshold for investment firms.

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors, and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

Summary

AFME and its members have noted and are concerned by the EBA's proposal to include the assets of every entity conducting relevant business in an institution's worldwide group in the calculation for the investment firms' threshold test, even where those entities are not part of an EU consolidation group and do not conduct activities within the EU. This intention was confirmed at the EBA's public hearing on 23 June.

There appears little reason for this approach to the inclusion of worldwide assets from either an economic or risk perspective and it introduces a range of very significant practical difficulties. Based on our observations below, the proposal does not appear to meet the IFR Roadmap principles[2] in relation to proportionality and level playing fields.

Our main observations and concerns are set out below.

Observations and Comments

CRD Level 1 Context

- The CRR Article 4 Level 1 text seems clearly intended to cover only EU assets in the test. For example, Article 4(1) of Regulation (EU) No. 575/2013 states the following 'where the undertaking is part of a third-country group, the total assets of each branch of the third-country group authorised in the Union shall be included in the combined total value of the assets of all undertakings in the group'. This text makes sense only in a context where the rest of the entity (outside the Union) and group as a whole are excluded. This was discussed and confirmed with policymakers, including the EBA and ECB, at the earlier stages of the RTS consultation and the change to bring in the worldwide assets of third country groups is not consistent with those prior conversations and stated application. Therefore the EBA's current proposals differ from the Level 1 text. Additionally, the Level 1 text does not provide a mandate for a change in the definition of 'group'.

1 AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

2 EBA Roadmap on Investment Firms, June 2020, pp. 4-5

- The proposal also runs counter to the objective stated in the EBA's recent report on the treatment of incoming third country branches[3] in relation to 'preserving the openness of the EU financial market to foreign players, acknowledging the beneficial contribution to the local economy and to international trade and finance.

<u>Economic and risk considerations</u>

- The IFR regime was intended to be proportional and the result of the EBA's intended approach would be that very small EU operations belonging to many third-country groups will be automatically required to become credit institutions. This would therefore penalise these small businesses and create a barrier to entry for third country groups which is not aligned with the objective of promoting the effective and efficient functioning of the EU's investment firm sector.
- It appears disproportionate also for the EBA to seek to get these small investment firms regulated as Class 1 systemic firms where in other jurisdictions (UK), these would be treated under the more preferential Class 2/IFPR regime. This immediately places the EU at a competitive disadvantage internationally and makes other countries a more attractive option for the establishment and centralisation of operations.

  One unintended consequence may be that remaining third country groups may be incentivised by the likely costs of re-authorisation to centralise EU activities in a single EU jurisdiction, choosing to operate one large credit institution rather than maintaining smaller investment firm operations in different EU jurisdictions where, as a result of the proposed RTS, each such smaller firm would have to be authorised as a credit institution. We do not think that this would be in the interest of the single market.

- The proposed approach to the threshold calculation does not appear sound from an economic or risk perspective as activities conducted outside the EU do not pose a direct risk to EU markets, consumers or market participants. The group threshold text already provides an appropriate 'anti-avoidance' measure to prevent EU or third country groups from dividing their EU activities across multiple entities to keep them individually below the threshold. The inclusion of non-EU activities is not required for this purpose.
- Where there is a perceived risk or concerns IFD Article 5 already provides discretion for competent authorities to apply requirements under the CRR to investment firms that are deemed systemically important.

- In addition, where the IFR entity is part of a group with another EU credit institution, for example due to the application of the Intermediate Parent Undertaking requirements, then consolidated requirements of the group will ensure that the IFR entity is effectively subject to the CRR. In this situation, the effect of the threshold change is not incremental group capital but unnecessary and excessive scrutiny, reporting and diligence for minor investment firms.

- We would note in addition that a threshold test based on EU assets limits the level of activity which could pose a competitive risk to EU-based groups to a very low level and therefore avoids the emergence of level playing field issues. It is suggested in paragraph 11 of the consultation paper that the proposed approach 'would ensure a level playing field in terms of treatment of relevant

[3] EBA Report to the European Parliament, the Council and the Commission on the treatment of incoming third country branches under the national law of Member States, in accordance with Article 21b(10) of Directive 2013/36/EU, June 2021, p, 55, para. 184.

undertakings of groups domiciled within the EU and relevant undertakings of groups domiciled outside the EU'. This is not substantiated, however, and there is no description or evidence provided in relation to the level playing field issue that policymakers are seeking to mitigate.

The cost-benefit analysis is not clear either on the policy objective and it does not consider credible proportionate options such as creating an upper threshold below which EU operations would not fall under the CRR. Indeed, it is not clear what the risks are that the change in policy is attempting to address. Instead, it considers options for the presumed position that the RTS will improve the functioning of the investment firm sector.

- There may be the risk that a regime in the EU which is perceived as super-equivalent may lead to further regulatory fragmentation internationally with associated challenges for EU firms seeking to access global markets.

Practical Implications

- A large number of third country groups have been preparing for their EU subsidiaries to move to the IFR for the last two years and under the proposals they would at this late stage face a move instead to the CRR. This very late change, which as mentioned appears to have little justification, would prove very disruptive and costly. It is already creating uncertainty for firms and is contrary to the stated aim of a non-disruptive transition.
- The amended approach will be impractical to implement as it requires large third-country groups to assess the activities of very large numbers of entities across the globe against EU definitions of their activities, and then apply IFRS consistently to these activities in order to measure them against thresholds. It would be unlikely also that this could be applied consistently across different groups.
- Each entity that is scoped into the consolidation group would need to convert local GAAP assets to IFRS. This is a difficult task as those familiar with the entity are unlikely to be familiar with EU GAAP/IFRS.
- Once asset data has been converted both for GAAP and exchange rate purposes, a consolidation between entities will need to be carried out, whereby intercompany assets are eliminated. Entity consolidation systems are set up to perform consolidations at particular levels incorporating all entitles in a group, but not necessarily set-up to accommodate a consolidation for a set of third country entities, where this data is not required for financial reporting purposes and whose only use is to indicate whether a threshold (€30bn) has been reached.
- In terms of the calculation methodology we would appreciate some clarity around which entities need to be included in the scope of the calculation. Should all entities that have the permissions (3) and (6) of Section A of Annex I to Directive 2014/65/EU (dealing on own account and underwriting respectively) be captured, or only those entities that are actively engaging in or carrying out such activities. It is also not clear from the consultation whether the asset value of entities that are directly credit institutions and so not subject to the threshold tests themselves, that are carrying out activities (3) and (6) should be included.
- The data collection template would be difficult to complete and submit regularly owing to significant lack of clarity around important definitions, including for example those in relation to 'equivalent activities' and 'undertaking'. The one-off cost of change and the on-going scale of the information request is disproportionate to the size of many of the entities involved. It would be more appropriate to suggest a threshold below which firms in the EU remain subject to the IFR and would not need to complete the template. Or if such a test is to be maintained, then a simpler approach should be

available, when it is clear, that the test will be met e.g. a simple declaration that relevant assets are greater than €30bn.

We would welcome the opportunity to discuss the points made in our response with the EBA further, if this would be helpful.

AFME Contacts