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European Banking Authority
Floor 46
One Canada Square
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(response submitted via EBA website)

Re: EBA/DP/2016/02 –
DESIGNING A NEW PRUDENTIAL REGIME FOR INVESTMENT FIRMS

Introduction

The Bank of New York Mellon Corporation (BNY Mellon) is a global investments company dedicated to helping its clients manage and service their financial assets throughout the investment lifecycle. As one of the world's largest investment services and investment management firms, BNY Mellon welcomes the opportunity to respond to the EBA Discussion Paper on designing a new prudential regime for investment firms.

BNY Mellon operates in Europe through: (i) branches of The Bank of New York Mellon (a New York state chartered bank) and (ii) directly established and duly authorised subsidiaries established in certain EU jurisdictions and branches of those entities operating in core EU member states.

BNY Mellon provides services to clients and end-users of financial services globally. Accordingly, BNY Mellon is keen to ensure global financial markets operate fairly and consistently, and that common standards are implemented in a way that ensures a level playing field.

Executive Summary

BNY Mellon supports the concept of a separate and harmonised prudential regime for investment firms, and we would encourage the EBA to build out its proposals in more detail. We think that a well-developed proposal would support important EU initiatives such as the Capital Markets Union, and jobs and growth. BNY Mellon would need to evaluate detailed proposals before being in a position to give unqualified support.

BNY Mellon is concerned that the proposal for an "intermediate EU parent undertaking" in Article 21b of the Capital Requirements Directive 5 (CRD5) counteracts the proposal for a new prudential regime for investment firms. Accordingly, we encourage the EBA to raise this issue with the European Commission, European Parliament and European Council.

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General Comments

BNY Mellon welcomes the EBA Discussion Paper on designing a new prudential regime for investment firms. Investment firms are a vital part of the financial landscape in the European Union and play a key role in providing jobs and growth across the Union.

As a global investments company, the BNY Mellon group includes several entities in the European Union which are "*investment firms*" as referred to in the Discussion Paper.

Examples of some of our investment firms in the region are:

- *Investment Management* – Insight Investment, Newton Investment Management, Walter Scott, BNY Mellon Investment Management EMEA Limited, Alcentra Limited
- *Investment Services* - Pershing Securities Limited, Pershing Securities International Limited, BNY Mellon Capital Markets EMEA Limited, BNY Mellon Fund Services (Ireland) DAC

Accordingly BNY Mellon has a strong interest in this Discussion Paper, as it is relevant for many of our business activities and entities in the European Union.

We also have a strong interest in this Discussion Paper in the context of the proposal for an "intermediate EU parent undertaking" contained in Article 21b of the Capital Requirements Directive 5 (CRD 5), published by the European Commission in November 2016.

BNY Mellon opposes the proposal for an "intermediate EU parent undertaking" for several reasons, one of which is that this proposal conflicts with the objectives of a new prudential regime for investment firms. We explain this in more detail below (see pp. 4-5).

A separate and harmonised prudential regime for investment firms

As a general principle, BNY Mellon supports the concepts of having:

- a *separate* prudential regime for investment firms versus credit institutions; and
- a *harmonised* prudential regime for investment firms across the EU member states.

We believe the Discussion Paper is a positive move in this direction.

Separate Prudential Regime

BNY Mellon supports the concept of a separate prudential regime for investment firms. Such a regime should be distinct from the prudential regime for credit institutions under the Capital Requirements Directive 4 (CRD4) and Capital Requirements Regulation (CRR). The rationale is that investment firms are fundamentally different from credit institutions in terms of their function, authorisations and risk profile. Accordingly, there should be a prudential regime that is tailored to investment firms.

Furthermore, as a general (but not universal) rule, investment firms are smaller than credit institutions, and are less systemically important. The application of CRD4/CRR requirements to a significant number of investment firms (such as "MiFID investment firms") creates a disproportionate burden upon such investment firms. Many of the CRR4/CRR requirements are not relevant or useful for investment firms. The economic and administrative burdens of CRR4/CRR upon investment firms, limits the ability of such investment firms to support jobs and growth in the EU.

In our view, having a separate prudential regime for investment firms would be consistent with and support the development of the Capital Markets Union (CMU), because investment firms (rather than credit institutions) must play a key role in the CMU to support jobs and growth.

Harmonised Prudential Regime

In situations where CRD4/CRR does not apply to investment firms, we currently have a system of national prudential regimes for investment firms.

We note that there is some degree of harmonisation of prudential regimes for investment firms already, as some categories of investment firms that are not required to apply CRD4/CRR, apply CRD3 equivalent rules instead.

We would argue that some of these national regimes work well in practice for investment firms, as they are more proportionate and tailored to investment firms. However, the fact that there are many national prudential regimes (sometimes even in the same jurisdiction) inhibits the creation of a truly EU-wide market in this space, and adds to compliance costs, particularly for smaller groups that may wish to operate in multiple jurisdictions.

Therefore, BNY Mellon supports the development of a harmonised prudential regime for investment firms across the EU member states. We also believe that a harmonised prudential regime is essential to support the CMU. The EBA may wish to retain an element of national discretion for non-MiFID investment firms, as is currently the case, but without detracting from the overall goals of a harmonised regime.

As we believe that the Discussion Paper is a positive move in the creation of a separate, proportionate and harmonised prudential regime for investment firms, BNY Mellon encourages the EBA to continue its work in this area, and to develop and publish more detailed proposals for public consultation. We say this subject to the following qualifications and caveats.

Qualifications and Caveats

BNY Mellon is supportive of the overall direction of the Discussion Paper and we encourage the EBA to develop more detailed policy proposals in this area. Such detailed policy proposals should be made available for public consultation through the usual EBA Consultation Paper process.

Although BNY Mellon supports the direction of travel, we must "reserve our position" until we have sight of the detailed proposals, as we will need to consider the detailed proposals before we can give unqualified support.

In developing the detailed proposals, we would make the following recommendations:

- The balance between "Pillar 1" and "Pillar 2" is important. Whilst we support the general concept of appropriately developed K factors to better reflect the risks posed by investment firms (a "Pillar 1" approach), the benefit of this in terms of simplicity, consistency and cost will be entirely eradicated if qualitative additions (such as the current "Pillar 2" process with CRD) becomes the norm and expectation of national regulators. Therefore, we would encourage the EBA to be explicit in respect of its

thinking as to what additional qualitative ("Pillar 2") assessment would feature in the new regime for both regulated firms and national supervisors alike.

- The detailed proposals should not result in a capital/prudential regime that creates higher capital requirements for investment firms than exist at present under CRD4/CRR or relevant national regimes. Instead the new prudential regime should create capital requirements which better reflect the risks posed by investment firms, which in many cases should lead to a lowering of the current capital requirements for investment firms. This is important to enable investment firms to support jobs and growth in the European Union.

- The detailed proposals should not result in an increased administrative or reporting burden on investment firms than exists at present under CRD4/CRR or relevant national regimes. This is important so that the new prudential regime is proportionate for investment firms. In particular, it is important to ensure that investment firms are not required to engage in a significant investment in systems and processes in moving across to the new prudential regime for investment firms. If non-MiFID investment firms were required to engage in such significant investment, this may impede their ability to support jobs and growth.

- The detailed proposals should be relatively straight-forward for investment firms to understand and apply in practice. Credit institutions often have a finance team that have CRD4/CRR subject-matter experts; it is disproportionate to expect that investment firms have the same level of expertise in this area.

The European Commission's "intermediate EU parent undertaking proposal"

Impact on the New Prudential Regime for Investment Firms

In November 2016, the European Commission published its legislative proposal for the Capital Requirements Directive 5 (CRD5). One of the proposals in CRD5, i.e., Article 21b, includes a requirement for certain non-EU banking groups (including all non-EU G-SIBs) to use an "intermediate EU parent undertaking". BNY Mellon is impacted by this proposal. We refer to this proposal in this response as the "EU IHC proposal".

Under the EU IHC proposal, impacted non-EU banking groups must ensure that all EU-domiciled credit institutions and EU-domiciled "*investment firms*" be direct or indirect subsidiaries of the intermediate EU parent undertaking (if not the intermediate parent undertaking itself).

We note that in the context of the EU IHC proposal, the definition of "*investment firms*" is narrower than the definition of "investment firms" in the EBA Discussion Paper. Nevertheless, the EU IHC proposal will apply to a wide range of investment firms covered under the EBA Discussion Paper - in particular it would apply to many of the investment firms currently subject to CRD4/CRR requirements that would otherwise benefit from the proposals in the Discussion Paper.

By requiring such investment firms to be within an EU IHC corporate structure, these investment firms will remain subject to CRD4/CRR requirements (or CRD5/CRR2

requirements), instead of moving to the new prudential regime for investment firms envisaged by the Discussion Paper.

It would also result in discriminatory outcomes in that standalone EU investment firms and investment firms that are part of EU groups would benefit from the new prudential regime, whereas investment firms that are part of groups subject to the EU IHC proposal would not.

This would of course be a poor outcome. Firstly, it would to a large extent counteract the intention of the European Commission that a new prudential regime for investment firms should be created. This is because the new prudential regime would only benefit a much narrower range of investment firms than envisaged.

Secondly, the work of the EBA in the context of the Discussion Paper is pursuant to the Call for Advice that the European Commission issued to the EBA to design a new prudential regime. It is therefore contradictory for the European Commission to pursue a new prudential regime for investment firms on the one hand, and then to limit its application by way of the EU IHC proposal on the other hand. It is clear from the Discussion Paper that the new prudential regime for investment firms should apply to all but the "systemic and bank-like" investment firms.

Accordingly, we would urge the EBA to engage with the European Commission, European Parliament and European Council in order to explain the adverse impact that the EU IHC proposal would have in achieving the objectives of implementing a new prudential regime for investment firms that the European Commission desires, and the broader impact on European Commission initiatives such as the Capital Markets Union, and the creation of jobs and growth.

Impacts on Recovery & Resolution

The impact on the new prudential regime for investment firms is not the only concern posed by the EU IHC proposal. The EU IHC proposal cuts across the objective of having a globally consistent recovery and resolution regime underpinned by FSB principles, such as those expressed in the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions*. This is because the EU IHC proposal gives primacy to geographic factors. Rather than simplifying corporate structures, the EU IHC proposal would make corporate structures more complex.

Furthermore, it will encourage other jurisdictions around the world to introduce similar requirements – if this occurs, then this would counteract substantial international efforts to develop credible cross-border resolution regimes, as well as future international cooperation on financial policymaking. Accordingly, the efforts to have a globally consistent recovery and resolution regime underpinned by FSB principles could be seriously undermined.

Given the significant work that the EBA has conducted to design an effective recovery and resolution regime in the EU, and to develop Level 2 text in support of the EU Bank Recovery and Resolution Directive (BRRD) - including in relation to cooperation between jurisdictions - it would be unfortunate for this work to be counteracted by the EU IHC proposal.

Responses to Specific Questions

Our responses to the specific questions raised by the EBA are contained in Annex 1 below. We have not sought to answer any question, but have focused on the key questions from our perspective.

BNY Mellon looks forward to further engagement with the EBA in regard to this Discussion Paper and any future consultation papers on this topic.

Paul Gough
Senior Counsel and Managing Director
Office of Public Policy and Regulatory Affairs
Legal Department
BNY Mellon

ANNEX 1 – Responses to Specific Questions

General principles governing the categorisation of investment firms

Q1. What are your views on the application of the same criteria, as provided for G-SIIs and O-SIIs, for the identification of 'systemic and bank-like' investment firms? What are your views on both qualitative and quantitative indicators or thresholds for 'bank-like' activities, being underwriting on a firm commitment basis and proprietary trading at a very large scale? What aspects in the identification of 'systemic and bank-like' investment firms could be improved?

Broadly speaking, BNY Mellon is supportive. In our view, it is appropriate that the CRD4/CRR regime (or in future, the CRD5/CRR2 regime) applies to systemic AND bank-like investment firms.

We agree with the EBA that "only a very small sub-set of investment firms" would meet the "systemic and bank-like" test, and we agree that this outcome is appropriate. Any extension of the test that brings more investment firms into scope of the CRD4/CRR regime would counteract the desire to have a new prudential regime for investment firms, because it would lead to a multi-tier and fragmented system of prudential regulation of investment firms.

In our view, the "Designated Firms List" maintained by the UK Prudential Regulation Authority (PRA) is a good indicator of the types of firms that should be considered as systemic and bank-like in terms of this Discussion Paper. Although this list is a UK-only list, we think that if the principles are extended to firms in other EU jurisdictions, the total number of so-called "Class 1" firms across the EU would (and should) remain a very small sub-set of the total number of investment firms in the EU.

Q2. What are your views on the principles for the proposed prudential regime for investment firms?

BNY Mellon is broadly supportive of the overarching principles expressed in paragraph 12 of the Discussion Paper. BNY Mellon, however, would want to more closely evaluate more detailed proposals, as mentioned in our "General Comments" above. We also support the comments of The Investment Association.

Prudential regime for investment firms

Q5. Do you have any comments on the approach focusing on risk to customers (RtC), risk to markets (RtM) and risk to firm (RtF)?

BNY Mellon is generally supportive of these concepts, but subject to review of detailed proposals.

<u>Other prudential considerations</u>

Q27. In the case of an investment firm which is a subsidiary of a banking consolidation group, do you see any difficulty in the implementation of the proposed capital requirements on an individual firm basis? If so, do you have any suggestion on how to address any such difficulties?

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Secondly, the work of the EBA in the context of the Discussion Paper is pursuant to the Call for Advice that the European Commission issued to the EBA to design a new prudential regime. It is therefore contradictory for the European Commission to pursue a new prudential regime for investment firms on the one hand, and then to limit its application by way of the EU IHC proposal on the other hand. It is clear from the Discussion Paper that the new prudential regime for investment firms should apply to all but the "systemic and bank-like" investment firms.

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Alternative approach to a new regime

Q34. Alternatively, should the CRR be amended instead to take into account a higher degree of proportionality? Which type of investment firms, if any, apart from systemic and bank-like investment firms, would be better suited under a simplified CRR regime?

The CRR regime is already very complex and is not tailored to investment firms. Adding proportionality into the regime would make the CRR even more complex and harder to navigate. We would strongly recommend that the EBA continue with the approach of developing a separate prudential regime for investment firms. We support the response of The Investment Association.

Q35. What are the main problems from an investment firm perspective with the current regime? Please list the main problems with the current regime.

The rationale for a new prudential regime for investment firms is that investment firms are fundamentally different from credit institutions in terms of their function, authorisations and risk profile. Accordingly, there should be a prudential regime that is tailored to investment firms.

Furthermore, as a general (but not universal) rule, investment firms are smaller than credit institutions, and are less systemically important. The application of CRD4/CRR requirements to a significant number of investment firms (such as “MiFID investment firms”) creates a disproportionate burden upon such investment firms. Many of the CRR4/CRR requirements are not relevant or useful for investment firms. The economic and administrative burdens of CRR4/CRR upon investment firms, limits the ability of such investment firms to support jobs and growth in the EU.

In our view, having a separate prudential regime for investment firms would be consistent with and support the development of the Capital Markets Union (CMU), because investment firms (rather than credit institutions) must play a key role in the CMU to support jobs and growth.

Harmonising the existing system of national prudential regimes for investment firms not subject to CRD4/CRR would also help to build the CMU.

We support the response of The Investment Association.