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bwf supplementary comments on the Discussion Paper[1] on the call for advice on the investment firms prudential framework

EBA/DP/2024/01, EBA & ESMA Joint Committee, 03/06/2024

The Bundesverband der Wertpapierfirmen (bwf) expressly welcomes the opportunity to comment on the Discussion Paper of the EBA & ESMA joint committee on the call for advice on the investment firms' prudential framework.

However, there is also some fundamental critique from our side regarding the proceeding: The 84 pages Discussion Paper (including 4 pages annex) is divided into eleven chapters with more than fifty subchapters. This contrasts to a catalogue of only 32 questions *"for public consultation"* which rely to 24 (sub) chapters. In other words, roughly one half of the "Discussion Paper" is in fact just a "proclamation" of thoughts and suggestions for potential legislative change developed by EBA & ESMA without any official possibility for stakeholders to raise their voice.

Even more, full chapters containing considerations with potentially far-reaching consequences, in particular Chapter 6. On *"Implications of the adoption of the Banking Package (CRR3/CRD6)"* and Chapter 8. *"Prudential Consolidation"* remain an "esoteric" exercise of contemplation within EBA & ESMA. – Even though we do not know what the reason for this unusual procedure was, we have to say that we find it very unfortunate and fundamentally inacceptable from the perspective of fair participation in forming opinions within the democratic legislative process. We therefore use the possibility to include this paper as an "attachment" together with our answers to the questionnaire provided in order to provide supplementary comments in a very brief and rather bullet point format at least on Chapter 6. On *"Implications of the adoption of the Banking Package (CRR3/CRD6)"* which we consider to be of particular importance to our members.

[1] https://www.esma.europa.eu/document/discussion-paper-call-advice-investment-firms-prudential-framework

DP 6. Implications of the adoption of the Banking Package (CRR3/CRD6)

Frankly speaking, we think that the headline is already misleading since it gives the impression that there are necessarily implications for possible changes to the IFR/IFD regime resulting from the adoption of the CRR3/CRD6 "banking package". It needs to be stated clearly that such an automatism does not exist. In the contrary, it was the clear legislative intent of the IFR/IFD framework to carve out all but Class 1(-) investment firms out from CRR/CRD provisions which were considered to be "bank-centred" and therefore inappropriate. There seems to be a general misconception on the side of EBA and ESMA which runs through the whole Discussion Paper that they would be mandated – as stated several times – to provide a *"better alignment to credit institutions"* regarding the existing rules for investment firms under IFR/IFD; this is simply not the case!

DP 6.1 Adoption of the fundamental review of the trading book for investment firms

The new "Basel" provisions known as *"fundamental review of the trading book"* (FRTB) are highly complex and were at no stage developed with investment firms as possible norm addressees in mind. In fact, even with respect to the application to large banks, the concept is still controversial as the latest European postponement of obligatory application for banks for another year to 1 January 2026[2] illustrates (by a delegated act of the European Commission from 24 July 2024).

The current IFR expresses the clear legislative intent that investment firms shall have a right to choose on a voluntary basis whether they want to apply the FRTB rules or not (cf. recital 25 of the IFR). Paragraph 142 of the DP acknowledges this *"optionality for investment firms to use the FRTB"* and expressly points out that *"Article 57(2) of the IFR shifts the use of the FRTB for investment firms until the latest date between 26 June 2026 and the date of application for banks as capital requirements"*.

Against this background we cannot comprehend on which ground EBA & ESMA conclude in paragraph 145 DP that *"With regards to Class 2 investment firms, three options may be available:*

a) introduce the FRTB alternative standardised approach as a mandatory methodology for firms that breach an absolute threshold to be defined following the data collection (the relative threshold is not meaningful for investment firms since their non-trading book activities are ancillary to the trading book business);

b) introduce the FRTB alternative standardised approach as an optionality for investment firms, regardless of the size of their trading book, subject to the approval of the NCA;

c) disapply the use of the FRTB for investment firms."

We think it needs to be urgently remembered that any suggestions resulting from the mandate of EBA & ESMA to review the current IFR/IFD framework need to be clearly evidence based and are technical and not political in nature. In other words, the man-

[2] https://finance.ec.europa.eu/news/banking-package-questions-and-answers-2024-07-24_en

date is limited to the evaluation whether the current framework delivers undesirable results or not. With respect to the *"optionality for investment firms to use FRTB"* there is simply no empirical ground to decide about this yet, simply because the rule is not yet applicable (cf. paragraph 142 DP).

As mentioned before and acknowledged by EBA & ESMA, the legislator clearly opted for an "optionality" for investment firms whether they want to apply FRTB or not. This was a political decision (and we think a very wise and proportionate one). The alleged "options" presented in paragraph 145 DP are therefore purely "political" in nature and therefore clearly lie beyond the mandate given to EBA & ESAMA. In particular, we see no basis for EBA & ESMA to discuss whether FRTB should be introduced on a mandatory basis (which we would consider completely disproportionate).

This said and only as precaution, we fully agree with the conclusion in paragraph 145(a) DP that *"the relative threshold is not meaningful for investment firms since their non trading book activities are ancillary to the trading book business"*. At the same time, we are highly alerted that EBA and ESMA consider it possible to *"introduce the FRTB alternative standardized approach as a mandatory methodology for firms that breach an (emphasis added) absolute threshold"*. We understand this wording to mean that it could be thinkable that investment firms would have to apply FRTB on a mandatory basis, if they breach a – still to be defined – absolute threshold below (sic!) the 500 million of trading book activities which applies to bank. As a result, this could result in a situation where investment firms with a certain size of their trading book could be mandatory to apply FRTB while credit institutions with a trading book of the same size would be not because the remain under the 10% threshold of the institution's total assets – this would be more than absurd!

DP 6.2. Credit valuation adjustment for investment firms

As EBA & ESMA describe substantially correct in paragraph 149 DP , *"for investment firms, the CVA is capitalised according to Article 32 of the IFR, applying a multiplication factor of 1.5 to K-TCD."* However, any Basel 3 changes to the calculation of the credit valuation adjustment (CVA) for credit institution are simply not relevant for investment firms and by the way the existing multiplication factor of 1.5 (which means a 50% surcharge) is already completely arbitrary. As mentioned already above, it is simply not acceptable to propose to *"align"* the regulatory framework for investment firms to the rules for credit institutions under CRR without a clear legislative mandate which EBA & ESMA are not given.

To describe the dilemma from an investment firms' perspective, we would like to quote a thought which we expressed in Question 14 of the official questionnaire: "Although, despite all of the problems described above, there was one big advantage in those "old days" compared to today: At least at the level of adapting Basel rules to the European supervisory framework, even though investment firms sometimes may have found it difficult to get heard, but they were at least "sitting at the same table" during all stages of the consultation process since it was clear that new rules – if no express exemptions were stipulated – would also apply to investment firms. This is not the case anymore since in principle investment firms (except Class1(-) firms) are formally carved out from the CRR."

6.3 Definition of the trading book

We agree with EBA & ESMA that the definition of the trading book is of paramount importance for investment firm (as far as the have a trading book) as stated in paragraph 158 DP. Equally true the IFR/IFD definition of the trading book as *"defined in Articles 4(1)(54) and (55) oft the IFR (...) (is) closely aligned with the definition in the CRR 2"* (paragraph 157 DP). The latter is not surprising since the CRR2 was the relevant banking regulation when the IFR/IFD regime was decided. At the same time, it was the clear intent of the legislator to end the application of bank-centered regulatory requirements to investment firms. This at least implies a "grandfathering" also of the definition of the trading book valid at the time when IFR/IFD were introduced.

Therefore, as mentioned above, we think that the blunt argument of a *"better alignment to credit institutions"*, which can expressly or implicitly be found throughout the Discussion Paper, in our view, simply lacks legal ground. In fact, such an *"alignment"* is exactly the opposite of what was intended by the introduction of a distinct *"prudential regime for investment firm"* as documented with the quotes below:

It is worthwhile to remember that the original intention, and this was one important reason why the legal initiative was initially broadly supported, was to insure *"a more suitable prudential and supervisory framework with lower compliance costs for investment firms (which) should help (to) (i) improve the overall conditions for businesses; (ii) boost market entry and competition in the process; and (iii) improve investors' access to new opportunities and better ways of managing their risks"* (European Commission, 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 Brussels, 20.12.2017, COM(2017) 790 final, 2017/0359 (COD), p. 5).

Furthermore, another important aspect was that *"the proposal is mindful of ensuring that the costs of the regime in terms of both capital requirements and associated compliance and administrative costs, which are generated by the need to manage the staff and systems in order to run the new requirements as well as report on compliance to supervisors, are kept to the minimum"* (European Commission, 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 Brussels, 20.12.2017, COM(2017) 790 final, 2017/0359 (COD), p. 6 f.)

And finally, *"setting capital and other prudential requirements, including remuneration and governance, that are proportionate to investment firms (in order to) alleviate for the first time the significant costs that firms incur as a result of the bank-centric requirements of the current regime"* (European Commission, 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 Brussels, 20.12.2017, COM(2017) 790 final, 2017/0359 (COD), p. 10).

All these statements illustrate that it was the clear aim to dare a pragmatic new beginning by “decoupling” banking- and investment firm regulations. Unfortunately, the DP presented by EBA & ESMA seems to point exactly in the opposite direction.