DEUTSCHE BÖRSE
GROUP

Deutsche Börse Group

Response

to Discussion Paper

"Designing a new prudential regime for investment firms"
(EBA/DP/2016/02)

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A. Introduction

Deutsche Börse Group (DBG) welcomes the opportunity to comment on EBA Discussion Paper 'Designing a new prudential regime for investment firms' issued on 4 November 2016.

DBG operates in the area of financial markets along the complete chain of trading, clearing, settlement and custody for securities, derivatives and other financial instruments and as such is mainly active with regulated Financial Market Infrastructure providers. All of our companies are corporations under different legal forms.

Among others, DBG operates several exchanges for securities and derivatives as well as a variety of Multilateral Trading Facilities (MTFs). As such, group companies of DBG are inter alia market operators as well as investment firms according to Directive 2004/39/EC (MiFID).[1]

While already the Capital Adequacy Directive (Directive 93/6/EEC, CAD) generally formed the prudential framework for "MiFID" investment firms back in 1993, no specific provisions have been set for MTFs in CAD and subsequently CRD / CRR. As such, as MTFs have been regulated only as of 1 November 2007 when MiFID became applicable, the generic rules of CRD (Directive 2006/48/EU and 2006/49/EU) were to be applied on them. However, the investment firm definition in CRD / CRR is narrowed compared to MiFID with regards to the prudential requirements of CRD / CRR on top of initial capital requirements and as such, MTFs could be assumed not to be in scope of the prudential rules of CRD until the CRD IV package entered into force.

With the CRD IV package the wording of the definition "investment firm" for CRD / CRR purposes has been changed in Article 4 (1) No. 2 lit c CRR. Due to that explicit wording, MTF operators are since the entry into force of CRD IV / CRR not only MiFID investment firms but are in addition to be regarded as CRR-investment firms. Although it is our understanding that the inclusion of MTFs (and OTFs) as CRR-investment firms with the change in wording in Article 4 (1) No. 2 CRR was not intended, this has put the investment firms of our group under the scope of CRR.

Different from the MTFs, market operators in the sense of Article 4 (1) No. 18 MiFID II are not in scope of CRR / CRD despite the fact that their activities are similar to investment firms operating an MTF (with no other activities).

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[1] Subsequently renewed by Directive 2014/64/EU (MiFID II)

The document at hand contains our general comments to the Discussion Paper and dedicated response to selected questions raised in the Discussion Paper which are relevant for our business.

B. General comments

As DBG and its group entities are mainly linked to the content of the Discussion Paper via its activities of operating Multilateral Trading Facilities (MTFs), we cannot comment on the entirety of the proposal in much detail. However, we see a substantial number of areas where we do want to contribute to the discussion and raise our concerns or make proposals for adjustments.

We agree to the conclusion of EBA in its report of 15 December 2015 and also in the current discussion paper that the actual fragmented dealing with investment firms need a more focussed and sharpened approach better shaped to fit for purpose and based on a homogenous set of rules mapping across the different legal texts of EU legislation.

This does not only include a clear approach on how and where the prudential requirements for investment firms are regulated but also how the regulations interact correctly with the prudential requirements of other regulated entities. While there is e.g. a link in the CSD-R (Regulation (EU) No. 909/2014) that regulates the way CSDs can offer MiFID investment services, such link is missing for CCPs in EMIR. Moreover, the above stated link lacks clarity as also does the ruleset in MiFID II regarding to the applicable clauses on market operators which also operate one MTF or one OTF. It is therefore necessary not just to look into the rules for investment firms on an isolated basis but also look how these are linked with other financial services legislative texts and prudential regulations.

Overall, we see the elements proposed by EBA **as by far being too complex** and not really solving the prudential supervision of investment firms in an adequate manner. **The regulatory framework needs to follow a well-balanced approach between risk sensitivity and simplicity**[2] while on the other hand also **keeping proportionality** into account.

The proposed framework is very granular and its details have not proven on their benefits. Investment firms are supposed to be less complex than credit institutions and are in principle supposed not to take deposits from clients according to Article 9 CRD IV (as this is reserved to credit institutions only). In addition, they fall within the scope of the Investor Compensation Scheme Directive (Directive 97/9/EC) to cover to some extent potential risks of investors doing business with them. As we value the proposed

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[2] See the BCBS discussion paper on "The regulatory framework: balancing risk sensitivity, simplicity and comparability" (http://www.bis.org/publ/bcbs258.htm) and our comment to this (http://www.bis.org/publ/bcbs258/deutschebrsegro.pdf)

approach inter alia for the capital requirements as by far more complex than the approaches for operational risk used for credit institutions (and also for CSDs and CCPs), this is putting a more complex rule set to less complex institutions. Already the additional work load is not proportionate to any assumed supervisory benefit.

We in general agree to classify investment firms into three categories like:

- "complex",
- "medium risk" and
- "low risk".

However, we completely disagree with EBA to allocate any investment firm by virtue of its activities as being "systemic" and referring to the banking rules related to G-SIIs or O-SIIs. Despite the fact that we would not rule out that there may be a very limited number of investment firms that might fall in such a category, we assume the likelihood as being marginal. Based on the fact that investment firms cannot take deposits (see above) and are otherwise also limited in their activities compared to credit institutions, the term "bank-like" needs to receive more clarity on what it comprises off. For us, investment firms holding money or securities belonging to their clients, "dealing on own account" or "underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis" may fulfil the "bank-like" status and in case the related activities **may surpass certain thresholds**, this may be considered as a "complex" investment firm. In this case, in general, the CRR rules should apply and we would not see much need to refine the banking rules as they are currently for that purpose (i.e. limited application of CRR within the scope as regulated today).

However, minor adjustments to articles 95 – 97 CRR may be justified (we comment on those adjustments in our responses to the EBA questions in part C of this document).

The Basel II process took nearly 10 years to find solutions deemed suitable for capturing "operational risk". These rules are currently under review by the BCBS and revised rules towards **only one unique and simple approach** (SMA) are well progressed. This shows the difficulties to capture operational risk. There is no explicit capturing of business risk in pillar I for banks which we assume to be the right approach. For CCPs and CSDs the banking framework is applied as well. However, a dedicated charge for business risk is introduced for both with slightly different details. While we have raised at various occasions our criticism on the details of the approaches on business risk for CCPs and CSDs, we clearly see a different and in general materially lower risk profile for investment firms in the category of "medium" and "low" risk compared to credit institutions as well as CCPs and CSDs. As such, we ask for a lean and simple solution.

The SMA – in case adopted without major changes to the latest BCBS proposal – will be a simple measure and will only allow to a limited extent business model driven components (e.g. related to proprietary trading). It does not make sense to develop a much more complex framework for substantially smaller undertakings as this is putting proportionality upside down.

Therefore, any approach going forward on the capital side should rather be simple and will consequently only be risk sensitive to a limited extent. In our view the complete set of prudential requirements should be put into CRR (even the initial capital topic to be moved from CRD IV).

In order to allocate investment firms to different risk categories, we propose three categories as follows:

"complex": investment firms that perform bank-like activities;

"medium risk": investment firms that otherwise should be in scope of some prudential (quantitative) requirements above a general basic requirement;

"low risk" investment firms should comprise of any other MiFID-investment firm (and they should continue to neither be in scope of general CRR provisions nor fall within the scope of prudential consolidation). This category should include MTFs (not performing any other MiFID investment service, however, investment of own funds in financial instruments which is not to be valued as dealing on own account should be allowed) and most likely also OTFs.

CRR should introduce the term "MiFID-investment firm" for the purpose of linking "basic" prudential requirements for all investment firms in a new section. This should comprise of some basic principles deemed necessary, minimum capital requirements and any additional prudential measure deemed necessary for "low risk" investment firms (see our proposals in detail in section C of this document).

Alternatively, and in order to be more focussed, CRR could change the wording from the current "investment firm" to "investment enterprise" and require that "complex" and possibly also "medium" risk investment firms can in the future (a phasing-in period should be set) not be set up as a business of a natural person ("sole-trader") which also would strengthen the 4-eye-principle. The entirety of "MiFID Investment firms" then could be referred to also in CRR as "investment firm" and "low risk" (and potentially "medium risk") investment firms could continue to be set up in whatever a legal form.

"Complex" and "medium risk" investment firms should continue to be "CRR-investment firms" (i.e. being defined as investment firms in Article 4 (1) No. 2) and all references to investment firms should be linked to them. The differentiation between these two categories with regards to the prudential requirements should in our view follow more or less the current differentiation within CRR. For some adjustments we refer to our answers in section C below.

Any minimum prudential requirements should be proportionate to the business of "low risk" investment firms. Therefore, we do not feel the need to set detailed remuneration rules. Moreover, liquidity is and will not be the driver for material risks of investment firms – some exceptions under the bank-like businesses may exist. As they cannot take deposits, the risk of maturity mismatch of client money is limited for investment firms as is the risk of highly volatile and unpredicted cash outflows. As such, we clearly do not support any introduction of the NSFR, the LCR, the ALMM or similar complex rules.

In the same vain also the introduction of the Leverage Ratio should not be considered. **We clearly support the EBA view in this regards.**

Finally, "low risk" but most likely also "medium risk" investment firms are small and have only a limited size of their balance sheet. This is not only to be taken into account when setting any kind of liquidity requirement – if at all – but also when dealing with concentration limits or large exposure rules. Very small investment firms with a current minimum capital of 50,000 € will have difficulties to diversify their cash over multiple banks. Also investing in liquid government bonds (or similar quality of financial assets) may not be an option. In extreme cases, already the use of a second bank may be almost impossible and economical very expensive. As such, we do not support the introduction of the large exposure regime to "low" and "medium" risk investment firms and a pragmatic approach on concentration risk is required.

The topic of consolidated supervision goes beyond the topics raised in the EBA discussion paper. We rather recommend to look into this topic to a substantial portion already in the course of the CRR II package and have a closer look to it in the course of the upcoming review of the Financial Conglomerates Directive (Directive 2002/87/EC – FiCOD). The topic cannot be seen for groups with investments firms and assets managers only but also need to tackle combinations of those with credit institutions, CSDs, CCPs, Trade Repositories, market operators, etc. We therefore see a variety of missing elements which go substantially above the scope of the current discussion paper.

Finally, we do want to raise the general element of harmonised definitions and terminology. Similar items across various financial services legislations should follow same rules and same terminology to the extent feasible.

C. Response to selected questions raised in the Discussion Paper

Question 1. 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?

As stated in section B of this document, we cannot see any benefit from using the approaches made for G-SIIs or O-SIIs as investment firms have a completely different profile. Moreover, we cannot see investment firms being "systemic" in the sense of the banking framework. We clearly see the need to exclude MTFs (and OTFs) from the current CRR application and to classify them as a "low risk" business going forward. Although not making concrete proposals here, we refer to our general comments made in section B of this document and the generic criteria for three categories of investment firms. It is crucial that some investment services should lead to a classification of "low risk" without any thresholds or caps.

Question 2. What are your views on the principles for the proposed prudential regime for investment firms?

We refer to our general comments in section B of this document. Taking into account that deposit taking requires a status as credit institution and the mandatory membership of investment firms in the investor compensation scheme, we disagree to material changes in the framework for capital (see nevertheless our comments below to questions 7, 9, 12, 15 and 17), we do not see the need for exhaustive liquidity regulations (see our simple proposal in questions 20 and 27 below) and recommend also to limit any measure on winding down and restructuring as this in general should be possible within a short time frame and capital being held for going concerns should be sufficient also to allow for an ordinary winding down or restructuring if need be.

Question 3. What are your views on the identification and prudential treatment of very small and non-interconnected investment firms ('Class 3')? If, for example, such class was subject to fixed overheads requirements only, what advantages and drawbacks would have introducing such a Class 3? Conversely, what advantages and drawbacks could merging Class 3 with other investment firms under one single prudential regime with 'built-in' proportionality have?

As stated in our remarks in section B of this document we clearly favour to have a category of "low risk" investment firms which only fall in scope of basic prudential requirements, do only have a very limited framework for capital and liquidity and are not treated as "CRR-investment firm" (or "investment enterprise") for other purposes of CRR including prudential consolidation.

We in general disagree to the current approach of FOR. There are several similar concepts e.g. in the Delegated Regulation (EU) No. 152/2013 (EMIR CCP capital requirements) and in the proposed Delegated Act on prudential requirements for CSDs under CSD-R.

We clearly see the need to harmonise those and to request that the basis for all this should be "**gross administrative and other operating expenses**" which should be the sum of general administrative expenses (including staff cost) and other operating charges as defined in the Banking Accounting Directive (Directive 86/635/EEC). Like in the proposed Delegated Act on prudential requirements for CSDs under CSD-R the depreciation and impairments of fixed assets, intangibles, etc. should not be taken into account, as they will not lead to cash outflows (already occurred) and with regards to intangibles they are in addition already deducted from own funds (see also our response to question 15 below) while for fixed assets it can be assumed that there is a sufficient high likelihood that their book value should be recoverable on the markets.

While we have no clear view on how taxes may or may not be included in the expense basis for any cost/expense related capital charge, we clearly disagree to include any profit distribution regardless if on a discretionary (e.g. dividends) or contractual basis (e.g. profit and loss pooling agreements).

Build in proportionality is reached due to the linkage of capital charge to expenses (see our proposal included in our answer to question 7) and can in addition be achieved by (i) putting "complex" investment firms under a broader scope of CRR while setting a few scaling factors to differentiate between "medium" and "low" risk investment firms (see below).

Question 4. What are your views on the criteria discussed above for identifying 'Class 3' investment firms?

For the above question, it would be useful to receive detailed comments on each of the following items, which would preclude an investment firm from being in 'Class 3':

a) holding client money or securities,
b) ancillary service of safekeeping and administration (B1),
c) dealing on own account (A3),
d) underwriting or placing with a firm commitment (A6),
e) the granting of credits or loans to an investor (B2),
f) operating a multilateral trading facility (or MTF) (A8),
g) the MiFID II activity of operating an organised trading facility (or OTF),
h) being member of a wider group,
i) using a MiFID passport, and
j) using tied agents.

In general, we refer to our thoughts in section B of this document.

We do not support the use of the SME criteria as "Nano" as being a possible indicator. 2 million € balance sheet size or even income may be easily reached by an MTF which nevertheless should be classified as "low" risk of "Class 3" investment firm.

a) Any investment firm being allowed to hold client money or securities should be in (limited) scope of CRR as today. We would recommend this as a knock out criterion for "Class 3". However, we could think about a threshold for holding client **securities** up to a certain volume;

b) Safekeeping and administration of securities qualifies under CRD as "financial institution" in case being the main activity of a company. We consider this services as being "bank-like" and it also brings (at least under safekeeping) the fact of "holding client securities". As such, this should in principle not classify for "Class 3". However, we could think about a threshold for safekeeping and administration up to a certain volume or if only done in exceptional cases;

c) Dealing on own account if not done to management liquidity only in our view is a bank-like business. We assume that this does not classify for "Class 2" or "Class 3" but requires treatment under CRR as today taking the threshold for market risk treatment into account (within the CRR rules but not as a basis for exclusion);

d) Underwriting or placing with a firm commitment should not classify for "Class 2" or "Class 3";

e) The granting of credits or loans to an investor should not classify for "Class 2" or "Class 3";

f) Operating a multilateral trading facility should classify in any case as "Class 3" in case no other investment services is performed other than investing in financial instruments for liquidity management purposes only (i.e. without trading intend);

g) The MiFID II activity of operating an organised trading facility (or OTF) should classify in any case as "Class 3" in case no other investment services is performed other than investing in financial instruments for liquidity management purposes only (i.e. without trading intend);

h) Being a member of a wider group should not be a criterion for the classification of the investment firm per se. We cannot see how this interacts with the principle risk of the business as such. It can also be risk increasing (dependency) or risk reducing (receiving financial and operational support). As such, to keep the approach simple, clear, free of discretion and proportionate, the criterion should not be used;

i) Using a MiFID passport in our view has only limited impact. The passport per se does not change anything. However, operating in multiple jurisdictions increases the operational risk. In line with our comments for item h), we recommend not to use this criterion.

Question 5. Do you have any comments on the approach focusing on risk to customers (RtC), risk to markets (RtM) and risk to firm (RtF)?

We reject the proposal as this is by far too complex and appropriate calibration will be a never ending story. Tracking the data is creating substantial cost with doubtful outcome. The approach is neither simple, nor proportionate with regards to the underlying business. Moreover, we have doubts on its risk sensitivity.

Question 6. What are your views on the initial K-factors identified? For example, should there be separate K-factors for client money and financial instruments belonging to clients? And should there be an RtM for securitisation risk-retentions? Do you have any suggestions for additional Kfactors that can be both easily observable and risk sensitive?

We reject the proposal as this is by far too complex and discussions on appropriate calibration will never come to an end. Tracking the data is creating substantial costs with doubtful outcome. The approach is neither simple nor proportionate with regards to the underlying business. Moreover, we have doubts on its risk sensitivity.

Question 7. Is the proposed risk to firm 'up-lift' measure an appropriate way to address the indirect impact of the exposure risk a firm poses to customers and markets? If not, what alternative approach to addressing risk to firm (RtF) would you suggest?

As stated in section B of this document, we disagree to the concept per se. "complex" or "Class 1" investment firms should fall in scope of CRR as today. For "medium" and "low" risk investment firms (or "Class 2" and "Class 3"), we propose the following approach with regards to capital requirements:

1. Set minimum capital requirements (initial capital requirement);
2. Calculate the capital requirement for operational risk like credit institutions (BIA currently, SMA going forward);
3. Calculate the capital requirement for credit and market risk (only for "Class 2" investment firms);
4. Calculate a given percentage of "gross administrative and other operating expenses" based on prior year audited accounts (three-year average). "Gross administrative and other operating expenses" being general administrative expenses + other operational charges as defined in the Banking Accounting Directive. The percentage should have one value (we propose 25 %) for "low risk" and a higher one (we propose 50 %) for "medium risk" investment firms;
5. Keep the maximum of (1), ((2) + (3)) and (4).

In doing so, the risk of "Class 2" investment firms is captured in two elements: (i) The need to calculate the capital charge for credit and market risk (as today) and compare this (together with the operational risk charge, **this is proposed to be added**) with the requirement based on "gross administrative and other operating expenses" and (ii) a

higher percentage for the capital charge based on gross administrative and other operating expenses.

The charge calculated under 4 in our view should also cover business risk as well as any capital need for gone concern situations, i.e. is supposed to be sufficient to cover any winding-down or restructuring measure.

A pillar II surcharge should be allowed, capital buffers under CRD IV should not be imposed on "Class 2" or "Class 3" investment firms.

Reporting obligations may be imposed in case a certain threshold (e.g. 110 % of the minimum requirements are not kept at the end of any given month) in combination with the obligation to deliver a plan to beef up capital or reduce risk (similar to the requirements under EMIR).

Question 8. What are your views on the 'built-in' approach to delivering simpler, proportionate capital requirements for Class 3 investment firms, (compared to having a separate regime for such firms)?

We have laid out in section B of this document and in our answers to questions 1 to 7 the cornerstones of an adequate model. We prefer to have a comprehensive prudential framework for all (MiFID) investment firms within CRR. However, "Class 3" investment firms should not fall in scope of other sections of CRR and a simple approach as outlined by us should be chosen to be comprehensive, proportionate and with the necessary degree of differentiation as outlined.

Question 9. Should a fixed overhead requirement (FOR) remain part of the capital regime? If so, how could it be improved?

The FOR in principle should remain. However, it should not refer to "fixed" and also not to "overhead" as this are vague terms. Furthermore, a harmonised approach is needed for all similar capital requirements in the financial services legislation. This includes i.a. the CSD rules and the EMIR rules for CCPs.

We prefer a clear basis related to "gross administrative and other operating expenses" based on the components as defined in the banking accounting framework (Directive 86/635/EEC) with taking into account general administrative expenses (including staff costs) and other operational charges only.

Any amount paid as profit distribution regardless of the underlying legal or contractual basis should not form part of the "gross administrative and other operating expenses". Commissions paid and interest expenses should be excluded in line with the allocation

under the banking accounting framework. Furthermore, depreciations and impairments should not be included; this is already the case in the CSD-R framework (proposed Delegated Act).

Question 10. What are your views on the appropriate capital requirements required for larger firms that trade financial instruments (including derivatives)?

Such companies should fall in the same scope of CRR requirements for investment firms as today.

Question 11. Do you think the K-factor approach is appropriate for any investment firms that may be systemic but are not 'bank-like'?

We do not agree to the too complex approach as presented by EBA. We have outlined our alternative concept in this document.

Question 12. Does the definition of capital in the CRR appropriately cater for all the cases of investment firms that are not joint stock companies (such as partnerships, LLPs and sole-traders)?

In principle, the definition of "capital" or "own funds" should be harmonised throughout the legislation for financial services. Especially for credit institutions, investment firms, CCPs and CSDs the same definition should be used. This includes elements to be included as well as any deduction to be used.

As such, corrections to the current CRR framework may be necessary or additional deductions may be requested in the legislation covering special purposes entities (e.g. CCPs or CSDs).

Any capital instrument being subject to contractual delivery of profits (so called profit and loss pooling agreements) should be included in the capital definition. As such, the current EBA positon in this regards should not persist going forward and necessary legal changes should be made in CRR. The contractual obligation to pass on "any" net income does not prevent form retaining income in case regulatory limitations occur. Moreover, in case the generic approach may not be seen as being suitable, such contracts could be adjusted to contractually fix this and secure that e.g. regulatory requirements being imposed have priority over contractual profit distribution obligations.

As we propose to limit "Class 1" and "Class 2" investment firms to corporates, the problem of partnerships, LLPs and sole-traders would be reduced. In fact, sole-traders may not exist any longer. We regard this as a possible solution as in case the trading

is in scope of MiFID, the general requirements may not fit for other forms of incorporation anyway. However, phase-in and / or grandfathering clauses should be foreseen.

The above statement does not apply for "Class 3" investment firms. For those, dedicated rules what would counts as "own funds" in this case need to be added in the dedicated investment firm section of CRR.

Question 13. Are the cases described above a real concern for the investment firms? How can those aspects be addressed while properly safeguarding applicable objectives of the permanence principle?

No comments.

Question 14. What are your views on whether or not simplification in the range of items that qualify as regulatory capital and how the different 'tiers' of capital operate for investment firms would be appropriate? If so, how could this be achieved?

We do not see the need for adjustments other than those which may be needed for dedicated forms of "partnerships" and alike organisations or individual persons performing the investment services. This in principle and in our view should be limited to "Class 3" investment firms.

Question 15. In the context of deductions and prudential filters, in which areas is it possible to simplify the current CRR approach, whilst maintaining the same level of quality in the capital definition?

We do in general not see the need to simplify the rules of deductions. Most of the items should not be relevant for investment firms at first instance. Moreover, we recommend an alignment across all financial services legislation (e.g. also to harmonise the rules related to CCPs and CSDs without an additional license as a credit institution).

Having said this, we in general have doubts on the rules for deductions for investments in other financial institutions and in particular with indirect investments in such undertakings, i.a. via investments in collective investment undertakings. Here a simplification for investment firms of "Class 2" and "Class 3" may be worth considering.

Question 16. What are your views overall on the options for the best way forward for the definition and quality of capital for investment firms?

We refer to our general comments and in particular to our responses to questions 14 and 15.

Question 17. What are your views on the definition of initial capital and the potential for simplification? To what extent should the definition of initial capital be aligned with that of regulatory capital used for meeting capital requirements?

We in general agree to harmonise the initial capital requirements. Therefore, they should be moved from CRD IV to CRR II. This should also be considered for credit institutions to have a unique place in the prudential framework for any kind of capital requirements. A unique treatment via a regulation is already in place e.g. for CCPs and CSDs via EMIR and CSD-R.

Furthermore, we also support to adjust the minimum amounts after 25 years with an appropriate lead and phase-in time. We assume that there should be a 2 years lead time and the need to step up by 25 % p.a. of the additional requirements over a period of 4 years for investment firms being authorised at the day of the revised amounts entering into forth beginning at the time of the new requirement becoming valid.

Example: In case the minimum amount is increased from 50,000 € to 100,000 € and the rules enter into force on 15 November 2018 with an effective date 1 January 2021 all investment firms being in scope of that requirement and being authorised on 15 November 2018 need to phase-in 12,500 € each 1 January of the years 2021 – 2024.

The capital definitions of initial capital and capital used for meeting capital requirements should be the same. However, as initial capital is a "gross" figure only, deductions cannot and should not be taken into account here. This once more should be done for all legislations in the financial services sector and include inter alia and explicitly CCPs and CSDs.

It is necessary to clarify the category of initial capital for MTFs / OTFs which in our view should be 50,000 € taking the current framework into account. This is currently unclear in the context of Article 29 CRD IV and this is most likely an unintended consequence of the last minute wording change of Article 4 (1) No. 2 lit. c CRR which to our understanding by mistake left out the investment services No. 8 (and 9) of section A of the Annex of MiFID / MiFID II in the list of services not qualifying as CRR-investment firm.

Related to the adjustment of the initial amounts, we consider to keep this simple and to raise the amounts to 1,500,000 € for "Class 1" investment firms, 250,000 € for "Class 2" investment firms and 100,000 € for "Class 3" investment firms.

We also support the simplification going forward not to allow any longer any alternative option to fulfil the requirement. The withdrawal of the option to use a professional indemnity insurance or to allow for a reduced amount for investment firms being also

insurance intermediaries should therefore from our point of view been withdrawn. Having said this, we nevertheless want to point out that this is only an opinion raised as based on the scope of our business activities we cannot judge the impact of such measures in detail. In any case, an adequate phase-in approach should be delivered and grandfathering for some time should be considered. Our opinion is based on the aim to reach simplification, harmonised rules and a level-playing field. There are no particular concerns against the current approach.

Question 18. What aspects should be taken into account when requiring different levels of initial capital for different firms? Is there any undesirable consequence or incentive that should be considered?

The three category approach as a mandatory EU wide rule set (single rule book) as outlined above in line with our general proposal on the approach seems to be a consistent and well balanced approach. We do not see the need to differentiate the initial capital requirement in a different manner than the ongoing capital requirements and prudential measures. This also would fit nicely with the coherent definition of capital.

Question 19. What are your views on whether there is a need to have a separate concept of eligible capital, or whether there is potential for simplification through aligning this concept with the definition of regulatory capital used for meeting capital requirements?

The capital definition for large exposures is currently updated within the CRR II package.

As stated above, GDB clearly supports a harmonised definition of capital for any approach on initial or ongoing capital requirements and its fulfilment. As such, for the (modified) FOR requirements (as per our proposal made in the answer to question 9), we do not see the need to maintain the definition of "eligible capital".

We also do not see the need for a capital definition different from the general definition of capital for the purpose of qualifying holdings. However, in order to avoid a chicken and egg problem for this topic, we consider it necessary to fix a gross capital amount consisting of all tier 1 elements and tier 2. We would favour to count all tier 2 capital elements in full. As such, we clearly favour a gross view for the capital definition for both (i) initial capital (see our answer to question 17) and for qualifying holdings. How and where this is done in our view does not matter and we rather would prefer not to have another definition but to refer to the "gross" approach when dealing with initial

capital requirements and limitations on qualifying holdings. Having said this, we recommend to EBA to leave this discussion for further consideration of the EU as this goes beyond the scope of the currently discussed topic of investment firms.

Question 20. Do you see any common stress scenario for liquidity as necessary for investment firms? If so, how could that stress be defined?

Liquidity is not the key topic for investment firms. We clearly agree not to request LCR, NSFR and ALMM on any investment firm.

The business of investment firms in general is rather short term and we recommend – at least for "Class 2" and "Class 3" firms to incorporate a rather simple metric with the following elements:

1. Liquid assets:
    a. Any fixed income security which is traded on a recognised market with its market value less 5 % haircut;
    b. Any equity instrument which is not an equity instrument of a participation where the investment firms holds a qualifying holding, which is traded on a recognised market and included in a major index with its market value less 15 % haircut;
    c. Any equity instrument which is not an equity instrument of a participation where the investment firms holds a qualifying holding, which is traded on a recognised market and not-included in a major index with its market value less 25 % haircut;
    d. Any holdings on bank accounts or central bank accounts with a remaining maturity of not more than 1 calendar month with its notional amount;
    e. Any holdings on bank accounts or central bank accounts with a remaining maturity of more than 1 month but not more than 1 year with 80 % of its notional amount;
    f. Any received committed credit line which is not revocable within 14 days with 50 % of the committed notional.

2. Liquidity requirement:

    a. For "Class 3" investment firms a certain percentage of its "gross administrative and other operating expenses" (as defined for capital purposes). In order to foster a liquidity buffer which is sufficient to cover in general 3 months' operational expenses, we propose to set the level to 25 % of the three-year average of "gross administrative and other operating expenses".

    b. For "Class 2" investment firms the requirement should be higher but kept similarly simple. We propose like for the capital requirement to have the liquidity minimum set to twice the ratio as for "Class 3" investment firms.

We cannot judge the liquidity situation for the variety of all different investment firms and this is in particular true for "Class 1" investment firms. We leave it therefore to EBA to consider to use the same approach also for "Class 1" investment firms and also to determine needed adjustments compared to "Class 2" investment firms – if any.

Having said this, we regard all detailed proposals of EBA as being too complex for investment firms. Our proposal closely links the capital requirement with the need to have liquidity as (i) investment firms are not allowed to take deposits and (ii) their capital and liquidity needs are commonly driven by operational needs. In the case of small investment firms, it will be difficult to keep the minimum liquidity as proposed above with only the minimum equity. As such, the liquidity requirement may become the driver for equity requirements. DBG regards this as a logical consequence of the need to cover liquidity needs for an adequate period of continued operations even under stressed conditions and also in order to cover any potential wind-down or restructuring. Consequently, the above outlined result should be acceptable.

Question 21. What is your view on whether holding an amount of liquid assets set by reference to a percentage of the amount of obligations reflected in regulatory capital requirements such as the FOR would provide an appropriate basis and floor for liquidity requirements for 'nonsystemic' investment firms? More specifically, could you provide any evidence or counterexamples where holding an amount of liquid assets equivalent to a percentage of the FOR may not provide an appropriate basis for a liquidity regime for very small and 'non-interconnected' investment firms?

We refer to our response to question 20.

Question 22. What types of items do you think should count as liquid assets to meet any regulatory liquidity requirements, and why? (Please refer to Annex 4 for some considerations in determining what may be a liquid asset).

We refer to our response to question 20.

Question 23. Could you provide your views on the need to support a minimum liquidity standard for investment firms with the ability for competent authorities to apply "supplementary" qualitative requirements to individual firms, where justified by the risk of the firm's business?

We refer to our response to question 20. GDB in addition regards some flexible options for "supplementary" qualitative but more important also quantitative additional "pillar II" requirements for investment firms under some general guidelines and limitations for reasonable.

Question 24. Do you have any comment on the need for additional operational requirements for liquidity risk management, which would be applied according to the individual nature, scale and complexity of the investment firm's business?

The need for investment firms to management its liquidity does only require a limited framework. This is in particular true for "Class 2" and "Class 3" investment firms. As there is in general no maturity transformation, only limited – if at all – foreign exchange business and the business is in principle rather short term, there should not be exhaustive liquidity management requirements above the general principles of proper organisation and adequate controls.

Question 25. What are your views on the relevance of large exposures risk to investment firms? Do you consider that a basic reporting scheme for identifying concentration risk would be appropriate for some investment firms, including Class 3 firms?

As outlined in section B of this document, based on the business model and the limited size of the bulk of investment firms, a certain amount of counterparty concentration is most likely a natural consequence. Taking the principle of proportionality into account, the application of the large exposure framework seems not to be appropriate. An inclusion of "Class 1" investment firm into the large exposure framework may be considered. However, we do not have the appropriate knowledge to form a more concrete opinion on this.

A general principle of adequate monitoring of counterparties and a dedicated requirement to manage concentration risk should be put in place. All investment firms should in general be requested to have at least 2 counterparties to maintain their liquid assets.

Any additional requirement may be difficult to implement to all or the majority of investment firms and therefore the competent authority would need to specify this in the course of its general authority to request adequate measures to implement an appropriate approach for the management of concentration risk.

Question 26. What are your views on the proposed approach to addressing group risk within investment firm-only groups? Do you have any other suggested treatments that could be applied, and if so, why?

We understand the rationale to check sources of capital and additional funding and avoid undue high risk due to group structures. GDB has analysed the proposal and disagrees with the proposal made. Moreover, the topic of consolidated supervision needs to be put in a broader context to also address other open items. Within a group under consolidated supervision it is currently unclear whether CCPs, Trade Repositories, market operators and investment firms not being included in the CRR scope of investment firms are to be consolidated or not.

Consolidated supervision for credit institutions has been introduced mainly in order to avoid loan pyramids and the unwanted multiple use of capital, i.e. capital leverage. While we agree that also within investment firm groups capital leverage can occur, the question is to which extent such capital leverage is "unwanted" and to be restricted as well as what in the context of investment firms may be the consequence.

In the context of credit institutions, the capital leverage gave room for a more expansive loan business and allowed for gearing up exposures. This in general cannot be the driver for the vast majority of investment firms and should not be a possibility for "Class 2" and "Class 3" investment firms if categories are well defined. As such, loan pyramids should be out of focus for the question raised.

Capital can nevertheless be leveraged in order to use the financing sources of a parent entity to cover risks of the subsidiaries. While loan pyramids should be avoided in order to protect client deposits and the well-functioning of the banking sector, the investment of debt finance investors into the business activities of a group including investment firms have a different quality.

Furthermore, even in a group under consolidated supervision, "unregulated firms" are excluded and they may receive funding by debt finance to a substantial degree.

On that basis we disagree to split the equity among the subsidiaries for a capital adequacy test in the way proposed. This would substantially limit the capability of a mixed group to invest into (non-regulated) subsidiaries by financing the acquisition with debt instruments. Although CRR provides for similar limitations under certain conditions for groups including a credit institution, the proposal is to be seen in the light of the different business activities of investment firms outside standard loan activities. Furthermore, the CRR approach foresees a consolidation of capital within the regulated group and as such higher equity values of consolidated entities compared to the book value of the participation adds to the group capital, this is not the case with the proposed method.

In addition, the relevance of the investment firm business in the group context need to be taken into account. A marginal investment in an investment firm which is well capitalised should not spill over to an industry group. This goes by far beyond the scope of consolidated supervision as applied in the context of credit institutions and more precisely in the context of Financial Holding Groups. A Financial Holding Group only exists, if the subsidiaries of the holding company are "**exclusively or mainly** institutions or financial institutions". Moreover, the level of application is unclear as the holding structures may have multiple layers.

Finally, the presented proposal does not give guidance on how to deal with situations where parts of wider groups may be "investment firms only" while other parts also include credit institutions.

All in all, we recommend to consult on the topic of changes in the consolidation rule in a broader context and with a focussed approach.

Question 27. 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?

We do not see any difficulty to apply standalone rules on investment firms as discussed within the current consultation while applying consolidated supervision under plain banking rules for capital adequacy purposes.

However, as today (at least in our reading), "Class 3" investment firms should be excluded from the scope of consolidation and also the threshold to exempt from consolidation as laid out in Article 19 CRR should stay in place. Further elements may be necessary.

A consolidation for LCR, NSFR, ALMM or leverage ratio purposes from our point of view does not make sense for "Class 2" and "Class 3" investment firms.

Question 28. What other aspects should the competent authorities take into account when addressing the additional prudential measures on an individual firm basis under the prudential regime for investment firms?

No comments.

Question 29. What examples do you have of any excessive burden for investment firms arising from the current regulatory reporting regime?

No comments.

Question 30. What are your views on the need for any other prudential tools as part of the new prudential regime for investment firms? And if required, how could they be made more appropriate? In particular, is there a need for requirements on public disclosure of prudential information? And what about recovery and resolution?

Disclosure requirements should focus on the fulfilment of the MiFID requirements. General information on corporate governance, capital requirements and liquidity as well as the risk management framework (including key figures for capital and liquidity requirements) should be sufficient. There is no need to enhance the current framework but rather to refocus and adjust in line with planned changes as discussed in the current consultation.

Recovery and resolution measures need to be reasonable and proportionate. As we do not expect investment firms to be or to become systemically important, the requirements should be much lower than for credit institutions, CSDs or CCPs if needed at all.

A capital coverage (as proposed by us above) should cover continuing operations for a limited period of time. This is also true for the liquidity requirement. Taking the size and the kind of business into account, standardised recovery and resolution measures seems not to be appropriate – at least not for "Class 2" and "Class 3" investment firms.

Bail-in tools are difficult to use as investment firms in general do not have deposits and any other client money is most likely under a dedicated protection (like the investor protection scheme).

If the general framework of BRRD should be applied to "Class 1" investment firms, we expect the need for dedicated adjustments.

Question 31. What are your views on the relevance of CRD governance requirements to investment firms, and what evidence do you have to support this?

As investment firms in general are small and less complex than credit institutions, any corporate governance requirement should respect the principle of proportionality and should not overload investment firms with administrative requirements which do not fit the business activities.

Question 32. As regards 'systemic and bank-like' investment firms, do you envisage any challenges arising from the full application of the CRD/CRR remuneration requirements, and if so, what evidence do you have to support this? For all other investment firms, what are your views on the type of remuneration requirements that should be applied to them, given their risk profiles, business models and pay structures?

Beside our comment that we doubt on the nature of investment firms being "systemic", we have no dedicated comment.

Question 33. What is your view on a prudential remuneration framework for other than 'systemic and bank-like' investment firms that should mainly aim to counteract against conduct related operational risks and would aim at the protection of consumers?

The remuneration framework should be proportionate to the business of the investment firms which in general is a short term business.

As such, the requirements on e.g. retention periods, pay-out ratios and claw backs should be less tight and stringent than those for credit institutions. Furthermore, we in general expect a more limited focus on potential risk takers compared to credit institutions.

Question 34. What are your views on having a separate prudential regime for investment firms? 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 prudential framework for investment firms should be included in the CRR. A dedicated part should cover special arrangements which are different from those for credit institutions. We refer to the elements of our proposal as laid out throughout this document.

Question 35. What are the main problems from an investment firm perspective with the current regime? Please list the main problems with the current regime.

The inclusion of MTFs and OTFs as CRR-investment firm seems not to be appropriate.

Furthermore, the basis for the FOR is not adequate and at least payments under a profit and loss pooling agreement need to be taken out of the definition of fixed overheads.

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We are at your disposal to discuss the issues raised and proposals made if deemed useful.

Yours faithfully,

Jürgen Hillen
Executive Director

Christian Süttmann
Regulatory Specialist