European Banking Authority (EBA)

Date: 2 February 2017

Public hearing: New prudential regime for investment firms (EBA/DP/2016/02)

The following answers have been filed by The Danish Association of Asset Management and Investment Firms (in Danish: Den danske Fondsmæglerforening) which represents approximately two thirds of registered Danish Investment Firms (24 out of 38 firms).

The answers have been filed via EBA's website on 2 February 2017.

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?*

In our general opinion, application of the same criteria, as provided for G-SIIs and O-SIIs, for the identification of 'systemic and bank-like' investment firms seem reasonable. 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, can be used.

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

We very much welcome EBA's proposal for not applying CRDIV requirements to non-systemically important firms that are not bank-like as we support designing a regime with a starting point in the risk relevant to investment firms.

Moreover, we believe that the prudential regime should target the risk for clients only, unless it is assessed that the failure of the firm may have a systemic impact. I.e. we do not view it as necessary to protect professional counterparties in the market who may before entering into transactions make an assessment of the risk posed to them by the investment firm. We do not regard switching cost – if an investment firm is closed down – as a significant issue, and we do not see the need to address it in the capital requirement.

We support making appropriate differences in the regulatory burden posed on smaller and larger firms and encourage EBA to take into consideration the need for a simple regime in order not to enhance the regulatory burden, especially to those investment firms which are not today within the scope of CRDIV.

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We find that a different regime for investment firms should reflect that investment firms differ from banks by not having bank-like client deposits or providing credit facilities to clients.

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?*

Identification of and the creation of a separate prudential treatment for very small and non-interconnected investment firms would be very welcome. Today the operational requirements are too comprehensive compared to the size of the firms, their organizational set-up and the risk they impose to clients and markets.

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

When determining which investment firms should be subject to the separate prudential treatment such as a Fixed Overhead Requirements only, emphasis should be on quantitative thresholds.

An investment firm, dealing on own account to a minor extent, does not as a result of these dealings add any significant risk to the clients that justify a more burdensome prudential treatment. Therefore, when determining whether or not an investment firm is non-interconnected, focus should be on quantitative thresholds and some degree of flexibility should be given with regard to the activities performed.

Considering the risks entailed in the activities listed, only items a), b), d) and e) should exclude an investment firm who are below the quantitative thresholds from benefitting from the simplest prudential treatment. Items h) and i) have no risk implications for clients and as such should not exclude an investment firm from the simplest prudential regime.

With regard to dealings on own account as listed under item c), a distinction should be made. An investment firm dealing on own account infrequently with the purpose of managing its capital, e.g. by investing in sovereign bonds or similar, should not influence the prudential treatment whereas dealings on own account pursuing a highly speculative investment strategy might entail as a consequence that the investment firm is excluded from the simplest prudential treatment.

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)?*

With regard to the risk to firm (RtF), we find this to be an excessive regulation, taking into consideration the risks already assessed in relation to customers and markets. We believe that a prudential regime should be kept simple and focus on the issues relevant in the field of non-systemically important firms, namely the need to protect clients.

Furthermore, we do not find it justified to make an unparalleled inclusion of legally separate entities as tied agents.

Please also refer to our general comments under Question 2.

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 K-factors that can be both easily observable and risk sensitive?

The K-factors AUA and AUM are not relevant risk factors to the extent that such client money and securities are not held by the investment firm. Risk to the clients are not necessarily correlated with the investment firm's AUA or AUM. Furthermore, the risk that clients are harmed due to incorrect discretionary management or unsuitable advice should not be addressed through the prudential treatment but rather through indemnification based on the contractual obligation towards the client and prudential rules in MiFID and MiFID II. The risk that an investment firm cannot honor its contractual obligations should remain a competitive resource.

We acknowledge that it can be relevant, to what extent the investment firm hold client money and securities, and hence that K-Factors ASA and CMH can be relevant. However, we note that K-Factor ASA and CMH to some extent capture the same risk - at least in the typical Danish Investment firm set-up. We also note that when considering K-Factors ASA and CMH, it is important to reflect that investment firms differ from banks by not having bank-like client deposits. Thus, if the actual set-up does not pose any risk for the client related to loss of client money or securities, the K-Factor should be reduced accordingly.

We find it important that the K-Factor LtC is limited to particular liabilities, such as the mentioned guarantees, security-lending, contract for difference, to avoid that the LtC captures risks already captured by K-Factors AUM and AUA. Apart from these specific situations, we find that the prudential rules in MIFID and MiFID II address this factor.

Furthermore, we note that K-Factor COH to some extent capture the same risk as the K-Factor AUM - at least in the typical Danish Investment firm set-up.

In relation to K-Factors for RtM, please refer to our comments under Question 5.

Separate RtM for securitization risk-retentions is not considered relevant for non-systemically important firms that are not bank-like. This is also considered the case in respect of investment firms dealing on own account, as loss on such trading will affect only the investment firm itself, but not neither directly nor indirectly the client's money or securities, to the extent that such client money and securities are not held by the investment firm.

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?*

We find that a lift-up measure is less relevant for investment firms, as investment firms differ from banks by not having bank-like client deposits or providing credit facilities to clients. Thus, we do not see the need for a lift-up measure, if it is not limited to a specific risk of loss of client money or securities.

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 prefer a separate regime for Class 3 investment firm. Simplicity should be the priority and with the built-in approach there is an inherent risk that Class 3 investment firms will have to obtain detailed knowledge and make qualified assessments simply to determine if they can benefit from the proportionality in the built-in approach which will negate the main objective of a simple prudential regime.

In line with the purpose of keeping it simple we suggest implementing a ceiling as an option whereby Class 3 investment firms can choose to fulfill the requirements in the prudential regime by reaching the ceiling at all times.

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

Yes, the FOR should remain part of the capital regime.

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

We find that specific capital requirements for larger firms that trade financial instruments being derivatives should only be applied for systemically important firms or investment firms that are bank-like.

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

N/A

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)?*

N/A

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?*

N/A

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?*

Please refer to our comments under Question 15.

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?*

As explained in para 93 of the discussion paper, any deduction in the own funds of an investment firms for holding capital instruments in other financial institutions should be omitted, as it happens in the course of the normal business.

Furthermore, we find that it should be considered to omit subordinated loans to financial institutions as well as any holdings in UCITS.

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?*

A new standard specifically tailored for investment firms should be introduced.

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?*

In our opinion, the rules governing initial capital and regulatory capital should be as simple and easy to handle as possible.

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?*

Please refer to the answer provided to Question 17.

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 concept of eligible capital is not needed. We do not see a need for this separate concept with regard to investments firms' capital structure.

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

Referring to our general comments to Question 2, we find it very important to limit any liquidity requirements to any obligation the investment firm may have towards clients. If no liquidity requirements exist towards any clients (as part of trading obligations, loss of client money or securities etc.), the investments firm should be unrestricted in handling its liquidity.

Therefore, as a general principle, we find that any common stress scenario for liquidity is not necessary, as that is a risk related to granting loans and taking deposits. Hence, if the business model of the investment firms does not pose any risk for the client related to loss of client money or securities, we see no need for common stress scenario for liquidity.

We do not find that liquidity requirements are the right way to provide for a measurement of appropriate management of an investment firm. Such prudential measures are sufficiently provided for in MiFID and MiFID II.

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 'non-systemic' investment firms? More specifically, could you provide any evidence or counter-examples 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?*

Please refer to our general comments under 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).*

Please refer to our general comments under 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?*

Please refer to our general comments under Question 20.

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?*

Please refer to our general comments under Question 20.

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?*

Large exposures arising from temporary receivables from client should not be included in large exposures. Receivables from clients is not a risk for the investment firms and is normally linked to a positive impact on the own funds (which may not be included right away). Receivables should only be considered a risk when payments are overdue and/or only if the income has been included in the own funds.

This can in general be a very cumbersome regulation, and we would strongly encourage any removal of bank-line exposure regulation.

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 believe that a group approach to investment firms should only be applied to the extent that a systemic impact of the investment firm group's is likely. If no systemic impact is likely, we do not see the need to apply a burdensome regime where the group's entities are already under supervision and regulated on an individual basis.

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?*

In our opinion, it is too early to make an assessment on this matter.

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?*

We find that the general principle of proportionality is key for a prudential regime, as investment firms in some regions include very small entities.

Prudential regimes providing for specific requirements on organizational set-up, separate functions, obligatory whistleblower set-up may be very cumbersome and less relevant in respect of small entities.

In general, we find that additional prudential measures are not needed as appropriate prudential measures are sufficiently provided for in MiFID and MiFID II.

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

The Gearing (CRR Article 329) reporting is not a valid indicator of an investment firm's risk. The calculation and reporting should not be included in a new prudential regime. Investment firms do not have the same complicated balance sheet as banks and generally investment firms – especially asset managers – do not have the same need to leverage the balance sheet.

The disclosure requirements (CRR Article 431) are made for banks and is by large not relevant for investment firms and therefore an unnecessary reporting burden. The information is generally not demanded by or relevant for clients.

Apart from the reporting regime, we also want to draw attention to the following regulatory approval procedures, etc.:

The approval procedure that applies to investment firms according to art. 77 and 78 in Regulation 575/2013, cf. article 11.2, is also made in respect of banks providing credit facilities and deposits. The procedures could without any risk towards clients or market be eased in respect of investment firms, and would furthermore provide needed flexibility in relation to smaller non-public investment firms. The present rules are burdensome for the investment firms as well as national authorities.

Furthermore, the requirement that there may be no exposures towards entities in which the management are either part of the Board of Directors or daily management seems well reasoned in respect of loans and credits, but is by large not relevant for investment firms. Such restrictions should not apply in relation to ordinary expenses, such as costs and expenses to be paid by such entity.

Finally, the requirements on organizational set-up, especially the qualification of risk takers (Regulation 604/2014) are made for banks and entities of a certain size and is by large not scaled to smaller investment firms.

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?*

We believe that the approach to a prudential regime is already provided by MiFID and MiFID II. This existing regime already provides for an appropriate set-up of investment firms and their services, providing a focus on the interests of clients to be the relevant and sufficient.

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?*

We believe that the approach to governance requirements already provided by MiFID and MiFID II in order to prevent payments with incentives contrary to the interests of clients to be the relevant and sufficient. Please refer to the general answer provided to Question 2.

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?*

For other investment firms than those systemic and bank-like we support not applying CRDIV requirements which do not seem relevant to the types of risks inherent in this business. We believe the approach to payment structures already provided by MiFID and MiFID II in order to prevent payments with incentives contrary to the interests of clients to be the relevant and sufficient.

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?*

Please refer to the answer provided to Question 32.

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?*

Please refer to answers provided above.

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.*

Please refer to answers provided above.

Kind regards

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