Association française des marchés financiers
FINANCIAL MARKET PROFESSIONALS

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EBA Consultation on simplified resolution obligations under article 4(6) of Directive 2014/59/EU

AMAFI contribution

This paper seeks to respond to the EBA Consultation Paper EBA/CP/2017/05 suggesting Draft Regulatory Technical Standards on simplified obligations under Article 4(6) of Directive 2014/59/EU, published on May 8th, 2017 on the EBA website.

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities. Nearly one-third of members are subsidiaries or branches of non-French institutions.

AMAFI welcomes the opportunity to comment on EBA's Consultation Paper EBA/CP/2017/05 published on May 8th, 2017 regarding simplified obligations under Article 4(6) of Directive 2014/59/EU, also called 'BRRD' (Banking Recovery and Resolution Directive). We are happy to seize the opportunity to make suggestions on the way the resolution regime could better achieve the objectives of simplification and proportionality.

Before responding to the specific questions of EBA's consultation document, AMAFI would like to point out the following general comments.

I. – GENERAL COMMENTS

From a general perspective, we welcome the Commission's and the EBA's willingness to make more objective the criteria for applying the simplified recovery and resolution regime mentioned in article 4(6) of Directive 2014/59/EU (hereafter 'BRRD').

It is worth noting that, given AMAFI's *raison d'être*, we focused on proposed rules for investment firms, not for credit institutions. Therefore, we did not make any comments on questions 1, 2 and 3 of the consultation.

In our views, key positive points of the consultation paper include the following.

- In itself, the existence of a simplified recovery and resolution regime, with lower reporting frequency and adjusted level of detail of recovery plans, is a good thing as it allows proportionality for smaller institutions.

- We support the principle of distinct application criteria for credit institutions on the one hand and investment firms on the other, as this allows to better take into account the specifics of investment firms, where a much larger range of firm sizes, business models and activities exist.

- We also favour the option that leaves a margin of appreciation to national regulators, as the characteristics of national markets (e.g. number, size and activity of investment firms) vary greatly between the various jurisdictions of the EU; therefore, having a minimum list of assessment criteria while allowing some discretion to national resolution authorities in defining thresholds appears a good compromise.

However, we would like to stress two potential negative effects that the EU regulator should seek to avoid when fine-tuning the application of different resolution regimes (simplified / not simplified). The first one is a potential additional reporting burden: the existence of classification criteria to make the difference between firms eligible to the simplified regime and other firms <u>must not result in additional reporting data</u>. In this respect, we agree with the EBA's proposal to use indicators that are already included in existing FINREP reports and made available to the EU supervisor.

The second potential negative effect would lie in the existence of multiple classification criteria depending on the piece of regulation considered. Typically, the EU regulator should avoid having different sets of classification criteria for solvency, liquidity and resolution respectively.

More specifically, the EU is currently engaged in a proposal for a new prudential regime for solvency and liquidity rules applicable to investment firms. According to this proposal, investment firms would be classified into class 1 (systemic), class 2 (other, non-systemic) and class 3 (small, non-interconnected) firms. <u>If this classification is confirmed, it should also be used for defining the appropriate resolution regime</u> and we suggest a possible way of so doing (please refer to our answer under question 4). In our views, this should ensure greater clarity and simplicity of the future prudential regime applicable to investment firms. This is critical for the largest possible number of firms across the EU to understand and endorse the future prudential regime.

II. – Responses to EBA specific questions

Question 1

Do you agree with the list of quantitative indicators for credit institutions provided in Annex 1?

As this question regards credit institutions only, we do not have any comments.

Question 2

Do you agree with the calibration of the total quantitative threshold for credit institutions? Do you expect any unintended consequences arising from the applying that threshold? If yes, please provide details on these consequences.

As this question regards credit institutions only, we do not have any comments.

Question 3

Do you agree with the list of qualitative considerations for credit institutions?

As this question regards credit institutions only, we do not have any comments.

Question 4

Do you agree with the list of quantitative indicators for investment firms provided in Annex II?

Annex II of the consultation paper lists four quantitative indicators for determining whether an investment form may or may not be eligible to the simplified regime. These indicators are based on data already reported as part of FINREP. They are: (i) total assets, (ii) total liabilities, (iii) total fees and commission income, and (iv) assets under management. This list inspires various comments on our side.

1. First, we approve of the fact that the criteria are based on indicators that are already defined and reported under FINREP. This is positive as it ensures that the indicators are unambiguous and defined in the same way throughout all EU jurisdictions.

2. Second, the 'total assets' and 'total liabilities' indicators, as they are defined in FINREP are by definition equal to one another: they equal the total balance sheet size of the institution. Therefore, our opinion is that they duplicate one another and, therefore, that one of them should be removed. <u>For clarity purposes, we suggest keeping 'Total assets' and removing 'Total liabilities' from the list of indicators.</u>

3. Our third comment is that all of the four criteria suggested seek to reflect a size criterion, as opposed to the criteria suggested for credit institutions (mentioned in Annex I), which also seek to capture interconnectedness, scope and complexity of activities and nature of business. We believe that such criteria as also relevant for investment firms and that they can also be captured by quantitative indicators.

More precisely, we suggest adding the following classification indicators for investment firms:

Criterion	Indicator	Proposed Definition
Interconnectedness	Intra-financial system liabilities	FINREP IFRS F20.06, rows 020+030+050+110+120+170+180, column 010, all countries
	Intra-financial system assets	FINREP IFRS F20.04, rows 020+030+050+110+120+170+180, column 010, all countries
Scope & complexity of activities	Value of OTC derivatives (notional)	FINREP IFRS F.10.00, rows 300+310+320, column 030 + F.11.00, rows 510+520+530, column 030
	Financial assets held for trading	FINREP IFRS F.01.01, row 050, column 010

We consider interconnectedness as a relevant criterion for the assessment of the risk borne by the financial system in case of failure, as it determines the extent of a potential contagion to other institutions. Therefore, in our views, a measure of exposures to other financial institutions should be taken into account when assessing whether an investment firm could benefit from a simplified resolution regime or not. This can be captured via the indicators 'intra-financial system liabilities' and 'intra-financial system assets'.

Scope and complexity of activities is another criterion that we consider relevant, especially in the case if investment firms that are active on financial markets and hold a portfolio of trading exposures. The following indicators could be used:

- Financial Assets held for trading: this indicator provides information on the size of the trading book. This indicator appears relevant for most investment firms that act as investment service providers, e.g. via market making, emission and hedging of structured products, etc.

- Value of OTC derivatives (notional): this indicator is suggested for credit institutions in the consultation paper, and we believe it would also be relevant for investment firms, a large number of which hold OTC derivatives positions.

4. Our final comment is to highlight current reflections aimed at a global revision of the prudential regime applicable to investment firms in the EU[1]. According to current EBA proposals, and subject to possible changes in the final future framework, the new regime would classify EU investment firms into 3 groups: (i) class 1 for systemic investment firms, (ii) class 2 for other, non-systemic firms, (iii) class 3 for small, non-interconnected firms. Revised solvency and liquidity rules would apply differently to each of these three classes of investment firms.

In this context, one could envisage to align the application of a simplified regime under article 4(6) of BRRD on the same classification as solvency and liquidity rules. In this context, we support the principle whereby the classification of an investment firm (as class 1, class 2 or class 3 firm) as

[1] Cf. EBA, *Designing a new prudential regime for Investment firms*, Discussion Paper DP/2016/02, 4th November 2016.

regards solvency and liquidity would also determine its recovery and resolution regime; this principle could be applied as follows:

- For class 1 investment firms, the application of the simplified regime under article 4(6) would not be possible;
- For class 2 firms, the potential application of the simplified regime would depend on a number of quantitative criteria such as size, interconnectedness and scope/complexity of activities (cf. criteria mentioned above);
- All class 3 firms would be applied the simplified regime under article 4(6) of BRRD.

The benefits would be the following:

(i) consistency with the classification rules of the new prudential regime for investment firms,
(ii) greater clarity and simplicity in assessing whether a firm is eligible to the simplified recovery and resolution regime (no additional assessment would be required for class 1 firms and class 3 firms),
(iii) application of the proportionality principle.

This raises the issue of timeliness in applying the EU Commission delegated regulation proposed in the consultation paper. In our views, its application for investment firms should be scheduled so as to enter into force at the same time as the future prudential regime for investment firms in the EU.

Question 5

Do you agree with the list of qualitative considerations for investment firms?

As we understand article 4 of the proposed draft RTS, even if an investment firm is not likely to have a significant negative effect on financial markets based on quantitative criteria, this firm would still be submitted to a qualitative assessment and could finally be declared not eligible to the simplified resolution regime.

Such qualitative criteria provide additional discretion for the national resolution authority to decide whether to apply a simplified resolution regime to a given institution. However, allowing too much discretion to national authorities would conflict with the purpose of greater harmonisation, throughout the EU, in the application of article 4(6) of the BRRD Directive. We therefore favour the definition of a set of quantitative criteria for which thresholds can help ensure that investment firms can define

We can understand the existence of such qualitative criteria in a context where size is the only quantitative criterion taken into consideration (as it is in the EBA's proposal), as qualitative criteria would capture relevant criteria other than size. However, in a situation where a multi-criteria, multi-indicator approach would be adopted, taking into account size, interconnectedness and activity, we believe that additional qualitative criteria would add complexity and arbitrary to the criteria for applying a simplified regime.

Our opinion is therefore that no qualitative criterion should prevent an investment firm from benefiting from the simplified resolution regime if, based on multiple quantitative criteria mentioned under question 4, it was declared eligible.

Question 6

Do you agree with our analysis of costs and benefits of the proposals in this Consultation Paper? If not, can you provide data to justify your position or further inform our analysis of the likely impact of the proposal?

We agree with the EBA's preferred option on how to specify the criteria for determining investment firms' eligibility to simplified obligations. The EBA's preferred option is, where possible, specifying eligibility criteria through a set of quantitative indicators, however without specifying any calculation methodology or threshold.

This option appears reasonable as is combines greater harmonisation through a specific list of criteria that resolution authorities must consider, while allowing some discretion in the way such criteria are assessed. Such discretion is required given the high degree of diversity between the investment firms markets of each EU jurisdiction.

Regarding costs and benefits, our comments are the following:

1) The main source of costs for investment firms lies in reporting workload. Sticking to FINREP indicators allows avoiding any additional reporting cost for investment firms.

2) The main source of costs for resolution authorities would be due to the workload required for determining all investment firms' eligibility to simplified obligations. Making a set of relevant quantitative indicators the only source for this (and, therefore, removing qualitative criteria, as suggested in our answer under question 5) would ensure this workload is reduced to its minimum level.

3) Benefits of the principles discussed would essentially lie in:
   a) symmetric information and approaches between supervision authorities;
   b) a even playing field, that is similar application of a single set of rules across the EU;
   c) reduction of regulatory arbitrage opportunities.