



Council of the  
European Union

Brussels, 26 April 2018  
(OR. en)

8409/18

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**Interinstitutional Files:**  
**2017/0358 (COD)**  
**2017/0359 (COD)**

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EF 120  
ECOFIN 367  
CODEC 646

#### COVER NOTE

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From: European Economic and Social Committee  
date of receipt: 25 April 2018  
To: Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of  
the European Union

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Subject: Review of the prudential rules for investment firms  
- *Opinion of the European Economic and Social Committee*

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Delegations will find attached the above mentioned opinion.

Encl.: [...]



*European Economic and Social Committee*

**ECO/447**

**Review of the prudential rules for investment firms**

## **OPINION**

European Economic and Social Committee

**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  
[COM(2017) 790 final – 2017/0359 (COD)]**

**Proposal for a Directive of the European Parliament and of the Council  
on the prudential supervision of investment firms  
and amending Directives 2013/36/EU and 2014/65/EU  
[COM(2017) 791 final – 2017/0358 (COD)]**

Rapporteur: **Jarosław Mulewicz**

Consultation	European Parliament: COM(2017) 790 final: 18/01/2018 and COM(2017) 791 final: 18/01/2018 Council of the European Union: COM(2017) 790 final: 14/02/2018 and COM(2017) 791 final: 14/02/2018
Legal basis	Articles 114 and 304 of the Treaty on the Functioning of the European Union
Section responsible	Section for Economic and Monetary Union and Economic and Social Cohesion
Adopted in section	26/03/2018
Adopted at plenary	19/04/2018
Plenary session No	534
Outcome of vote (for/against/abstentions)	193/2/3

## 1. Conclusions and recommendations

1.1 The EESC welcomes the Commission's proposals and hopes that they will contribute effectively towards meeting the goals set by the Commission.

1.1.1 The EU needs stronger capital markets to promote investment, unblock existing and provide new sources of financing for companies, offer better financial opportunities for households, and strengthen the Economic and Monetary Union. The Commission is committed to putting in place all the elements completing the Capital Markets Union by 2019.

1.1.2 The second goal relates to Brexit and the need to attract investment firms to the EU. The UK's decision to withdraw from the Union creates the need to update the regulatory framework in the EU to attract financial firms. Acting as an important hub for capital markets and investment activities, the UK has the largest number of European Economic Area (EEA) investment firms, with roughly half of them based there. The next most important hubs are Germany, France, the Netherlands and Spain. Most EEA investment firms are small or medium-sized. The European Banking Authority (EBA) estimates that some eight investment firms, concentrated in the UK, control around 80% of the assets of all investment firms in the EEA.

1.1.3 The third goal is to create a dedicated legal framework for investment firms. The current prudential framework focuses on credit institutions and the risks associated with them. Investment firms do not take deposits or make loans. This means that they are a lot less exposed to credit risk and the risk of depositors withdrawing their money at short notice. Their services focus on financial instruments, which unlike deposits are not payable at par but fluctuate according to market movements. However they do compete with credit institutions in providing investment services, which credit institutions can offer to their customers under their banking licence. Credit institutions and investment firms are therefore distinct types of institution. However, systemic investment firms do not escape the scope of CRR/CRD IV<sup>1</sup>, but are treated as financial institutions. Such firms, by virtue of becoming credit institutions, should therefore continue applying Regulation (EU) No 575/2013 and Directive 2013/36/EU and be subject to supervision by the authorities, including the ECB in the framework of the Single Supervisory Mechanism, in charge of credit institutions.

1.1.4 With the fourth goal the Commission aims to create a single EU integrated regulatory framework for investment firms. Because of their different business profiles, investment firms are subject to many legal exemptions according to the country, which creates regulatory complexity for many firms, especially those operating in many countries. This creates additional risk. Implementation of the current legal framework by the Member States gives rise to fragmentation in the overall regulatory landscape for investment firms, with scope for harmful regulatory arbitrage. This could threaten the integrity and functioning of the single market. The

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<sup>1</sup> [Regulation \(EU\) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation \(EU\) No 648/2012](#). Together with [Directive 2013/36/EU \(Capital Requirements Directive, or CRD IV\)](#), this provides the current prudential framework for investment firms.

prudential rules for investment firms proposed by the Commission apply to a majority of small and medium-sized investment firms in all the EU Member States.

- 1.2 The EESC notes that, however unintended, the relocation of the UK-based investment firms would be to Member States which are in the banking union or euro area, and in particular to financial centres in euro area countries such as Germany, France, Luxembourg, the Netherlands and Ireland. Member States that do not belong to the euro area would be overlooked.
- 1.3 The EESC is pleased that SMEs are expected to be among the main beneficiaries of the Directive and the Regulation. A more proportionate and appropriate prudential framework for them should improve conditions for conducting business and eliminate barriers to entry. This applies in particular to capital requirements and administrative burdens. The EESC notes that the rules may encourage innovative firms seeking to grow through digital means. This includes facilitating access to finance for SMEs which are not banks or investment firms themselves. A more suitable prudential framework should help free up capital from unproductive regulatory procedures and allow small investment firms to offer better services to their customers, including other SMEs. This should contribute to helping investment firms act as intermediaries in mobilising investments from savers across the EU and thereby facilitating non-bank sources of finance for European companies.
- 1.4 The proposed Directive and Regulation on the prudential requirements and supervision of investment firms establish the necessary norms and requirements for initial capital and existing capital, supervisory powers, publication and remuneration. This diminishes risk, which is inherent in the financial operations of investment companies. The question remains of the extent to which the risk borne by investment companies will be passed on to the individual investors and companies that are their clients. If firms act exclusively as agents for their clients and limit their services to investment advice or portfolio management, the risk inherent in the financial instruments will mostly reside with the client.
- 1.5 It remains to be seen whether the unilateral introduction by the EU of a specific legal framework for investment firms in the Union, without taking account of markets such as the USA, Japan, China and India, and in the light of globalisation and electronic markets, will trigger a flight of investors from Europe. Owing to the complexity of the MiFID II legal framework and the need to register financial products, between 20% and 50% of products are no longer offered. Therefore, in the case of a specific legal framework for investment firms, the new rules should be monitored and amended in a flexible way if financial markets respond negatively. The EESC shares concerns that financial transactions, amounting to 54% of global GDP, pose a considerable risk. However, they also offer a major opportunity for development finance. If the legal framework is not amended in a flexible way, then, despite the best of intentions, investment firms from the United Kingdom will move to the USA instead of the EU.

## 2. **Background**

- 2.1 There are many different types of investment firms in the EU, with different services and different clients. EBA data show that at the end of 2015 there were 6 051 investment firms in the European Economic Area (EEA). Most investment firms are SMEs. The EBA estimates that

about eight investment firms control 80% of the assets. These are firms that are based in the United Kingdom. According to EBA information, around 40% of EEA investment firms are authorised exclusively to provide investment advice. 80% of EEA investment firms limit their activities to investment advice, reception and transmission of orders, portfolio management and execution of orders. Around 20% are authorised to carry out dealing on their own account and underwriting, the services which are currently subject to the most stringent prudential requirements.

- 2.2 Acting as an important hub for capital markets and investment activities, the UK has the largest number of EEA investment firms, with roughly half of them based there, the next most important hubs being Germany, France, the Netherlands and Spain. Most EEA investment firms are small or medium-sized. Currently, investment firms identified as systemic are typically subsidiaries of US, Swiss or Japanese banking groups/broker-dealers.
- 2.3 Until now, the EBA has broken down investment firms into 11 categories, primarily determined by the investment services they are authorised to undertake under MiFID<sup>2</sup> and by whether they hold money and securities belonging to their clients. Investment firms which conduct a broad range of services are subject to the same requirements as credit institutions in terms of capital requirements for credit, market and operational risk, and potentially liquidity, remuneration and governance rules, while firms with limited authorisations (typically those which are considered less risky, i.e. investment advice, reception and transmission of orders) are exempt from most of these requirements. The EBA is proposing a new categorisation of investment firms: instead of 11 categories, there would be three main ones. Under the initial recommendations, systemic investment firms constitute Class 1 and would remain in the CRR/CRD IV. Class 2 firms are those which either: deal on own account and incur market and counterparty credit risk; safeguard and administer client assets; hold client money or are above given size thresholds (assets under management under both discretionary portfolio management and non-discretionary (advisory) transactions higher than EUR 1.2 bn; client orders handled of at least EUR 100 m/day for cash trades and/or at least EUR 1 bn/day for derivatives; balance sheet total higher than EUR 100 m; total gross revenues higher than EUR 30 m). These firms are required to calculate their capital requirements in relation to the new risk factors (K-factors). Class 3 firms are those which do not conduct the above activities and which are below all the above thresholds. Class 3 firms are not required to meet a capital requirement set in relation to the K-factors.
- 2.4 The EU regulatory framework for investment firms consists of two main parts: first, the Markets in Financial Instruments Directive (MiFID) and, as of January 2018, MiFID II/MiFIR<sup>3</sup>, which set out the conditions for their authorisation and organisational and business rules. Second, they are subject to the prudential framework under the Capital Requirements Regulation and Capital Requirements Directive CRR/CRD IV, in the same way as credit institutions. This is because

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<sup>2</sup> Markets in Financial Instruments Directive: [Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC.](#)

<sup>3</sup> [Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU and Regulation \(EU\) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation \(EU\) No 684/2012.](#)

they can compete with credit institutions in performing these investment services, which credit institutions can offer to their customers under their banking licence. Credit institutions are in turn subject to the key provisions of MiFID, aligning the conditions for the provision of investment services between investment firms and credit institutions both in terms of the investor protection and conduct provisions of MiFID and in terms of the key prudential requirements of the CRR/CRD IV.

- 2.5 As mandated under the provisions of the CRR, a review of the prudential framework for investment firms was carried out in consultation with the EBA, the European Securities and Markets Authority (ESMA) and the competent national authorities. Following a call for advice by the Commission in December 2014, the EBA published a report on the current prudential framework for investment firms in December 2015, calling for changes to the current approach. Following a second call for advice by the Commission in June 2016, the EBA in November 2016 published a discussion paper on a potential new prudential regime for the vast majority of investment firms. The paper was open for comments for three months. Taking account of the feedback and the additional data it had gathered from investment firms together with national competent authorities, the EBA published its final recommendations in September 2017, inviting comments from stakeholders. The precise calibration of the recommendations for new capital requirements was supported by a detailed data-gathering exercise involving investment firms. This was carried out by national competent authorities on behalf of the EBA in two stages in 2016 and 2017.
- 2.6 The EBA report provides a comprehensive and publicly available analysis of the status quo, with data on numbers and types of investment firms in the Member States. The report also puts forward a new regime for the majority of investment firms by carving them entirely out of the CRR/CRD IV framework and leaving only systemic investment firms within the scope of the latter, in accordance with the revised approach of identifying them in the proposal. The proposal is also consistent with MiFID and MiFID II/MiFIR. By setting prudential requirements that are tailored to the business and risks of investment firms, it clarifies when and why these requirements apply. As such, it would overcome some cases of arbitrary application of prudential requirements which currently arise because the requirements are set in relation to banking investment services listed in MiFID rather than to business conducted by investment firms.
- 2.7 The findings of the EBA review<sup>4</sup> were discussed with Member States in the Financial Services Committee in March and October 2017 and in the Expert Group on Banking, Payments and Insurance in June and September 2017. Account was also taken of stakeholder input received on the Commission's inception impact assessment published in March 2017. Finally, the Commission also considered input received previously in the wide-ranging call for evidence on the efficiency, consistency and coherence of the overall EU regulatory framework for financial services. Given the detailed public consultation and data collection undertaken by the EBA, the

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<sup>4</sup> [EBA report on investment firms, response to the Commission's call for advice of December 2014 \(EBA/Op/2015/20\)](#). As set out in the relevant articles of the CRR mandating the review, this was carried out in consultation with the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the national competent authorities represented in these European Supervisory Authorities (ESAs).

Commission considered it unnecessary to run a general public consultation in parallel. It instead consulted stakeholders in a targeted fashion. The consultation included:

- a round table with industry stakeholders (investment firms, investors, law firms, consultants) on 27 January 2017 on the EBA's draft proposals for a future regime;
- a workshop on the costs of the current regime on 30 May 2017;
- a workshop on the EBA's draft final recommendations on 17 July 2017.

2.8 The EBA estimates that the new rules would increase capital requirements in aggregate for all non-systemic EU investment firms by 10% compared with current requirements, and that they would decrease them by 16% compared with total requirements applied as a result of Pillar 1 add-ons. The way in which these impacts would be distributed among investment firms depends on their size, which investment services they provide and how the new capital requirements will apply to them. On available own funds, the EBA considers that only a few firms – just a small number of investment advisors, trading firms and multiservice firms – would not have sufficient capital to comfortably meet the new requirements. However, for firms in this group whose increases would be over twice their current requirements, a cap could be granted for a number of years.

2.9 The Treaty on the Functioning of the European Union gives the EU the power to lay down appropriate provisions concerning the establishment and functioning of the internal market (Article 114 TFEU). Directives are issued to make it easier for persons to take up and pursue commercial activities across the EU (Article 53 TFEU). This extends to legislation dealing with the prudential supervision of providers of financial services, in this case investment firms. The provisions of the proposed Directive under discussion replace those in CRD IV, which are also based on Article 53 TFEU as they relate to investment firms. The provisions of the proposed Regulation replace those in Regulation (EU) No 575/2013, which are also based on Article 114 TFEU as they relate to investment firms.

2.10 The new rules will not have implications for the EU budget.

### 3. **Observations and comments**

3.1 The EESC welcomes the fact that the proposal sets out requirements for the appointment of prudential supervisory authorities, the initial capital and existing capital of investment firms, liquidity, concentration risk, the supervisory powers and tools for the prudential supervision of investment firms by the competent authorities, reporting and publication requirements and public disclosure, supervisory review and evaluation, corporate governance, and remuneration. Thus the Directive sets out rules for the supervision and control of investment firms and reduces all types of risk inherent in the business activities of investment firms. The Directive applies to all investment firms covered by MiFID II as of January 2018.

3.2 The EESC draws attention to the fact that the proposal requires Member States to appoint an authority to exercise powers of prudential supervision under the Directive. Member States may either bestow these on an existing authority under CRD IV or vest them in a new authority. Competent authorities should have powers to review and evaluate the prudential situation of

investment firms and, where necessary, to require changes in areas such as internal governance and controls, and risk management processes and procedures, as well as where necessary powers to set additional requirements, including in particular capital and liquidity requirements.

- 3.3 In the EESC's view, it is important that the competent authorities are to cooperate closely with the public authorities or bodies responsible in their Member State for the supervision of credit institutions and financial institutions. Member States will have to ensure that competent authorities, as parties to the ESFS (European System of Financial Supervision), cooperate when ensuring the flow of appropriate and reliable information between themselves and other parties to the ESFS. In particular they should exchange information about: the management and ownership structure, compliance with capital requirements, concentration risk and liquidity of the investment firm, the administrative and accounting procedures and internal control mechanisms of the investment firm, and any other relevant factors that may influence the risk posed by the investment. In the EESC's view, this will make the European investment market more transparent.
- 3.4 Competent authorities may provide the EBA, ESMA, the European Systemic Risk Board (ESRB), the central banks of the Member States, the European System of Central Banks (ESCB) and the ECB in their capacity as monetary authorities, and, where appropriate, public authorities responsible for overseeing payment and settlement systems, with confidential information where that information is necessary for the performance of their tasks. The EESC believes that this will lead to the creation of a European information system on investment firms which should, in theory, prevent firms that act dishonestly from carrying out financial operations.
- 3.5 The initial capital requirements, especially for SME investment firms not holding clients' money or securities, increase slightly from EUR 50 000 to EUR 75 000. Systemic investment firms' initial capital requirements are regulated by the CRR/CRD IV directives. The EESC notes again that the proposal for a Directive on the prudential supervision of investment firms creates an opportunity for SMEs and SMEs growing through digital means in particular.
- 3.6 Based on data from over 1 200 firms, 80% of firms meet the proposed liquidity requirements. Around 70% of firms have over three times the amount available. The EESC therefore believes that the new rules will not remove the vast majority of existing investment firms from the market.
- 3.7 Remuneration policy in investment firms must be transparent and linked to the risks borne and profits generated. Remuneration systems must be controlled and approved by the supervisory bodies. Member States would require investment firms to disclose their remuneration policy and would ensure that investment firms provide competent authorities with information on the number of natural persons who receive remuneration of EUR 1 million or more per financial year. In such cases authorities must be provided with information on job responsibilities, the business area involved, the main elements of salary, bonus, long-term award, and pension contribution. The information would be forwarded to the EBA and published. The EESC believes that this is an appropriate course of action which seeks to link remuneration to the business performance of investment firms.

- 3.8 The EESC is pleased to note that branches of foreign investment firms are subject to checks and would be required to provide annual information on the name, nature of activities and location of any subsidiaries and branches, the turnover, the number of employees on a full-time equivalent basis, profit or loss before tax, the tax on profit or loss, and public subsidies received.
- 3.9 The EESC also supports the fact that, under Article 33 of the proposal for a Directive, the competent authorities would be required to take appropriate action where the review and evaluation referred to in point (e) of paragraph 1 of said article has shown that the economic value of the equity of an investment firm has declined by more than 15% of its capital. This would generally be done by the investment firm increasing its own capital.

#### 4. **Specific comments**

- 4.1 The EESC believes that, with the extension of MiFID to all derivatives markets in 2007, some specialised firms dealing in commodity derivatives were carved out entirely from the MiFID and prudential rules. The business of many of these firms involving financial instruments tends to revolve around hedging the risks of their parent companies related to the physical production, transmission, storage or purchase of the underlying physical commodities. Depending on the sector (e.g. energy, agriculture) their volume of hedging activity can be substantial, implying a major impact from capital requirements under the current framework. These firms will now operate under the proposed Directive on the prudential supervision of investment firms.
- 4.2 In the EESC's view, it is important that the proposals for a Directive and a Regulation introduce new risk metrics (K-factors) and the possibility of phasing in and capping higher requirements. K-factors capture risk to customer (RtC) and, for firms that deal on their own account and execute client orders in their own name, risk to market (RtM) and risk to firm (RtF).
- 4.3 The EESC notes that in its opinions on *Banking reform – Capital requirements and resolution framework amendments* (ECO/424)<sup>5</sup> and on the *MiFID & MiFIR* (INT/790)<sup>6</sup>, and in other earlier opinions on CRR/CRD IV, it was always supportive of prudential rules for EU capital markets.

Brussels, 19 April 2018

Luca Jahier

The president of the European Economic and Social Committee

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<sup>5</sup> [OJ C 209, 30.6.2017, p. 36.](#)

<sup>6</sup> [OJ C 303, 19.8.2016, p. 91.](#)