

**Deutsche Börse Group Response to
ESMA - EBA Discussion Paper on the Commission's Call for
Advice on the review of the Investment firm's prudential
framework**

Eschborn, 02. September 2024

Deutsche Börse Group (DBG) appreciates the opportunity to comment on the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) discussion paper EBA/DP/2024/01 “EBA-ESMA Discussion Paper on the Commission call for advice on the investment firm’s prudential framework”, issued on June 3, 2024.

Deutsche Börse Group supports that the prudential rules for investment firms should be proportionate, appropriately calibrated and tailored to the specific nature, activities and risks that such firms pose to the market. Investment firms, operating as market makers, play a key role in EU capital markets by ensuring liquidity provision, thus safeguarding market balance and stability, in particular during periods of market stress. The assurance of liquidity is essential to a transparent and fair price formation process and optimal functioning of markets, ultimately benefiting end-investors. As such, market makers contribute to the growth, resilience and overall competitiveness of EU markets.

Moreover, investment firms, in particular the ones dealing on own account, are generally of medium or small size, do not have clients nor engage in deposit-taking, and therefore operate with a business model that is fundamentally different from the one of credit institutions and pose limited risks to the market. Nevertheless, above certain currently defined thresholds, investment firms become subject to the CRR/D banking framework. This distinction shall be accurately accounted and reflected in the overall classification methodology and associated balance sheet thresholds to ensure that it does not have unintended adverse effects such as investment firms being faced with disproportionate and wrongly calibrated prudential requirements, limited in their ability to provide liquidity as envisaged by MiFID II/R or incentivized to consider alternative business opportunities outside of the EU market.

Therefore, DBG encourages conducting a holistic review, that considers the positive contributions and role of investment firms, the risk mitigating factors of investment firm groups, as well as the interdependencies with other regulation such as MiFID, EMIR and others. Furthermore, DBG advocates to account for the challenges and requirements that EU-based investment firms face in international markets, by recognizing aspects such as EU-competitiveness and extra territorial affects that the application of the IFR framework can generate for EU investment firms operating globally. With EU-based investment firms operating in multiple jurisdictions, the IFR requirements affect all entities, while their international competitors are required to adhere with the IFR only for their EU operations. While we recognize that inherent differences in markets will persist, we encourage the ESAs to recognize possible effects on the attractiveness of EU markets and investment firms on the global perspective. Especially considering the recent CMU initiatives and the role of the EU in international capital markets, the IFR framework needs to supplement and nurture growth of EU based investment firms while retaining stability, safeguarding competition and the level playing field between EU and non-EU based investment firms.

The following DBG legal entities are affected by the scope of the Regulation (EU) 2019/2033 (IFR) and the Directive (EU) 2019/2034 (IFD):

- **360 Treasury Systems AG** (360T) is licensed as a Multilateral Trading Facility (MTF) and Organised Trading Facility (OTF) providing trading solutions for FX market participants. 360T is classified as a Class 2 investment firm;
- **360X AG** (360X) is licensed as inter alia MTF and classified as a Class 3 investment firm;
- **Eurex Repo GmbH** (ExR) is licensed as a MTF and classified as a Class 3 investment firm;

This document reflects DBG's opinion on Question 2, 3, 15, 23 and 32 of the underlying discussion paper. In the absence of a specific question on Section 5.4, we refer to the possible exclusion of OTFs and MTFs from the definition of small and non-interconnected investment firms in an obiter dictum in the commentary to Question 2.

Question 2: Would you suggest any further element to be considered regarding the thresholds used for the categorisation of Class 3 investment firms?

1) Notwithstanding EBA's concerns that investment firms may shift assets or revenues to a group entity outside the EU to avoid the application of some IFR/IFD provisions, DBG holds the view that criteria (h) and (i) were added as requirements of the IFR as a conscious decision of the EU legislature and should therefore be kept. The deletion would overrule this opinion held by the EU at the time and henceforth raise more concerns about market stability. Instead of removing said criteria, it would be a viable solution to revise the rules and periodically increasing the thresholds for investment firms, investment holdings and investment holdings outside the EU.

EBA's argument has been considered by the EU legislature during the legislative process and ultimately considered in the recitals of the IFR (recital No. 18 of the IFR). As a result, the EU legislator decided that the thresholds for assets under management, client orders handled, balance sheet size and total gross annual revenues should be applied on a combined basis for all investment firms that are part of the same group. The other conditions, namely whether an investment firm holds client money, administers or safeguards client assets, or trades financial instruments and incurs market or counterparty risk, are binary and leave no scope for such restructuring, and should therefore be assessed on an individual basis.

The general removal of criteria h) and i) may also impact not only the appropriateness and effectiveness of the categorisation of investment firms, but also market stability. Investment firms that were originally classified in class 2 solely due to the fact that they exceed threshold h) and/or i) would have to be (re-)classified into class 3 if criteria h) and i) were removed. This means that investment firms that may pose a higher risk to clients, the market or themselves depending on the nature of their activities would have to be considered as class 3 investment firms instead of having to comply with more stringent class 2 conditions in terms of capital requirements, liquidity, and regulatory reporting.

Additionally, current threshold values consider a consolidated view at a group level but apply equally to investment firms and investment firm groups (see Article 12 (2) IFR). This leads to a higher burden of requirements for investment firm groups, without sufficiently taking into account the appropriateness and liquidity risks at group level compared to a single investment firm.

Considering the additive nature of the threshold calculation on a consolidated basis, we see value in maintaining and revising the criteria h) and i). Raising the current numerical thresholds would allow balance sheets and revenues to grow on an individual basis without directly triggering the re-classification as class 2 investment firm simply because of exceeding these thresholds on a group level (assuming that all other criteria and conditions for a classification as small and non-interconnected firm are met). Given that all criteria in Art. 12.1 IFR need to be met cumulatively for a firm to be classified as class 3 firm, such increase of these thresholds would be commensurate with the IFR/D's principle of considering numerical thresholds to determine the risk of a firm's business

activities. These thresholds should be re-assessed periodically to maintain a sound balance between risk mitigation and dynamic market developments.

In this context, DBG would also like to point out the EBA's considerations to revise the term financial holding company ("fine-tuning the definitions in the IFR"). In principle, DBG shares the EBA's view on the grounds that the current IFR prudential consolidation rules are sufficient regarding the consolidated activities (para. 189 of the DP). DBG would like to combine this view with the aforementioned aspects regarding criteria of Article 12 h) and i) on group level.

2) EBA's second argument, namely, if only criteria h) and i) made an investment firm not to be a small and non-interconnected one, the K-factor system in the IFR still would not be applicable, may also need to be reconsidered.

Reference is made to the DBG argument that by deleting the criteria h) and i), even more investment firms might not be able to achieve the applicability of the K-factor system. In addition, although the K-factor requirements for small and non-interconnected investment firms are not considered when determining the capital requirements, they are still of significant importance. The IFR threshold values, which serve as the basis for attributing an investment firm to the future category of medium or small investment firm, are based on these K-factors and must be determined in accordance with the respective IFR requirements.

DBG considers that certain circumstances would not be adequately considered if OTFs and MTFs were excluded from the definition of small and inter-connected investment firms. Instead, it would impose stricter capital requirements, liquidity and regulatory reporting requirements for smaller OTFs and MTFs, without taking into account their size and market activity and business. Any new regulatory requirement should be evidence-based and proportionate to the nature, scale and complexity of the regulated entities. Introducing new K-factors for MTFs without detailing the factual necessity contradicts ESMA's general aim to streamline and simplify its regulatory products and make them proportionate to the nature, scale and complexity of the regulated entities.

An MTF's business model does not face market or firm risks within the meaning of chapter 3 and 4 IFR (RtM or RtF). Investment firms operating an MTF also do not incur default risk or liquidity risk as they only facilitate the purchase and sale of financial instruments between trading participants but do not become a counterparty of the resulting trades. Similarly, investment firms operating an OTF do not incur liquidity risk in a manner which would justify the categorical exclusion.

DBG is concerned that the EBA proposal may ultimately lead to a blanket classification as a class 2 investment firm without considering the circumstances, risks, and the intent of the legislature of providing a risk-sensitive supervisory framework tailored to the size, activities, and complexity of investment firms, thereby making the regime inappropriate and costly.

3) DBG proposes that the criteria h) and i) should be assessed and designed with a distinction for individual investment firms and investment firms that are part of a larger group. We recommend the distinction as individual investment firms face higher liquidity risks and larger group structures provide risk mitigation through the liquidity and capital of other group entities and organisational arrangements. While individual group structure might differ, they can generally serve as protective measures against external effects or market events, against which individual investment firms have to protect themselves by adhering to the lower thresholds of criteria h) and i). Furthermore, such an amendment would have the additional advantage that it can reduce the EBA's concerns mentioned

above by involving groups of investment firms outside the EU and requiring them to comply with similar requirements on a consolidated basis.

Question 3: Do you have any views on the possible ways forward discussed above regarding the transition of investment firms between Class 2 and Class 3 should be introduced?

DBG supports EBA's proposal for a transition period ("freezing period") of more than 12 months, with the result that investment firms must be classified as Class 2 investment firms for a period of at least one year after their reclassification, regardless of whether the conditions of Article 12 IFR for conversion into a Class 3 investment firm would be met within this period.

DBG would like to emphasize that this transition period should apply in both directions, i.e., from a Class 2 investment firm to Class 3 and from a Class 3 investment firm to Class 2. Only that considers the purpose of effective categorisation of investment firms.

Finally, DBG would like to suggest that the beginning of such a transition period should be specified. The date of the investment firm's initial (re-)classification seems preferable in comparison to a specific calendar date (such as the end of the (fiscal) year) as the latter may bring with it the disadvantage of potential reclassification within a short period of time. For example, if an investment firm was classified at the end of the third quarter, but by continuing to operate as an investment firm at the end of the (fiscal) year, it exceeds one or more thresholds of Article 12(1) IFR.

Question 15: In the context of addressing operational risk for investment firm trading on own account, is there any further element to be considered to ensure that the requirements are proportionate to their trading activities?

The current risk assessment methodology imposes limitations and does not adequately reflect the true market risk exposure of firms dealing on their own account. This is particularly true with K-CMG. Although given as an option in the legislation, K-CMG is not widely used in practice due to the limitations imposed by the high watermark methodology. This leads to an overstatement of actual losses while most of these firms' trading positions are effectively hedged, and transactions are centrally cleared, significantly mitigating market risks. As a result, K-CMG can lead to disproportionately high capital requirements, making it less practical for firms. To ensure proportionality, it would be preferable to introduce the true optionality by revising the current methodology as well as preserve firms' ability to determine the market risk capital metric (i.e. K-CMG or K-NPR or FRTB) that is most suitable to the nature and scale of their activities.

Question 23: What other elements should be considered in removing the possibility of the exemption in Article 43 of the IFR?

DBG would like to point out why the exemption in Article 43 IFR should be maintained and be eligible for MTF/OTF operators in the future.

1) Liquidity requirements set out in the IFD/IFR take into account the proportionality principle, ensuring that certain investment firms, which because of their size or the nature of their activities are not exposed to liquidity risk, can be exempted from the liquidity requirements. Nevertheless, such an exemption is subject to the permission of an investment firm's competent authority. This approach, including the review of an investment firm's application by the competent authority, further reduces the risk and provides further certainty that investment firms with a higher risk framework, based on their business model, are eligible for the exemption in Article 43 IFR.

2) DBG does not concur with the view that investment firms operating an MTF/OTF are not considered eligible for exemption in Article 43 IFR at that time.

Although an MTF/OTF may have a special role compared to other investment firms (see EBA argument No 12, EBA/GL/2022/10, 29 July 2022), investment firms operating an MTF generally do not incur liquidity risk as they merely facilitate the purchase and sale of financial instruments between multiple trading participants. Similarly, investment firms operating an OTF generally do not incur liquidity risk in a manner which would justify the categorical exclusion.

DBG also noticed that investment firms dealing on own account as referred to in Annex I, Section A, point (3) MiFID II and/or carrying out the underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis as referred to in Annex I, Section A, point (6) MiFID II may pose a higher liquidity risk than other investment services. Nevertheless, investment firms which offer these services have not been excluded from the scope.

Therefore, DBG proposes that investment firms operating an MTF/OTF should be eligible for the exemption under Article 43 IFR based on the application process by the responsible NCA and the role that OTF/MTF currently serve as facilitators of financial instruments.

[Question 32: Should there be the need to introduce prudential requirement for firms active in commodity markets and that are not currently subject to prudential requirements? How could the existing framework for investment firms be adapted for those cases? If a different prudential framework needs to be developed, what are the main elements that should be considered?](#)

In line with the responses from the Futures Industry Association (FIA) and Energy Traders Europe (ETE) we do not believe that prudential requirements designed for financial markets should be extended to commodity firms. Any proposal to introduce prudential requirements for firms in commodity markets should be based on clear evidence of the specific systemic risk or significant market failures that such requirements would aim to solve or mitigate, the rationale for which does not appear to be supported by analysis done and events that have occurred to date. As a regulated market, we are particularly concerned about the potential impact on the liquidity and proper functioning of energy derivative markets.

Furthermore, the EU Commission has the mandate to review the commodity derivatives regulation under Art. 90 (5) of the Markets in Financial Instruments Directive II ("MiFID II"). The review will assess inter alia the impact of prudential requirements as set out in IFR, and clearing, margining and collateralisation obligations as set out in Regulation (EU) No 648/2012 ("EMIR") on specialised commodity and emission allowance firms if they were to be regulated as investment firms under IFR.