ABMB
Association Belge des Membres de la Bourse
Belgische Vereniging van Beursleden
BVBL

afei
Association Française des Entreprises d'Investissement

Association of Members of the Athens Stock Exchange

APC

APCIMS
EASD
Working for the Investment Community

ASSOSIM
Associazione Italiana Intermediari Mobiliari

bwf

Norges Fondsmeglerforbund
The Association of Norwegian Stockbroking Companies

VUV

REB

SWEDISH
SECURITIES DEALERS
ASSOCIATION

Memorandum to the Honourable members of the EMAC Commission of the European Parliament

The memorandum below is sent by the following European associations of investment firms.

Association Belge des Membres de la Bourse : **ABMB-BVBL** : Belgium
Association Françaises des Entreprises d'Investissement : **AFEI** : France
Association of Members of the Athens Stock Exchange: Greece
Associação Portuguesa de Sociedades Corretoras e Financeiras de Corretagem : APC : Portugal
The Association of Private Client Investment Managers and Stockbrokers : APCIMS : UK
Associazione Italiana Intermediari Mobiliari : Assosim : Italy
Bundesverband der Wertpapierfirmen an den deutschen Börsen e.V. BWF : Germany
The Association of Norwegian Stockbroking Companies : NFMF : Norway
Raad van de Effectenbranche : REB : Nederlands
Verband unabhängiger Vermögensverwalter Deutschland : VUV : Gemarny
Swedish Securities Dealers Association: SSDA : Sweden

Application of CAD 3 to investment firms

1. The application of the new Capital Adequacy Directive (CAD 3) to investment firms is considered as an important subject for the associations of investment firms within Europe. For more than two years, trade associations of ten European countries have been joining their forces in order to share their views on this issue.

2. The trade associations have met the European Commission and it can be considered that some improvement have been achieved if compared with the first proposal of the Commission. The main progress concern:

- The possibility to have a prudential supervision on a consolidated basis.
- A special treatment for firms with limited licenses (50 K and 125 K) regarding operational risks which will remain subject to the current regulation (Expenditure Based Requirement: EBR).
- The split of firms with a full licence (730 K) into two categories in order to minimise the consequences of the new regulation for investment firms that are not trading on own account and that are not working on the primary market.
- The definition of the trading book.

3. Nevertheless, the trade associations would like to point out some key point about the new regulation.

4. This Directive seeks to apply to investment firms the model of operational risk, credit risk and market risk developed by Basel for banks. A bank that has exposure in these three areas will be have capital reductions in some areas and in others capital increases, with the intention of achieving overall neutrality.

However, an investment firm does not have exposure to credit risk, exposure to market risk is incidental and often the only risk that such a firm runs is operational risk.

The Directive in its current form can therefore only be cost additive for investment firms, requiring them to hold additional capital without any additional exposure to risk. By some estimates[1] CAD3 will raise the capital adequacy requirements for investment firms by as much as 37%. It was the stated intention of Basel II to maintain capital requirements at approximately current levels: as it is proposed to implement Basel II through CAD3, this will not be the result.

5. The new regulation doest not concerns investment firms in the US or in other countries outside Europe which in the long run could be at the disadvantage of the European industry.

6. Our associations believe that application of Basel II to investment firms is a mistake in principle that will result in a significant weakening of the international competitiveness of European investment firms. It may be argued that, insofar as such firms engage in securities underwriting or OTC derivative structuring, they engage in money creation and thus should fall within the scope of bank capital regulation. We would not dispute this, and would welcome a reduction in the scope of CAD3 to these firms only.

However, if the Commission or Parliament are committed to the belief that all investment firms should, uniquely in Europe, be subject to the provisions of Basel II, then as a less preferred alternative, our associations can accept the exemptions as outlined in Article 20 of CAD3, provided that there is significant clarification of the extent of their applicability and the precise nature of the capital adequacy obligations that are imposed on firms eligible for these exemptions.

[1] Price Waterhouse Coopers (PWC), Study on the financial and macroeconomic consequences of the draft proposed new capital requirements for banks and investment firms in the EU (MARKT/2003/02/F) vom 20.04.2004, p. 100 http://www.europa.eu.int/comm/internal_market/regcapital/index_de.htm#capitalrequire