

EBA/CP/2020/06

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4 June 2020

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## Consultation Paper

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Draft Regulatory Technical Standards related to implementation of a new prudential regime for investment firms on:

- The reclassification of investment firms as credit institutions under Article 8a (6) of Directive 2013/36/EU
- The prudential requirements for investment firms under Articles 7(5), 9(4), 13(4), point (a) to (c) of Article 15(5) and Article 23(3) of Regulation (EU) 2019/2033
- The prudential requirements for investment firms under Article 5(6) of Directive (EU) 2019/2034

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# 1. Responding to this consultation

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The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in Section 13.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

## Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 4 September 2020. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

## Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

## Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

## 2. Executive Summary

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The Directive (EU) 2019/2034 (IFD) and Regulation (EU) 2019/2033 (IFR) give a significant number of mandates to the EBA covering a broad range of areas related to the prudential treatment of investment firms.

The implementation of the mandates is divided in four phases according to the legal deadline set out in the IFD/IFR for the draft regulatory technical standards (RTS). A comprehensive work plan for delivering all mandates is established in a Roadmap on Investment Firms Prudential Package which was published by the EBA on 2 May 2020<sup>1</sup>.

These draft RTS have been developed in accordance with the principles laid down in the Investment Firms Roadmap:

- **Proportionality.** Ensuring proportionality with regard to the regulatory requirements aimed at investment firms of different size and complexity;
- **Non-disruptive transition.** Investment firms performing certain activities will be subject to the banking framework as of IFR implementation date, whereas others may transition to the banking framework over time; therefore, the technical standards should provide for these transitions to occur without significant disruptions;
- **Level playing field.** Considerations should be given to the level playing field between investment firms and credit institutions, in particular regarding the net position risk, the trading counterparty default and the concentration of trading book positions, whereas recognising the specific risk structure and risk drivers of investment firms and investment firm groups;
- **Harmonization.** Further strengthening of a harmonised regulatory environment, in order to foster a European level playing field across types and categories of investment firms.

The first two draft RTS included in this CP have been developed for the mandates related to the reclassification of certain investment firms to credit institutions:

- Article 8a(6)(a) of the CRD asks the EBA to draft RTS specifying the information to be provided to competent authorities (CAs) for the authorisation of an investment firm as credit institution in accordance with the new definition introduced in point (b) of Article 4.1.(a).1 of the CRR. Mindful of a smooth transition between the CRD/CRR and the framework introduced with the application of the IFR and IFD, the proposed draft RTS consist of a subset of the information for authorisation of a credit institution as proposed to be required in the EBA RTS/2017/08.
- Article 8a(6)(b) of the CRD asks the EBA to draft RTS on the calculation of the EUR 30 bn thresholds for an investment firm to be required to apply for a credit institution authorisation. These RTS cover a number of areas relevant for the implementation of this threshold, including the clarification of the notion of consolidated assets, the definition of assets, the procedure to calculate the total assets on a monthly basis, the treatment of assets of branches of third country groups, the inclusion of undertakings that are established outside the EU being part of EU groups.
- Article 55(5) of the IFR asks the EBA to draft RTS on the monitoring of information related to the thresholds for credit institutions. This draft RTS is not included in this Consultation Paper

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<sup>1</sup>[EBA Roadmap on investment firms](#)

as it is addressed together with ITS on reporting requirements under Article 54 of the IFR and will be part of the consultation paper on the reporting and disclosure requirements.

The second group of the mandates related to capital requirements for investment firms at solo level. The mandates are implemented by developing the following draft RTS:

- Article 13(4) of the IFR asks the EBA to draft RTS specifying the deductions to be applied for the calculation of the fixed costs, that are the basis for the calculation of the fixed overheads requirement. The notion of ‘material change’ is also specified, in accordance to which CA may allow the fixed overheads requirement to be adjusted.
- Point (a) of Article 15(5) of the IFR asks the EBA to draft RTS specifying the methods for measuring the K-factors to the extent these are not already fully detailed in the IFR. The draft RTS provides clarification on the measurement of most of the Risk-to-Client (RtC) K-factors, whereas the Risk-to-Market (RtM) K-factors are either defined as references to the CRR or detailed in the IFR and therefore require no further specification.
- Point (b) of Article 15(5) of the IFR asks the EBA to draft RTS providing clarification on the notion of segregated accounts by setting the criteria for their identification for the purpose of calculating the capital requirement related to holding client money (K-CMH).
- Point (c) of Article 15(5) of the IFR asks the EBA to draft RTS specifying the adjustments for the K-DTF coefficients in correspondence of stressed market conditions when markets experience a period of extreme volatility. The draft RTS provides a formula for the calculation of the adjusted coefficients under exceptional circumstance as referred in point (a) of Article 3 of the Regulation (EU) 2017/578.
- Article 23(3) of the IFR asks the EBA to draft RTS specifying the calculation of the amount of the total margin for the calculation of the clearing margin given (K-CMG) and the criteria to avoid regulatory arbitrage in case that approach is used.
- Article 5(6) of the IFD asks the EBA to further specify the criteria set out in points (a) and (b) of paragraph 1 of Article 5 of the IFD and ensure the consistent application thereof.

The last mandate relates to the scope and methods of prudential consolidation for investment firm groups:

- Article 7(5) of the IFR asks the EBA to draft RTS elaborating on the scope and methods of prudential consolidation for investment firm groups. Furthermore, the draft RTS provides rules for the calculation of the capital requirements in a consolidated situation.

The Consultation Paper explains the policy choices of regulatory requirements for draft RTS and outlines their legislative basis. The EBA is of the view that proposed regulatory requirements ensure a proportionate and technically consistent prudential framework for investment firms.

The purpose of this Consultation Paper is to seek the view and useful insights of external stakeholders to make a better informed decision on which, if any, regulatory actions are needed to ensure that the prudential framework for investment firms mitigates risks and is proportional and not burdensome for the firms to implement. Stakeholders’ input is sought through specific questions, which are summarized in Section 13.

The last section of this CP details initial cost-benefit and impact assessment analysis concerning the draft RTS in order to gather feedback on possible costs and benefits of the proposals and the relative scale of these costs and benefits for different stakeholders.

## Next steps

The draft regulatory technical standards will be submitted to the Commission for endorsement [following which they will be subject to scrutiny by the European Parliament and the Council] before being published in the Official Journal of the European Union. The technical standards will apply from June 2021.

The analysis of the responses of this Consultation Paper will be communicated in due time in the form of final report.

## 3. Background and rationale

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### 3.1 Background

1. Investment firms (IF) authorized under Directive 2014/65/EU (MiFID)<sup>2</sup> vary greatly in terms of size, business model, risk profile, complexity and interconnectedness, ranging from one-person companies to large internationally active groups. Currently, the prudential treatment of investment firms is set out in the Directive 2013/36/EU (CRD) and Regulation (EU) No 575/2013 (CRR). However, some investment firms are exempt from full CRD/CRR requirements depending on which services they provide, and their combination or size.
2. The IFD and the IFR, which were published in the Official Journal of the European Union on 5 December 2019 and entered into force on 26 December 2019, will replace the existing prudential framework for investment firms.
3. A significant number of mandates have been given to the EBA under the IFD and the IFR. The mandates cover a broad range of areas related to the prudential treatment of investment firms. These include 18 RTS, 3 implementing technical standards (ITS), 6 sets of guidelines, 2 reports, and the requirement for the EBA to maintain a list of capital instruments and a database of administrative sanctions, and a number of notifications in various areas. Overall, the mandates are divided into four phases, mostly in accordance with the legal deadlines.
4. The EBA has published a Roadmap on Investment Firms Prudential Package, which details the EBA's strategy for delivering on the mandates, as well as the main principles it considered while delivering those mandates. More precisely:
  - a) The EBA is committed to ensuring proportionality with regard to the regulatory requirements aimed at IFs of different size and complexity, regarding it as a key aspect of the new regime.
  - b) Given the interlinkages between the CRR/CRD, on the one hand, and the IFR/IFD package on the other hand, the EBA technical standards should allow for transitions between the two frameworks without significant disruptions.
  - c) Nonetheless, the EBA recognises the specific risk structure and drivers of IFs and will therefore be particularly mindful of ensuring that the main risks to clients, market and the investment firms itself are well covered.
5. This CP covers mandates developed under the first phase. These included nine draft RTS, which focus on the following areas: reclassification of investment firms to credit institutions, capital requirements for investment firms at solo level and requirements on a consolidated basis. Other

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<sup>2</sup> [EBA/Op/2015/20 Report on investment firms](#)

mandates that are part of the first phase but are not included in this CP are those concerning variable remuneration<sup>3</sup> and those related to reporting requirements,<sup>4</sup> disclosure requirements and monitoring of the threshold referred to in Article 8a(6) of the CRD.<sup>5</sup>

6. The next sub-sections provide detailed explanation of the background and rationale for each of the draft RTS.

### 3.2 Draft RTS on the information to be provided for the authorisation of credit institutions (Article 8a(6) point a) of the CRD)

7. The IFD and the IFR amend the definition of a credit institution by extending it to undertakings which perform activities of dealing on own account and underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis and are subject to certain quantitative thresholds.
8. Article 62 of the IFD introduces Article 8a of the CRD on the specific requirements for authorisation of the new credit institutions. The EBA is mandated by point (a) of Article 8a(6) of the CRD to develop the draft RTS to specify the information to be provided by the investment firms to the competent authorities in the application for authorisation.
9. Under Article 8(2) of the CRD, the EBA has received a mandate to develop a regulatory text on the issues related to the authorisation of credit institutions. To deliver this mandate, the draft RTS were developed on the information to be provided for the authorisation of credit institutions, the requirements applicable to shareholders and members with qualifying holdings and obstacles, which may prevent the effective exercise of supervisory powers ('EBA/RTS/2017/08'<sup>6</sup>). These draft RTS provides a number of information requirements on the credit institutions: identification details, historical information of the applicant credit institution, including its existing licensing, activities proposed, current financial situation, programme of operations, as well as initial capital.
10. The IFR amends Article 4(1) of the CRR by identifying credit institutions based on certain criteria: one as per point (1)(a) – credit institution which takes deposits or other repayable funds from the public and grants credits for its own account; and one as per point (1)(b) – institutions carrying out certain activities<sup>7</sup> and fulfilling certain conditions with regards to the value of their consolidated assets<sup>8</sup>. The present RTS only targets the latter. The EBA (draft) RTS 2017/08 is

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<sup>3</sup> Article 30(1) and Article 32 (8) of Directive 2019/2034 (IFD).

<sup>4</sup> Article 54 of Regulation 2019/2033 (IFR).

<sup>5</sup> Article 55(5) of Regulation 2019/2033 (IFR).

<sup>6</sup> <https://eba.europa.eu/eba-publishes-final-standards-specifying-information-requirements-for-the-authorisation-of-credit-institutions>

<sup>7</sup> Activities in point (3) and (6) of Section A of Annex I to Directive 2014/65/EU of the European Parliament and of the Council.

<sup>8</sup> Either one of the following applies:



used as the starting point when delivering on the mandate under point (a) of Article 8a(6) of CRD as amended by the IFD with a view to avoid duplication of efforts and potential sources of inconsistencies.

11. Therefore, this regulation is based on the information requirements specified in the EBA RTS 2017/08. The regulation aims to reflect the business model (for instance, the lack of deposit taking) of the credit institutions which provide certain investment services and activities (dealing on own account and underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis subject to certain quantitative thresholds) as defined in point (1)(b) of Article (4(1) of the CRR.
12. Furthermore, these draft RTS aims to provide the necessary flexibility to the competent authorities to require information in addition to requirements set out in the RTS EBA/ 2017/08. In duly justified cases, dependent on the national specificities of the investment firms licensing, the competent authorities might request additional information, for instance, when further assessing investment activities.
13. Finally, in well-defined cases, this regulation allows competent authorities to waive some information requirements taking into consideration the business model, the activities of the applicant credit institution concerned and any prior licenses the applicant credit institution might possess. This accounts for the spirit of Article 8a (5) of the CRD as amended by the IFD, according to which in the case of re-authorisation, the competent authority needs to ensure that the existing authorisations are taken into account.

### 3.3 Draft RTS on the methodology for calculating the EUR 30bn threshold required to be authorised as a credit institution (Article 8a(6) point b) of the CRD)

14. Article 62 of the IFD introduces Article 8a of the CRD on the specific requirements for authorisation of a new credit institutions. Investments firms that qualify as credit institutions pursuant to point (1)(b) of Article 4(1) of the CRR and have already obtained an authorisation pursuant to Title II of the MiFID are required to submit to the competent authority an application for authorisation as a credit institution when reaching the EUR 30bn threshold.
15. The new provision differentiates the methods for calculation of the threshold at individual and group level. At the individual level, undertakings are required to submit the application at the

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- (i) the total value of the consolidated assets of the undertaking is equal to or exceeds EUR 30 billion;
  - (ii) the total value of the assets of the undertaking is less than EUR 30 billion, and the undertaking is part of a group in which the total value of the consolidated assets of all undertakings in that group that individually have total assets of less than EUR 30 billion and that carry out any of the activities referred to in points (3) and (6) of Section A of Annex I to Directive 2014/65/EU is equal to or exceeds EUR 30 billion; or
  - (iii) the total value of the assets of the undertaking is less than EUR 30 billion, and the undertaking is part of a group in which the total value of the consolidated assets of all undertakings in the group that carry out any of the activities referred to in points (3) and (6) of Section A of Annex I to Directive 2014/65/EU is equal to or exceeds EUR 30 billion, where the consolidating supervisor, in consultation with the supervisory college, so decides in order to address potential risks of circumvention and potential risks for the financial stability of the Union;
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latest on the day when the average of monthly total assets – calculated over a period of 12 consecutive months – is equal to or exceeds EUR 30bn. At the group level, undertakings are still required to submit the application at the latest on the day when the average of monthly total assets – calculated over a period of 12 consecutive months – is less than EUR 30bn, and the undertaking is part of a group in which the total value of the consolidated assets of all undertakings in the group – that individually have total assets of less than EUR 30bn and carry out any of the relevant activities – is equal to or exceeds EUR 30bn, both calculated as an average over a period of 12 consecutive months.

16. The EBA is mandated under Article 8a(6)(b) of the CRD to develop draft RTS to specify the methodology for calculating the thresholds referred to in paragraph 1 of the same article. This regulation provides clarity on all the areas that deemed relevant in developing such a methodology, namely the definition of assets and the concept of consolidated assets, the calculation of assets' value, including the assets of third country branches and undertakings of European groups that are established outside the EU.
17. For the purposes of measuring the amount of assets, this regulation acknowledges the different accounting standards applicable to investment firms and credit institutions and therefore adopts a hierarchical approach in the definition of assets. Such an approach should also ensure consistency with Articles 50 and 51 of Regulation (EU) No 468/2014 (i.e. the SSM Framework Regulation) providing for a methodology based on quantitative thresholds to assess the significance of credit institutions. It should however be noted that different accounting standards can determine different results in the methodology.
18. In providing further guidance on the calculation of the total value of 'consolidated assets', this regulation relies on a narrow approach, which implies that consolidated assets would be calculated by summing the assets of all undertakings in the group carrying out the MiFID services (3) and/or (6) at individual level and by subtracting intragroup exposures which occur exclusively between those undertakings, subsidiaries in third countries and third country branches carrying out MiFID services (3) and/or (6); this approach chiefly aims to avoid double counting of assets.
19. An alternative option was also considered, relying on a broader approach. Under this approach, consolidated assets would be calculated by summing the assets of all undertakings in the group carrying out MiFID services (3) and/or (6) at individual level and by subtracting intragroup assets and other consolidation adjustments which occur between all the entities in the group. This approach aims to work out the contribution of each individual relevant entity to the group figures.
20. The approach of consolidated assets for the purpose of this regulation involves the technical choices related to the definition of consolidated assets, including the definition of intragroup assets and other consolidation adjustments. It aims to identify a definition that would facilitate the reporting activity for the undertakings. Additionally, the definition of consolidated assets might be prone to different outcomes when the different accounting bases (IFRS, GAAP) are applied.

21. While the narrow definition of intragroup exposures described in Article 2(1)(9) of the draft RTS is recommended as the way forward for the draft RTS, the cost-benefit analysis in Annex to this document does also analyse an alternative option. This alternative definition of intragroup exposures may have implications for how branch assets are being taken into account in the designation of the largest investment firms. For example, under the narrow definition proposed in the RTS, branches should submit total asset figures on a solo basis, with currency and accounting adjustments having been made where necessary to arrive at the total asset figure. Under the alternative option, branch assets added in line with accounting standards for consolidation.
22. This Regulation does not consider off-balance sheet items as part of the calculation of the total value of the assets. First, the IFR and the IFD do not require including those items in the total value of the assets. Second, the inclusion of off-balance sheet items is not deemed to be in line with the accounting standards upon which the total value of the assets is calculated.
23. Article 8a of the CRD requires undertakings to submit an application for an authorisation as a credit institution at the latest when the average of their monthly total assets is equal to or exceeds EUR 30bn over a period of 12 consecutive months. This Regulation adopts a less burdensome approach and clarifies that the calculations of the total value of the assets should be performed on a quarterly basis, requiring undertakings to work out the asset values four times per year. This interpretation is considered to be the most appropriate as Article 8a of CRD does not specifically require the calculation to be performed on a monthly basis and does not indicate the time of the year when starting the calculation. Moreover, it refers to the average over a period of 12 consecutive months: this might be interpreted as the average of four quarters (or two semi-annual values). In all the above cases, a lag will inevitably exist between the reference month and the availability of the sought value.
24. Another element to be considered is assessing whether firms should calculate 12 monthly data points for performing the threshold calculation, or whether they can rely on quarterly information only (for a total of 4 data points a year). On the one hand, a monthly calculation may be very burdensome for complex groups, and it would not produce results substantially different from a quarterly calculation, as in both cases an average over a 12 months window has to be considered. On the other hand, the level one text refers to “monthly total assets”, which would justify the stricter requirement of 12 monthly data points, although, as explained above, this is not explicitly stated.

### 3.4 Draft RTS on the monitoring of information related to the EUR 30bn threshold required to be authorised as a credit institution (Article 55(5) of the IFR)

25. Article 55(5) of the IFR requires the EBA to develop, in consultation with ESMA, the draft RTS ‘to specify further the obligation to provide information to the relevant competent authorities referred to in paragraphs 1 and 2 in order to allow effective monitoring of the thresholds set out in points (a) and (b) of Article 8a(1) of Directive 2013/36/EU’. Therefore, these draft RTS should

provide national competent authorities (NCAs) with the list of elements and the tools for carrying out the ongoing monitoring of the EUR 30 bn threshold for investment firms.

26. Since the mandate requires the EBA *'to specify further the obligation to provide information'*, it is understood that a list of elements necessary to ensure the monitoring of the EUR 30bn threshold should be provided. This list should be in line with the methodology for the computation of the above-mentioned threshold, specified in the draft RTS under Article 8a(6)(b) of the CRD. Furthermore, it is understood that an *'effective monitoring'* of the EUR 30bn threshold is best achieved by CAs through having access to the necessary elements to compute the above-mentioned threshold themselves. Subsequently, a reporting template is needed for the investment firms to fill in, in the same conditions as for the rest of the reporting framework.
27. Therefore, in line with the draft RTS under Article 8a(6)(b) of the CRD, at a minimum monthly values of the total assets both for a solo firm, as well as for a group should be reported to the CAs on a quarterly basis (i.e. every quarter, three values should be reported, one for every month). Additionally, two other pieces of information should be included to enable the reporting of the average amount over the past 12 months of individual assets of any subsidiaries established outside the Union that carry out any of the activities referred to in points (3) and (6) of Section A of Annex I to the MiFID, as well as the reporting of the average amount over the past 12 months of individual assets of relevant EU branches of the third-country parent (if it exists).
28. More specifically, separate templates were constructed for the individual reporting of one entity and for the reporting of the EU parent entity. The former template asks for the information at the level of a single entity, both with regard to the entity's consolidated assets (in case the entity is not member of a group, then this value will be equal to the total individual assets of the entity), as well as with regards to the necessary information for computing the group test (i.e. verify whether the entity is part of a group that is above the threshold). The latter template asks for the information at the EU parent level, first asking for the information necessary for the group test, then asking for the information on the group structure.
29. Furthermore, while the wording of the mandate in paragraph (5) of the same article does not provide for the specification of the target population for the purposes of Article 55 (5), an ensemble reading of the whole Article 55 of the IFR does suggest that the EUR 5 billion threshold could be used as a proportionality threshold, therefore excepting from the reporting those entities with total consolidated assets below EUR 5 billion.
30. Finally, as clarifications specific to reporting are needed in order to ensure the reporting of the template in harmonised conditions, the present RTS (i.e. RTS under Article 55(5) of the IFR) has been included in the Consultation Paper on the ITS on reporting under Article 54 of the IFR.

### 3.5 Draft RTS to specify the calculation of the fixed overheads requirement and to define the notion of a material change (Article 13(4) of the IFR)

31. The EBA is mandated under Article 13(4) of the IFR to develop, in consultation with ESMA, the draft RTS to supplement the calculation of the fixed overheads requirement presented in paragraph 1 of the same article. Specifically, investment firms are required to hold eligible capital of at least one-quarter of the fixed overheads of the previous year, or projected fixed overheads in the case of an investment firm not having completed business for one year. The draft RTS outline the calculation of fixed overheads and other aspects relevant for this purpose.
32. The EBA has already developed under Article 97 (4) of the CRR an RTS for investment firms with limited authorisation. However, the IFD and the IFR takes investment firms out of the scope of application of the CRR and provides a tailored prudential regime for investment firms. Moreover, the fixed overhead requirement (FOR) is a major component of the capital requirements calculation under the IFR and the IFD.
33. The IFR introduces a new system for investment firms to calculate own funds. Investment firms always will have to comply with the higher of FOR, permanent minimum capital requirement (PMR) or the K-factor methodology of the IFR, which was specially designed for larger investment firms to calculate own fund requirements. While the FOR under CRR was developed for investment firms with limited authorisation, the FOR in the IFR act as minimum to the capital requirements for all classes of investment firms. This means that every investment firm has to calculate the FOR to find out whether it is relevant to determine own funds requirements or not. This explains why the FOR is important for investment firms.
34. The aim of the draft RTS is to specify the calculations of capital requirements and to provide a clear definition of fixed overheads. In particular, the approach for calculating the fixed overheads proposed in the present RTS is a so-called subtractive approach, whereby variable cost items are deducted from the total expenses as calculated according to the applicable accounting framework. The regulation can also be used in cases where a firm does not use IFRS and is, therefore, appropriate for smaller or limited-authorisation investment firms.
35. The subtractive approach results from Article 13(4) of the IFR that specifies some items that, at a minimum, have to be deducted from the amount required for determining the fixed overheads. On the one hand, the elements for deduction listed in Article 13(4) of the IFR are a non-exhaustive enumeration. On the other hand, they illustrate what characteristics deductions should carry and are in accordance with the purpose of the IFR. For instance, the legal text discusses fixed expenses by third parties which may be illustrating cases where, for example, tied agents or an outsourced IT provider for the firm are incurring expenses connected to carrying out business on behalf of the IF, but these expenses are not reimbursed by the IF.
36. In line with Article 13(2) of the IFR, competent authorities can make adjustments in own funds requirements where there has been a material change in the business activities of the firm. However, in the IFR there is no clear definition of what a material change is. In order to ensure that competent authorities apply the same conditions across the EU, it is necessary to establish criteria on what constitutes a material change. Minimum thresholds should be established so that those firms are exempted from the adjustments in own funds requirements if their own funds requirements fall below the threshold.

37. As required in Article 13(4) of the IFR, the EBA has consulted ESMA on the draft RTS in order to ensure that a consistent framework for investment firms shall be implemented.

### 3.6 Draft RTS to specify the methods for measuring the K-factors (Article 15(5)(a) of the IFR)

38. As set out in point (a) of Article 15(5) of the IFR, the EBA has mandate to develop the draft RTS on 'the methods for measuring the K-factors'. Other mandates in Article 15(5) of the IFR consist of the mandate on the notion of segregated accounts, as referred in point (b), and the mandate on the adjustments for the DTF (Daily Trading Flow) coefficients, as referred in point (c) of the same paragraph. A separate but related mandate is given in Article 23(2) as regards the margin and the method of calculation of K-CMG (Clearing Margin Given).
39. For some of the K-factors, the requirements in the IFR are, in general, clear and often do not require further specifications. This is the case for the K-NPR (Net Position Risk), which introduced by references to the market risk requirements set out in the CRR. The draft RTS also do not include further clarification on the K-CON (for concentration risk), as this is located in Part Four of the IFR. Part Four already contains detailed requirements on how to measure and calculate the K-CON, which in any event uses other K-factors as inputs that are covered under Part Three: i.e. K-NPR and K-TCD.
40. For each of the K-factors, the following sub-sections summarise the rationale for the inclusion of further specifications in the draft RTS concerning the K-factors' calculation methods.

#### 3.6.1 Tied agents

41. According to point (29) of Article 4(1) of the MiFID, the IF on whose behalf the tied agent is acting, must take full and unconditional responsibility for the investment business undertaken via that tied agent. Therefore, it should be made clear that for each K-factor that is relevant to the investment business conducted by a tied agent (e.g. K-AUM), the relevant amount of metric (e.g. AUM) should be included within the total amount of metric (e.g. AUM) of the IF, for the purposes of the calculation of the relevant K-factor (e.g. K-AUM) by that IF. This approach seeks to capture all the K-factors that could be relevant to the investment business that tied agents allowed to carry out under MiFID.

#### 3.6.2 K-AUM – Assets Under Management

42. The term 'asset under management' is defined in point (28) of Article 4(1) of the IFR. However, it is helpful to provide in the draft RTS a brief clarification on how to measure the value of assets for the purposes of Article 17 of the IFR. For example, point (c) of Article 60(2) of the MiFID Delegated Regulation (EU) 2017/565,<sup>9</sup> which deals with reporting to clients obligations in respect of portfolio management, states that 'each financial instrument held, its market value, or fair value if market value is unavailable'.

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<sup>9</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32017R0565>

43. The draft RTS refers then to fair value accounting for all positions (including derivatives and cash) encompassing the market value or estimated values in accordance with the hierarchy of the IFRS 13 or other applicable accounting standards.
44. Nonetheless, in order to capture properly the value of the AUM, no offset should be taken into consideration, including for the instruments that might have negative value. Therefore, the draft RTS require to calculate all positions at fair value and to take the absolute value where the fair value is negative.
45. The draft RTS also considers the articulation between various K-factors, including between K-AUM and K-CMH and K-ASA. The draft RTS includes the possibility to exclude client money held from the calculation of the K-AUM and K-ASA since client money held are already included in the calculation of K-CMH and their inclusion in K-AUM or K-ASA factors may lead to double counting and increased capital requirements for the same level of risk.

### **3.6.3 Non-discretionary advisory arrangements (of an on-going nature)**

46. Point (22) of Article 4(1) of the IFR defines investment advice of an on-going nature as ‘recurring provision of investment advice as well as continuous or periodic assessment and monitoring or review of a client portfolio of financial instruments including of the investments undertaken by a client on the basis of a contractual arrangement.’ The definition of AUM includes assets managed under certain nondiscretionary arrangements.
47. Since, for example, it is likely that there will be different forms of remuneration in different jurisdictions, then any reference to whether an on-going advice should be considered when it involves fees might not be helpful or providing any harmonisation.
48. It might be more helpful to clarify in the draft RST what ‘shall not’ be included in respect of assets under on-going advice. For example, this is the case where an investment firm performs the ancillary service referred in point (3) of Section B of Annex I of the MiFID, as any related advisory activities provided for entrepreneurial purposes and in connection with an industrial strategy, rather than a pure financial return, would be corporate finance advice rather than an investment advice as it is set out in point (5) of Section A of Annex I of MiFID.<sup>10</sup>

### **3.6.4 Delegation of management of assets to another financial entity**

49. Paragraph 2 of Article 17 of the IFR covers what to do regarding AUM, where:
  - a) the investment firm has formally delegated the management of assets to another financial entity; and
  - b) another financial entity formally has delegated the management of assets to the investment firm.

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<sup>10</sup> This reflects the Q&A issued by the Committee of European Securities Regulators (CESR) in 2010 (‘CESR/10-293’, dated 19 April 2010).

50. Further, the intention behind delegation provisions was to avoid ‘double counting’ (but not to promote ‘avoidance’), where two authorized firms (IFs and AIFMD/UCITS management companies) were involved and otherwise both would include the same portfolio assets within their respective AUM-based calculations; rather the relevant obligation to include those AUM will lie with the entity that has the direct relationship with the client receiving the portfolio management service. However, the text in Article 17(2) of the IFR does not actually state explicitly about one of the entities having included the relevant amount of AUM within an AUM-based capital requirement.
51. Furthermore, whilst the text covers discretionary portfolio management, it does not seem to cover cases where an IF portfolio management uses another IF (or AIFMD/UCITS firm) in respect of providing it with investment advice for carrying out that portfolio management. AUM also includes certain non-discretionary advisory arrangements. In such a situation, it is two different services being provided (advice and discretionary management), not simply delegation of (part of) the one service. Therefore, an IF that is providing such advisory arrangements (to another IF undertaking portfolio management) on an on-going basis should include the relevant amount of AUM within its own calculation, even if it does not have the direct relationship with the client for whom the portfolio management is being provided.

### 3.6.5 K-CMH – Client Money Held

52. The draft RTS only considers the specific mandate under point (a) of Article 15(5) of the IFR, which is the measurement of K-CMH. The specific mandate under point (b) of the same article regarding the segregation of client money is discussed separately.
53. The definition of ‘client money held’ is provided in point (29) Article 4(1) of the IFR. Recital 24 of the IFR clarifies that K-CMH excludes client money that is deposited on a (custodian) bank account in the name of the client itself, where the investment firm has access to the client money via a third-party mandate. There is no further or alternative definition of ‘client money or ‘client funds’ neither in the MiFID, nor in the MiFID Delegated Directive (EU) 2017/593.<sup>11</sup> Therefore, in terms of the basis of measurement, it suggests that the investment firm measures CMH based on balances that it would use for its internal reconciliations. This means using the values contained in the investment firm’s internal records, for example its cash book, rather than values contained in statements received from its banks and other third parties.

### 3.6.6 K-ASA – Assets Safeguarded and Administered

54. As with the definition of CMH above, the definition or scope of the K-factor ‘assets safeguarded and administered’ (ASA) in point (30) of Article 4(1) of the IFR could benefit from additional clarity for the purposes of its measurement. The recommendation is therefore to follow an approach for the valuation for ASA similar to the one for the measurement of the AUM. By referring to the fair value of the instruments, implicitly addresses the various cases where market valuation of instruments is available because they are traded in active markets, as well

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<sup>11</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32017L0593>



as the alternative valuation methods in accordance with the IFRS 13, or applicable accounting standards, in case the market value is not immediately available in the market. In the latter cases, the hierarchy for the fair valuation should be used, depending on the market information available.

### 3.6.7 K-COH – Client Orders Handled

55. According to Article 20(2) of the IFR, the K-COH 'shall exclude transactions executed by the investment firm in its own name either for itself or on behalf of a client'. Instead, where the IF is executing (or dealing) in its own name, the K-DTF will apply. As a result, certain features for the measurement of COH will also need to rely upon the same features that are used by DTF, both to provide clarity and to help avoid arbitrage between the two.
56. Point (d) of Article 16 of the IFR states that 'K-COH is equal to COH measured in accordance with Article 20, multiplied by the corresponding coefficient in Article 15(2)'. Whilst in general the IFR only tends to refer to 'K-COH' as if it is a single K-factor, it is implicit from point (d) of Article 16 of the IFR that in practice it is the sum of two separate components – (i) the value of cash trades multiplied by the coefficient for cash trades, and (ii) the value of derivative trades multiplied by the coefficient for derivative trades. A similar point also applies to K-DTF under Article 24 of the IFR.
57. When it comes to K-COH there will actually be four separate components in practice – one for execution in name of client and one for reception and transmission of orders, both of which may have cash trades and derivative trades or orders. The rest of this section therefore looks at where clarification may be added to COH, which will include IFs not trading on own account.

### 3.6.8 Execution of client orders

58. Given there may be practical differences in the national approaches to the understanding and implementation of 'execution of client orders' under the MiFID, it helps providing clarity as regards the point at which a client order should be included within COH for measurement purposes. For the execution of client orders (in the name of the client) at least, Article 20(2) of the IFR establishes a method for measuring COH, which requires, for cash trades at least, calculation by reference to the value paid or received on each trade. It is therefore suggested that the IFR envisages reference to the price of executed orders, with an ordinary reading of the terms 'paid' or 'received' supporting the view that a trade must actually have taken place. Providing such clarity helps removing any uncertainty in situations where there may not be a definite observed price until after the fact, for example, in a limit order or for an OTC derivative contract.
59. It is therefore proposed that the RTS clarify that for the purpose of calculating K-COH where an investment firm is executing a client order (in the name of the client), such an order shall be included at the point at which the investment firm has confirmation that the execution has taken place and the price is known.

60. There may be practical circumstances where an IF assumes some best execution responsibility for a client's order, but in order to achieve this determines that another broker must be used. This could lead to a timing difference, as could also be the situation depending upon the size of the order and market liquidity. In such cases, the above suggested clarification should ensure that the order is included in the calculation at the time it is executed in the market (rather than when it is placed with the relevant broker). The definition in point (31) of Article 4(1) of the IFR '*through the execution of orders*' does seem to imply the actual execution phase, but this may be interpreted as executed by the IF with the broker (as opposed to actually executed in the market), so with the proposed draft RTS potential confusion is avoided.

### 3.6.9 Reception and transmission of client orders

61. According to the definition in point (31) of Article 4(1) of the IFR, COH covers not only the 'execution of orders on behalf of clients' but also the 'reception and transmission of client orders'. Some clarity might therefore be useful in respect of measuring reception and transmission for the purposes of COH.
62. This situation is different to where executing a client order (in the client's name) in the sense that a different investment service is being provided, and as such that it should not need to be linked to when execution takes place. For example, the fact that an IF makes a mistake when processing the order could lead to the order not being executed. It is therefore proposed that the draft RTS clarifies that for the purposes of calculating K-COH where an investment firm is receiving and transmitting a client order, such an order shall be included at the point at which the investment firm transmits the order (to another investment firm or executing broker).
63. Given that the MiFID service is 'reception and transmission', it makes more sense to measure the order 'at the point of transmission' and not the alternative of 'at the point of reception' by the investment firm, i.e. before it transmits it onwards for subsequent execution. This ensures consistency and so helps avoid confusion or even possible double counting. It should then be noted that the last sub-paragraph of Article 20(2) of the IFR provides that 'investment firms may exclude from the calculation of COH any orders which have not been executed, where such non-execution is due to timely cancellation of the order by the client'. The investment firm receiving and transmitting the client order presumably has the contact with the client and so should know when the client has cancelled the order, hence allowing for proportionate application of such exclusion.
64. Provisions then need to be provided in respect of any circumstances where the price may not be known at the time of transmission of the order, for example, for limit orders. It is suggested that this is best solved by requiring the use of the price contained in the order, or of the order does not contain a price (e.g. only 'at best' execution) then the current market price on the day when the order is transmitted shall be used. The draft RTS includes that for the purposes of measuring COH where an investment firm has received and transmitted a client order, the investment firm shall measure that order using the price in the order, or if there is no such price use the current market price for the order on the day of transmission.

65. Recital 24 of the IFR states that: ‘K-COH captures the potential risk to clients of a firm which executes its orders (in the name of the client, and not in the name of the firm itself), for example as part of execution-only services to clients or when a firm is part of a chain for client orders’. Therefore, the draft RTS does not need to clarify this aspect.

### 3.6.10 Executing a client order received

66. The performance of the investment service of ‘reception and transmission’ of point (1) of Section A of Annex I of the MiFID is the case where the IF must both receive and transmit the order, i.e. essentially, it must act as an intermediary between the client and the recipient of the order. So, where an IF, e.g. a broker, receives the client order and then executes it, it is not normally carrying on the MiFID service of ‘reception and transmission’, although it will normally be carrying on the separate MiFID service of execution of client’s orders. Therefore, the executed order will fall within K-COH (provided it is executed in the client’s name) for that IF, but the fact that it has received the order from another IF (where that other IF might be carrying on reception and transmission) is irrelevant for the purposes of COH.
67. The draft RTS therefore clarifies this aspect to prevent any confusion over the unintended risk of double-counting of an order in the context of an IF calculating K-COH (because in the ordinary course of business, an IF cannot simultaneously be both transmitting and executing the same order for the MiFID purposes) recognising that for the purpose of calculating K-COH under Article 20 of the IFR, where an investment firm executes client orders (in the name of the client) that are received from another investment firm, the executing investment firm shall include such orders within its total of orders measured for the purposes of execution of client orders and shall exclude such orders from its total of orders measured for the purposes of reception and transmission of orders.

### 3.6.11 K-DTF – Daily Trading Flow

68. When measuring DTF for the purposes of calculating K-DTF, Article 33(2) of the IFR distinguishes between cash trades and derivatives. For cash trades, the value is ‘the amount paid or received on each trade’ and should, in general, be straightforward to determine. However, for derivatives the value of the trade is the ‘notional amount of the contract’ and (apart from an adjustment for duration) there is no further content in the IFR on how this ‘notional amount’ should be measured. This contrasts with the more developed text on ‘notional amount’ in Article 29 for K-TCD.
69. Accordingly, it is proposed to provide similar clarity on how the ‘notional amount’ is to be measured, in this case for the purposes of DTF. This would introduce consistency and the text should clarify that when measuring DTF for the purpose of calculating K-DTF under Article 33 of the IFR, the ‘notional amount’ shall be determined according to the provisions of Article 29(3) of the IFR.
70. The above cross reference avoids repeating full text in the draft RTS for each of the appropriate treatment in Article 29(3) of the IFR, although if necessary, could be copied out in the narrative to explain the above text.

71. Further, in order to avoid ambiguity and ensure harmonisation, it is suggested that clarification should be provided on what is included under a 'cash trade' (where the higher coefficient applies accordingly) for the purposes of measuring DTF and COH. For the purpose of measuring DTF under Article 33(2) of the IFR and measuring COH under Article 20(2) of the IFR, an investment firm should include as 'cash trades' transactions where a counterparty undertakes to receive or deliver a transferable security, money-market instruments, units in a collective investment undertakings or exchange traded options, at a market standard settlement or delivery date. For trades that are executed the cash value should be the amount paid or received, for exchange traded options it shall be the premium, and for orders that are transmitted it shall be the amount that would be paid or received if the trade were to be subsequently executed at the price contained in the order or the current market price if there is no clear price in the order.
72. The list of instruments included above, referring to the transactions, is based on the financial instruments listed in Section C of Annex I of the MiFID.
73. A 'cash trade' or 'cash contract' is generally understood by the market participants as a trade of a security or a derivative where settlement occurs on the same trading day. In the clarification provided above, this is extended by the requirement for there to be market standard or settlement dates. The reason to include exchange traded options, with premium paid for such options, is related to how the trading occurs and the parallel between the settlement of a security (stocks or bonds). For example, when trading a security, the buyer is buying the security (financial instrument) and settling the market value of that security according to market standard. The same applies to the trading of an exchange traded option, where the buyer is buying the option (financial instrument) and settles the market value of that option, which is the premium of the option.
74. Other types of derivatives, however, would not have the same parallel in terms of trading of the instrument and so could not be said to be a 'cash' trade. It should also be noted that Article 7(2) of Delegated Regulation (EU) 2017/565 extends a settlement period (of 2 days) to a longer period 'generally accepted in the market' while still not defining the financial instrument as a derivative this is a further example of the blurred lines that can occur between cash and derivatives and so warrants a tailored clarification for the specific purposes of the measurement of DTF and COH under the IFR.
75. As noted previously, for consistency purposes and to avoid arbitrage between the two, the above suggestions for measurement of DTF for the purpose of Article 33 of the IFR should also be applied to the measurement of COH for the purpose of Article 20 of the IFR.

### **3.6.12 K-TCD – Trading Counterparty Default**

76. The IFR dedicates eight articles to the trading counterparty default (K-TCD) requirement that captures risk for the firm itself, and hence comprises some of the most detailed and comprehensive technical provisions in the IFR. As such, the draft RTS takes note that there is nothing that needs to be added for clarifying K-TCD measurement.

### 3.6.13 K-CMG – Clearing Margin Given

77. Point (2) of Article 23 of the IFR contains a separate mandate in respect of requirements on K-CMG. This requires work on specific aspects such as the calculation of the amount of total margin. To the extent that there is anything additional to clarify in respect of measurement of K-CMG under the mandate in point (a) of Article 15(5) of the IFR, it might make sense to cover this alongside the material for Article 23(2) of the IFR rather than provide two separate sets of drafting on the same K-factor.

### 3.6.14 K-NPR – Net Position Risk

78. For the K-NPR the IFR simply refers to the market requirements set out in CRR and Regulation (EU) 2019/876 (CRR II). The draft RTS therefore takes note that there is nothing to be further clarified in the draft RTS for the purposes of measuring K-NPR.

## 3.7 Draft RTS on the notion of segregated accounts (Article 15(5)(b) of the IFR)

79. The mandate under point (b) of Article 15(5) of the IFR asks EBA to specify the notion of segregated accounts for the purpose of the IFR for the conditions ‘that ensure the protection of client money in the event of the failure of an investment firm’. The term ‘segregation’ is not used in the MiFID text notwithstanding the fact that it is a bedrock of the MiFID regime for protecting client money. Point (33) of Article 4(1) of the IFR already defines ‘segregated accounts’ for the purposes of Table 1 of Article 15(2): ‘accounts with entities where client money held by an investment firm is deposited in accordance with Article 4 of Commission Delegated Directive (EU) 2017/593 and where applicable national law provides that, in the event of insolvency or entry into resolution or administration of the investment firm, the client money cannot be used to satisfy claims in relation to the investment firm other than claims by the client.’
80. The above seems to be comprehensive in specifying the notion of segregated accounts. However, it may be still possible to draw from other parts of the Delegated Directive 2017/593 that are not covered explicitly by the definition above or by Article 4 of that Directive. Where taken together, points (a) to (c) and (e) to (f) of Article 2(1) of that directive are relevant. In particular, points (e) and (f) of paragraph 1, and paragraphs 2 and 3, of Article 2 seem the most directly relevant. To note, however, that paragraphs 2 and 3 set out where a firm might still hold client money where it cannot comply with the requirements on safeguarding set out in paragraph 1.
81. It is therefore proposed that the draft RTS clarifies that when calculating K-CMH, investment firms shall only apply the coefficient for segregated accounts in Table 1 of paragraph 2 of Article 15 of the IFR on client money held where the conditions in paragraph 1 of Article 2 of the Delegate Directive 2017/593 are applied. For all other client money held, investment firms shall apply the coefficient for unsegregated accounts provided in the same Table 1. The consequence of the above is that where an IF is already in compliance with the relevant aspects of Article 2(1)

of that directive, it will be in compliance with this provision in an RTS under IFR and so may take advantage of the lower calibration for calculating K-CMH on amounts held in segregated accounts.

82. Without that distinction, the IFR would not lead to all client money held being treated the same, without delving into any specific national differences arising from legal and accounting practices.

### 3.8 Draft RTS to specify adjustments to the K-DTF coefficients (Article 15(5)(c) of the IFR)

83. Point (c) of Article 15(5) of the IFR concerns the development of draft RTS to: ‘specify adjustments to the K-DTF coefficients referred to in Table 1 of paragraph 2 in the event that, in situations of market stress as referred to in Commission Delegated Regulation (EU) 2017/578,<sup>12</sup> the K-DTF requirements seem overly restrictive and detrimental to financial stability.’ The Delegated Regulation (EU) 2017/578 relates to the MiFID and specifies the requirements on market making agreements and schemes.

#### 3.8.1 Context and market making under MiFID Delegated Regulation (EU) 2017/578

84. The MiFID allows an IF that wishes to operate as market makers on regulated markets and other trading venues (MTF and OTF) to benefit from certain incentives, in exchange for which the IF has to agree to a market making agreement. The Delegated Regulation (EU) No. 2017/578 sets out the detailed obligation for IFs to enter into such a market making agreement and its content as well as obligations upon trading venues for having market making schemes in place.
85. Article 3 of Delegated Regulation (EU) No. 2017/578 describes ‘exceptional circumstances’ where the obligation for investment firms to provide liquidity on a regular and predictable basis set out in the MiFID shall not apply. In particular, point (a) of Article 3 covers definition of extreme volatility: ‘a situation of extreme volatility triggering volatility mechanisms for the majority of financial instruments or underlyings of financial instruments traded on a trading segment within the trading venue in relation to which the obligation to sign a market making agreement applies.’ Point (a) of Article 3 therefore seems to regard such an extreme volatility situation the circumstances that might potentially be of more relevance to the calculation of the K-DTF.
86. For the purposes of assessing whether any adjustment to the calculation of K-DTF is required, it seems that only point (a), i.e. a situation of extreme volatility (that triggers volatility mechanisms for the majority of financial instruments on a trading segment within the trading venue) is of relevance. The other situations referred in points (b) to (e) of Article 3 would appear to either prevent the trading venue from operating effectively, or the market making IF is prevented from doing so. In such circumstances, it is not immediately clear how trading volumes/values could be so unusual as to lead to an overly high/restrictive K-DTF requirement.

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<sup>12</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32017R0578>

87. Article 4 of Delegated Regulation (EU) 2017/578 deals with the identification of exceptional circumstances, where under paragraph 1 trading venues are required to: ‘make public the occurrence of the exceptional circumstances referred to in points (a), (b), (c) and (e) of Article 3 and, as soon as technically possible, the resumption of their normal trading after the exceptional circumstances have ceased to exist.’ Furthermore, under paragraph 2 of Article 4 of 2017/578 ‘trading venues shall set out clear procedures to resume normal trading after the exceptional circumstance have ceased to exist, including the timing of such resumption, and shall make those procedures publicly available.’
88. Paragraph 2 of Article 6 of Delegated Regulation (EU) 2017/578 then states that ‘Trading venues shall set out the parameters to identify stressed market conditions in terms of significant short-term changes of price and volume. Trading venues shall consider the resumption of trading after volatility interruptions as stressed market conditions’. All the aforementioned elements have been considered when developing the draft RTS for the calculation of the adjusted coefficient for K-DTF.

### 3.8.2 Calculation of the adjusted coefficient

The IFR mandate is to adjust the coefficients (referred to in Table 1 of paragraph 2 of Article 15 of the IFR). However, how to make an adjustment to the coefficients is not a straightforward matter, given that according to Article 24 of the IFR, the K-DTF is equal to DTF measured in accordance with Article 33 of the IFR, multiplied by the corresponding coefficient set out in Article 15(2) of the IFR. Such that a single coefficient applies to the whole of the total DTF for the relevant monthly calculation, which in turn is based on the averaging of daily observations over a 6-month period.

89. This means that whatever adjustment may be given to the coefficient would then apply to the whole of the trading values for a given calculation. Further, a given trading day which gives rise to the use of an adjusted coefficient could then apply for 6 monthly calculations in a row, as that event would remain part of the daily observations over a 6-month period being averaged.
90. For example, the calculation does not provide for the possibility of adjusting the coefficient on a daily basis, and does not provide for using more than one coefficient (other than the distinction between cash and derivative trades) for a given monthly calculation. It follows from the above that care is therefore required in proposing any adjustment, as any different (i.e. lower) coefficient would have to apply to the whole calculation taking into account periods shorter than a day and potentially for a long period.
91. The suggested means of achieving this is to be proportional in terms of the volume of daily observations that might be affected by an extreme volatility event relate to the total daily observations for the calculation period.
92. The draft RTS therefore provides for a formula that takes into account all the aforementioned elements and provides the necessary instructions for its calculation.

### 3.9 Draft RTS to specify the calculation of the amount of the total margin for the calculation of K-CMG (Article 23(3) of the IFR)

93. The K-CMG provides an alternative to the K-NPR for calculating the Risk to Market requirement for the trading book positions for an investment firm dealing on own account. According to Article 23 of the IFR, the competent authority shall allow an investment firm to use the K-CMG for positions that are subject to clearing or margining under the responsibility of a clearing member, provided that a number of conditions are satisfied. In case these conditions are fulfilled, K-CMG shall be calculated as the third highest amount of total margin required on a daily basis by the clearing member from the investment firm over the preceding three months multiplied by a factor of 1.3.
94. The EBA, in consultation with ESMA, is given the mandate to develop draft RTS to specify the calculation of the amount of the total margin required, the method of calculation of K-CMG, in particular where K-CMG is applied on a portfolio basis, and the conditions for the fulfilment of the provisions in point (e) of paragraph 1 of Article 23 of the IFR. The latter provisions concern the assessment by the competent authority that the choice of the portfolios subject to K-CMG has not been made to engage in regulatory arbitrage of own funds in a disproportionate or prudentially unsound manner.

#### 3.9.1 Calculation of total margin required

95. For the purposes of specifying the calculation of the amount of the total margin required, it is clarified that this shall be the required amount of collateral in the collateral account, as required by the clearing member's margin model.
96. Paragraph 2 of Article 23 of the IFR refers to a calculation of total margin required 'on a daily basis'. Given that clearing members may adapt their margin requirements within one day, e.g. during extreme volatility events, it is clarified that the highest amount of margins required per day should be used for the calculation of total margin required.

#### 3.9.2 Case of multiple clearing members

97. Investment firms may use the clearing services of multiple clearing members. For the cases where an investment firm will use K-CMG for positions that are subject to clearing by multiple clearing members, it is clarified that K-CMG shall be sum of the margins required by the individual clearing member. In other words, investment firms shall first calculate the third highest daily amount of margin required by each clearing member, and then add these amounts for all clearing members to obtain the sum for all clearing members. Consequently, the calculation of K-CMG may be based on different reference dates for the amount of total margin required, depending on the clearing member.
98. There might be situations where double counting may arise when investment firm uses several clearing members for the same positions. Clearing members will require margins for the same positions and all the margins required by each clearing member will be added. However only



one clearing member will execute the transaction for that position. The situations may lead to increased own funds requirements for the same position event if the risk for the market remains at the same level as IF would use only one clearing member.

### 3.9.3 No arbitrage criteria

99. Regarding the specification of conditions for the fulfilment of the provision that the choice for K-CMG has not been made with a view to engage in regulatory arbitrage of the own funds requirements in a disproportionate or prudentially unsound manner, it is required that the investment firm is able to demonstrate for its competent authority, that applying K-CMG would be an appropriate methodology that reflects the nature of its trading book positions.
100. It is also required that the investment firm would regularly compare its own risk assessment with the margins required by clearing members, for the purpose of assessing whether the margins required by the clearing members are still a good indicator of the level of risk to market of the investment firm. The outcome of the the K-CMG calculation shall be used in investment firm's risk management framework.
101. At the point of assessment by the CA, the investment firm shall make a comparison between the capital requirements under K-NPR and K-CMG. It shall be able to adequately justify the difference between these capital requirements to its competent authority when the trading desk (e.g. because of a change in trading strategy). or margin model by clearing member are changing significantly.
102. In order to achieve proper balance between the need to ensure regulatory arbitrage of own funds requirements and proportionality, it is reasonable to identify the cases where investment firm has to compare K-CMG and K-NPR. Those cases can be triggered if investment firm's business strategy of trading desks change leading to a change of 20 or more per cent capital requirement based on the K-CMG; or where clearing member's margin model changes resulting to 10 or more per cent of margin's requirement. The percentage changes of respectively 20 and 10 percent are considered significant and thus the proper balance would be achieved.
103. For the purpose of applying K-CMG on a portfolio basis, the draft RTS clarify that competent authorities, after granting the permission, shall allow an investment firm to use K-CMG for the portfolio of all positions assigned to a trading desk, on the conditions mentioned in paragraph 1 of Article 23 of the IFR. As such, a portfolio of cleared positions assigned to one trading desk can make use of K-CMG and, at the same time, a portfolio of cleared positions assigned to another trading desk can make use of K-NPR. In order to prevent arbitrage, the use of K-CMG and K-NPR across trading desks shall be consistent, which means that the same approach shall be used for similar trading desks in terms of business strategy and type of trading book positions.
104. Arbitrage shall also be prevented by limiting the switches between the use of K-NPR and K-CMG for a trading desk. In principle, an investment firm shall make continuous use of one of these methods for a trading desk for at least two years. Only in exceptional circumstances (e.g. a

business restructuring), the CA could allow an investment firm to change methods within this 24 month period.

### 3.10 Draft RTS on the criteria for subjecting certain investment firms to the CRR (EUR 5bn threshold) (Article 5(6) of the IFD)

105. Article 5 of the IFD provides the discretion to competent authorities to decide to apply the requirements of the CRR to certain investment firms. This discretion may be used with regard to investment firms for which all of the following applies:

- a) the investment firm has a total value of consolidated assets equal or exceeding EUR 5bn;
- b) the investment firm performs activities of dealing on own account, underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis; and
- c) one or more of the criteria set out in points (a), (b) and (c) of paragraph 1 of Article 5 of the IFD applies to the investment firm.

The EBA, in consultation with ESMA, is given the mandate to develop the draft RTS to further specify the criteria set out in points (a) and (b) of paragraph 1 of Article 5 of the IFD. Criterion (a) of this article refers to the carrying out of activities on such a scale that the failure or the distress of the investment firm could lead to systemic risk. Criterion (b) of this article refers to the statute of clearing member. These elements are summarised in the next sub-sections.

106. No mandate is provided to specify the criteria set out in point (c) of paragraph 1 of Article 5 of the IFD, which therefore provides discretion to the competent authority to subject other investment firms to the requirements of the CRR should it consider this justified in light of the size, nature, scale and complexity of the activities of the investment firm concerned.

#### 3.10.1 Scale of activities

107. In order to specify when an investment firm carries out its activities on such a scale that the failure or distress of the investment firm could lead to systemic risk, four quantitative thresholds are provided in Article 2 of the draft RTS. If any of these thresholds is exceeded, an investment firm's activities should be considered to be of a significant scale, which could lead to a systemic risk. Consequently, criterion (a) of paragraph 1 of Article 5 of the IFD shall be deemed to apply and the competent authority may apply the requirements of the CRR to the particular investment firm.

108. The quantitative thresholds are inspired by the indicators of the EBA Guidelines on criteria for the assessment of O-SIIs ('EBA/GL/2014/10'<sup>13</sup>). The focus is on activities that result in credit risk and bilateral counterparty credit risk and lead to bank-like exposures. The level of the threshold for the notional value of OTC derivatives is derived from the phase-in threshold of the initial margin requirements of the Regulation (EU) No 648/2012 as per 1 September 2020.

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<sup>13</sup>

<https://eba.europa.eu/sites/default/documents/files/documents/10180/930752/964fa8c7-6f7c-431a-8c34-82d42d112d91/EBA-GL-2014-10%20%28Guidelines%20on%20O-SIIs%20Assessment%29.pdf?retry=1>

109. The four thresholds should not necessarily be considered an exhaustive list of indicators for competent authorities to consider in order to use of the discretion in Article 5 of the IFD. Criterion (c) of paragraph 1 of article 5 of the IFD provides room for judgement to competent authorities to consider additional indicators, or a combination of indicators, if these relate to the size, nature, scale and complexity of the activities of the investment firm.

### 3.10.2 Requirements related to the provision of clearing services

110. The definition of clearing member is provided in point (3) of Article 4(1) of the IFR. This statute of clearing member is further specified in the draft RTS by the fact that the investment firm offers its clearing services to other financial institutions that are not clearing members themselves, as such an investment firm is considered to be more interconnected with the financial sector. If a clearing member provides such clearing services, criterion (b) of paragraph 1 of Article 5 of the IFD shall be deemed to apply and the competent authority may apply the requirements of the CRR to the particular investment firm.

111. A competent authority may still use the discretion in Article 5 of the IFD for investment firms that are clearing members and are not offering their clearing services to other financial institutions, if criterion (c) of paragraph 1 of that article applies.

## 3.11 Draft RTS on the methods of prudential consolidation of investment firms (Article 7(5) of the IFR)

112. The EBA has developed this CP for these draft RTS in accordance with the mandate in Article 7(5) of the IFR, which states that: 'EBA shall develop draft regulatory technical standards to specify the details of the scope and methods for prudential consolidation of an investment firm group, in particular for the purpose of calculating the fixed overheads requirement, the permanent minimum capital requirement, the K-factor requirement on the basis of the consolidated situation of the investment firm group, and the method and necessary details to properly implement paragraph 2.'

113. This mandate requires three key aspects to be addressed:

- a) the scope of consolidation, i.e. which entities should be included in the consolidation of the group and how they shall be included (consolidation methods);
- b) calculation of the three components of IF's own funds requirement according to Article 11(1) of the IFR based on the consolidated situation of the investment firm group; and
- c) how to implement the requirements in Title II of Part Two of the CRR for inclusion of minority interests upon consolidation as per paragraph 2 of Article 7 of the IFR.

114. It is possible to build upon existing material regarding the first and the last aspects, whereas the own fund requirements introduced by the IFD/IFR derive from a different perspective than the CRR's. Indeed, own funds requirements under the CRR are calculated using balance sheet items. Therefore, the consolidation of entities for accounting and prudential purposes are similar in nature under the CRR. On the contrary, the K-factor metrics mainly use management data instead of accounting data. Therefore, in order to define the own funds requirements based on

the consolidated situation of the investment firm group, it is not possible to rely on the consolidated balance sheet of the group.

115. These elements are summarised in the next sub-sections.

### **3.11.1 General approach and existing material**

116. The proposed way forward is to build upon existing material, in particular deriving from the CRR for two main reasons. First, most IFs are, until the entry into application of the IF package, subject to the CRR provisions regarding scope and methods of prudential consolidation. Building upon existing provisions fosters continuity and lessens the adaptations cost. This being said, considering the need for proportionality that has initiated the IF package project, the provisions stemming from the CRR must be scrutinised in order to consider unduly burdensome features.

117. Second, already existing provisions in the CRR have a proven record of accomplishment. Building on a resilient set of rules provides legal certainty to the industry and mitigates risks of major drawbacks.

118. Against this background, some relevant material can be found in the current framework in terms of scope and methods of prudential consolidation derived from the CRR, in particular from Articles 11 and 18. This Consultation Paper takes into account amendments done to date to Article 18 of the CRR in the CRR II.

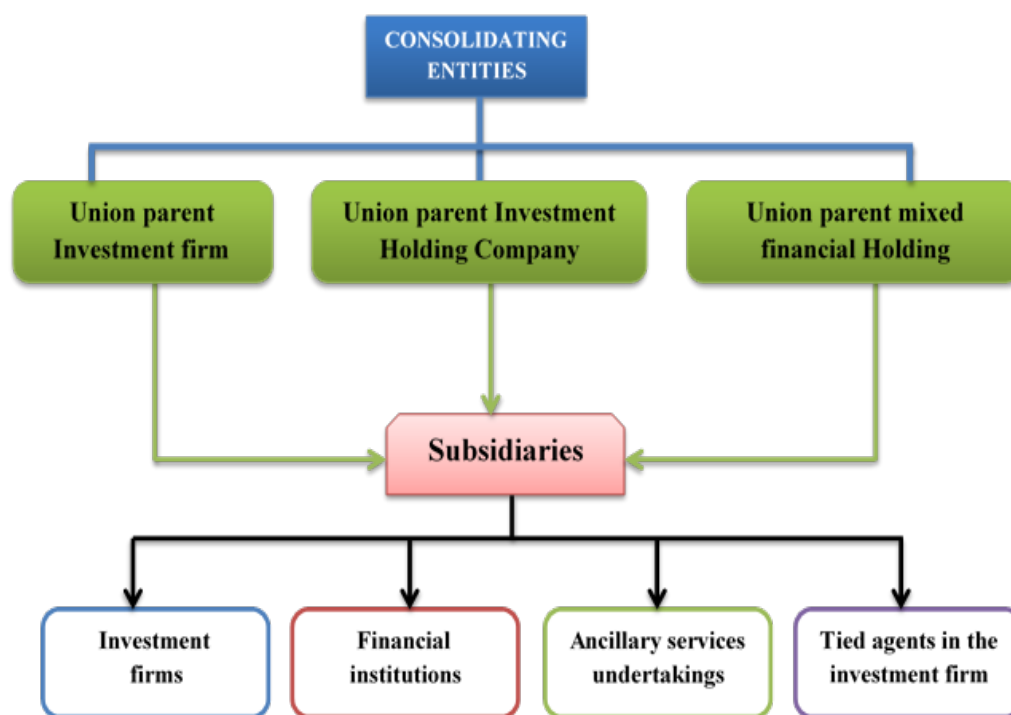
### **3.11.2 Scope of prudential consolidation under IFR**

119. The determination of the scope of consolidation is the first step in the prudential consolidation process. The objectives of the scope control are mainly to ensure that a group does not wrongly exclude or include companies, which could have the effect of distorting the risk bases or artificially increasing the amount of own funds.

120. Pursuant to Article 7 of the IFR, the scope of prudential consolidation starts with a consolidating entity at the top of the group as union parent. Three types of consolidating entities are possible: Union parent investment firms, Union parent investment holding companies and Union parent mixed financial holding companies. These consolidating entities carry out consolidation of four types of their subsidiaries: investment firms, financial institutions, ancillary services undertakings and tied agents in an investment firm.

121. Figure 1 shows a summary of the type of entities within the scope of consolidation of an investment firm only group.

*Figure 1: Scope of prudential consolidation, from Article 4.1(11) of the IFR.*

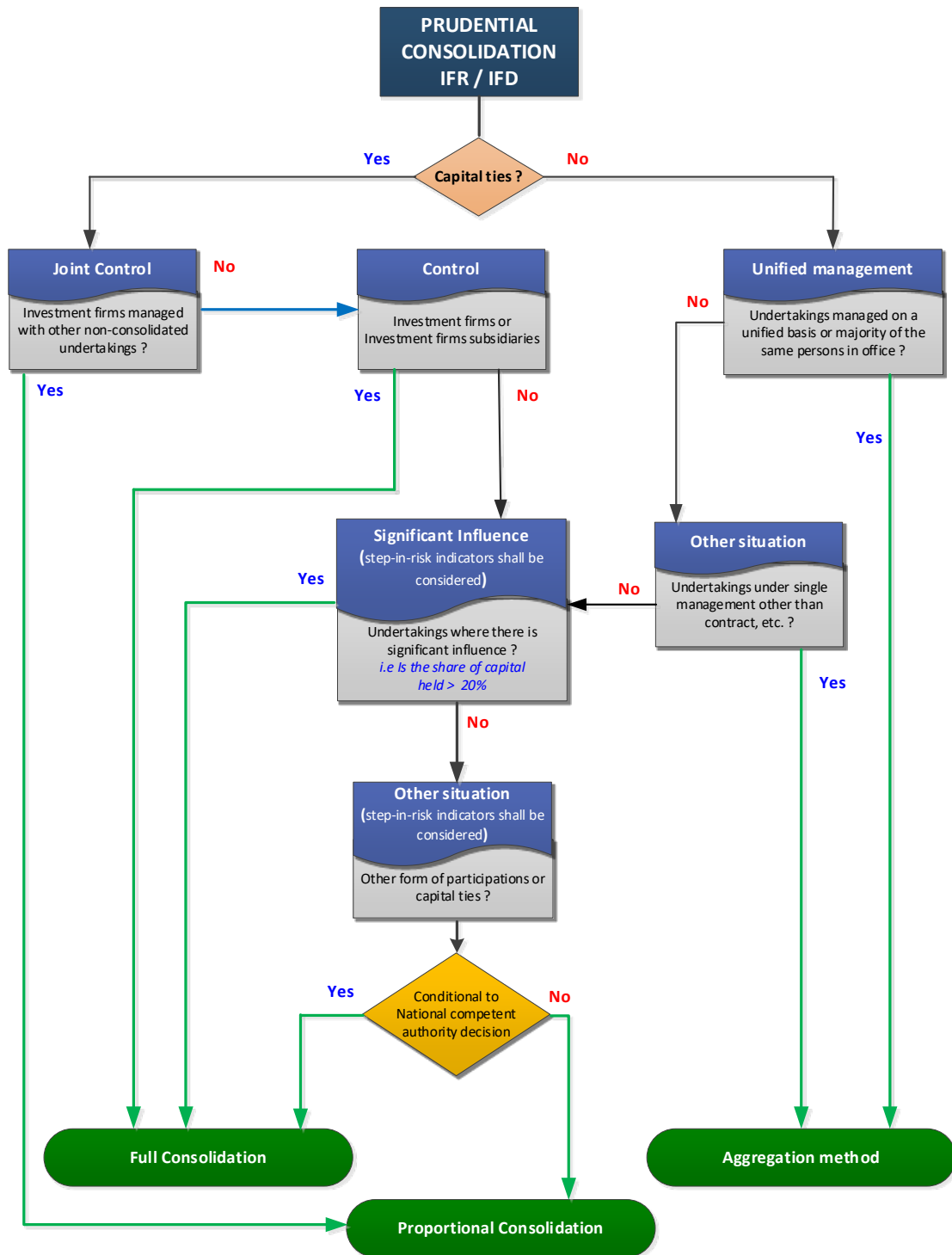


122. Prudential consolidation of an investment firm group under the IFR does not apply to insurance undertakings, which are financial sector entities but not financial institutions.

### 3.11.3 Selection of the consolidation method

123. The mandate in Article 7(5) of the IFR requires that particular attention is paid to the method to be used on a consolidated basis. The consolidation methods derive from the CRR as set out in Article 18(2) to 18(6), and are adapted to IF groups. The equity method used under the CRR would not be directly relevant as a technique for prudential consolidation under the IFR, as the proportional consolidation method covers all situations.
124. Unless a prudential waiver has been granted, the IFR applies to investment firms on an individual and on a consolidated basis, and the general rule for the preparation of their consolidated situation for prudential purposes is the ‘full consolidation’.
125. According to Article 18(4) of the CRR II, in case of joint control, the default treatment shall be proportional consolidation. This exception to the general rule of full consolidation of subsidiaries is subject to the permission of the competent authorities on a case-by-case basis, upon application from the supervised entity.
126. The aggregation method shall be used when undertakings are placed under single management, are managed on a unified basis or by the same persons.
127. Figure 2 summarizes the process for the choice of the consolidation method.

*Figure 2: Selection of the consolidation method*



#### **3.11.4 Implementation of the consolidation method**

128. The own funds requirement calculation on a consolidated basis follows the same principle as on an individual basis under the IFR, which consists in requiring that the own funds are at least equal to the highest of three components: a fixed overhead requirement, a permanent minimum capital requirement, and a K-factor requirement linked to the activities.
129. The group fixed overhead requirement follows a hierarchical approach of using the consolidated expenditures account if it is available and corresponds to the same scope of consolidation.
130. The consolidated permanent minimum capital requirement has to follow a prudent approach, which is best implemented by summing the individual requirements of the group undertakings, including third-country undertakings.
131. The consolidation of K-factor requirements has to follow the same prudent approach, while giving recognition to the fact that undertakings belong to the same group. The various metrics that underlie the K-factors are considered on a case-by-case basis for capturing the risks they represent.
132. These three components have to be consolidated for the group before calculating the highest of them.

## 4. Draft RTS on the information to be provided for the authorisation of investment firms as credit institutions (Article 8a(6) point a) of the CRD)

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In between the text of the draft RTS that follows, further explanations on specific aspects of the proposed text are occasionally provided, which either offer examples or provide the rationale behind a provision, or set out specific questions for the consultation process. Where this is the case, this explanatory text appears in a framed text box.



**COMMISSION DELEGATED REGULATION (EU) No .../..****of XXX**

[...]

**supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the information to be provided by an undertaking in the application for authorisation in accordance with Article 8a of Directive 2013/36/EU.**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,  
Having regard to Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU , and in particular Article 62[(6)] thereof,

Whereas:

- (1) Under Article 8a of Directive 2013/36/EU, investment firms that meet the conditions set out in point (1)(b) of Article 4(1) of Regulation (EU) No 575/2013 should apply for an authorisation as credit institutions. Those undertakings should provide sufficient information to the competent authorities as to enable them to carry out a comprehensive assessment of the applicant credit institutions.
- (2) The list of information to be provided in an application by entities seeking to obtain the authorisation referred to in Article 8a of the Directive 2013/36/EU should be specified in a regulation. Such information should include the identification details and historical information of the applicant credit institution, including its existing licensing, activities proposed, current financial situation, programme of operations, as well as initial capital.
- (3) To ensure consistency and harmonisation of the authorisation information required for applicant credit institutions, this Regulation should refer to the existing [draft] EBA RTS 2017/08 on the information to be provided for the authorisation of credit institutions, the requirements applicable to shareholders and members with qualifying holdings and obstacles which may prevent the effective exercise of supervisory powers and should aim to expand its scope to the investment firms that classify as credit institutions.
- (4) Regulation (EU) No 2033/2019 amends Article 4(1) of Regulation (EU) No 575/2013 by identifying two types of credit institutions – one as per point (1)(a), which takes deposits or other repayable funds from the public and grants credits for its own account; and one

- as per point (1)(b); this Regulation only targets the latter. Differently, credit institutions whose business consists of taking deposits or other repayable funds from the public and to grant credits for its own account shall follow the requirements of [EBA RTS 2017/08].
- (5) The list of information requirements provided in this Regulation for the applicant credit institutions, should take into consideration the specificities of the investment firms' business model and any prior licences granted by a competent authority.
  - (6) Competent authorities may need to expand the requested information in order to be in a position to thoroughly assess the applicant credit institution, taking into account the range of different business models and legal forms that applicant institutions may take. This Regulation should enable competent authorities to require additional information from an investment firm when assessing the application for a credit institution.
  - (7) The competent authority may consider waiving some information requirements in light of the size, nature, scale and complexity of the activities of the applicant credit institution concerned, and taking into account the principle of proportionality and the implementation burden on the institutions. However, this should not compromise the possibility to conduct a comprehensive assessment of the application for a credit institution.
  - (8) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the Commission.
  - (9) EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010<sup>14</sup>.

HAS ADOPTED THIS REGULATION:

*Article 1*

*Scope of required information*

1. An application for the authorisation of a credit institution as per point (1) (b) of Article 4(1) of Regulation (EU) No 575/2013 shall comply with the following requirements from the draft RTS 2017/08 on information for the authorisation of credit institutions:
  - (a) Article 3 - Presentation of the applicant credit institution, place of head office and history;
  - (b) Article 4 - Programme of activities, Paragraph (1) and Paragraph (3);
  - (c) Article 5 - Financial information, with the exception of Paragraph (7)(e) and (7)(f);
  - (d) Article 6 - Programme of operations, structural organisation, internal control systems and auditors;
  - (e) Article 7 - Initial capital;

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<sup>14</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

- (f) Article 8 - Effective direction;
  - (g) Article 9 - Shareholders or members with qualifying holdings; and
  - (h) Article 10 - 20 largest shareholders or members.
2. Competent authorities may require information, which is additional to that which is set out in Paragraph 1, provided that such information is proportionate and relevant for the purposes of the authorisation assessment.
  3. Unless the competent authority requires otherwise, an application is not required to provide the information set out in Paragraph 1 where the information is already held by the competent authority, including where it has been requested and obtained from another competent authority, provided that the applicant certifies that such information gives a true, accurate and complete account of its situation to date to the point of authorisation.
  4. An applicant credit institution may omit from the application information which is solely relevant to activities not indicated in the information set out in the programme of activities pursuant to Article 4(1) of the RTS 2017/08, provided that the applicant identifies in the application the information omitted and cites this provision as the basis for the omission.
  5. Following the assessment of the information submitted in the application, the competent authority may require the applicant to provide supplemental information, or additional explanations, where the authority considers it necessary for the purposes of verifying whether all requirements for authorisation have been satisfied.
  6. The information in an application shall remain true, accurate and complete account of the applicant credit institution's situation regarding the requirements set out in Paragraphs (1) to (4).

## *Article 2*

### *Entry into force*

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission*  
*The President*

*For the Commission*  
*On behalf of the President*

*[Position]*

## 5. Draft RTS on the calculation of the threshold referred to in Article 4(1)(1b) CRR (Article 8a(6) point b) of the CRD)

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**COMMISSION DELEGATED REGULATION (EU) No .../..****of XXX**

[...]

**supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards for the calculation of the threshold referred to in Article 8a(6)(b) of the CRD**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,  
Having regard to Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU, and in particular Article 62[(6)] thereof,

Whereas:

- (1) Under Article 8a of Directive 2013/36/EU, investment firms that qualify as credit institutions pursuant to point (1)(b) of Article 4(1) of Regulation (EU) No. 575/2013 – and have already obtained an authorisation pursuant to Title II of Directive 2014/65/EU – are required to submit an application for authorisation to the competent authority for credit institutions when the total value of the consolidated assets is equal to or exceeds EUR 30 billion at solo or group level.
- (2) This Regulation is intended to provide a methodology for calculating the thresholds upon which investment firms under point (1)(b) of Article 4(1) of Regulation (EU) No. 575/2013 shall apply for an authorisation of credit institutions.
- (3) The methodology for calculating the thresholds should take into account that the total value of the consolidated assets of all undertakings of a group can potentially encompass intragroup exposures. While these elements are relevant from a prudential point of view, the methodology should be devised in such a manner to avoid double counting and ensure that consolidated assets can be determined at group level.
- (4) For the purposes of defining the concept of assets, this Regulation takes into account the different accounting standards applicable to investment firms and credit institutions and adopts a hierarchical approach to ensure consistency with Articles 50 and 51 of Regulation (EU) No 468/2014 (SSM Framework Regulation) providing for a methodology based on quantitative thresholds to assess the significance of credit institutions.

- (5) For the purposes of determining the average of monthly total assets, the level one text refers to “monthly total assets”, which would justify the stricter requirement of 12 monthly data points, although this is not explicitly stated. Calculated over a period of 12 consecutive months, a monthly calculation may be very burdensome in particular for complex groups, and it would not produce results substantially different from a quarterly calculation, as in both cases an average over a 12 months window has to be considered. A quarterly calculation requires undertakings to work out the assets values four times per year, leading to a less burdensome implementation. Moreover, this reporting frequency is aligned with other provision of the level one text (in particular with the reporting requirements in Article 55(5) of the IFR aimed at monitoring the significance of an IF).
- (6) In performing the calculation under Article 8a of Directive 2013/36/EU, investment firms that are part of third country groups shall include the total assets of all the branches of third country group in the combined total value of the assets of all entities in the group, as indicated in Article 4(1)(1) of Regulation (EU) No. 575/2013. The total value of assets of third-country branches shall be calculated following the same principles of the statistical data reporting pursuant to Regulation (EU) 1071/2013 (ECB/2013/33) in order to ensure consistency in the treatment of credit institutions as per Article 8 of the Directive 2013/36/EU and the credit institutions as per Article 8a of the Directive 2013/36/EU.
- (7) This Regulation acknowledges that a consistent definition of the exchange rate is necessary to ensure that those investment firms that do not report in euro can perform the calculation laid down Article 8a of Directive 2013/36/EU.
- (8) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the Commission.
- (9) EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010<sup>15</sup>].

HAS ADOPTED THIS REGULATION:

## **Chapter 1**

### **Scope and definitions**

#### *Article 1*

##### *Subject matter and scope*

1. This Regulation specifies the methodology to calculate the threshold referred to in Article 8a(1) of Directive 2013/36/EU, by identifying:

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<sup>15</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

- (a) The definition of assets and calculation of assets' values;
- (b) The perimeter of undertakings to consider in the calculation of the threshold; and
- (c) The calculation of assets of relevant branches of third country groups.

### *Article 2*

#### *Definitions*

1. For the purposes of this Regulation, the following definitions shall apply:
  1. 'relevant undertaking' means any undertaking carrying out the services referred to in point (1)(b) of Article 4(1) of Regulation (EU) No 575/2013 and which has already obtained an authorisation pursuant to Title II of Directive 2014/65/EU;
  2. 'group test' means the calculation as in point (b) of Article 8a(1) of Directive 2013/36/EU;
  3. 'relevant activities' mean the activities referred to in points (3) and (6) of Section A of Annex I to Directive 2014/65/EU;
  4. 'relevant institution' means any credit institution as defined in point (1) of Article 4 of Regulation (EU) No 575/2013 or investment firm as defined in point (1) of Article 4(1) of Directive 2014/65/EU which carries out relevant activities;
  5. 'relevant third country branch' means a branch of third country groups which is authorised to carry out relevant activities in the Union and that is not a commodity and emission allowance dealer, a collective investment undertaking or an insurance undertaking;
  6. 'third country group' means a group as defined in point 64 of Article 3(1) of Directive 2013/36/EU;
  7. 'relevant subsidiary in third country' means the subsidiary established in a third country that carries out relevant activities, that is not a commodity and emission allowance dealer, a collective investment undertaking or an insurance undertaking and that is either part of a group established in the Union or the subsidiary of a firm established in the Union;
  8. 'intragroup exposure' means any exposures that occur between relevant institutions, relevant third country branches and relevant subsidiaries in third countries, including adjustments based on the applicable accounting standards.

## **Chapter 2**

### **Accounting standards and relevant exchange rate**

#### *Article 3*

##### *Accounting standards and audited figures*

1. For the purposes of this Regulation, the relevant undertaking shall calculate the total value of the assets of relevant institutions in accordance with paragraphs 2 to 4.
2. The total value of the assets of a relevant institution shall be determined on the basis of the prudential individual reporting in accordance with applicable law.
3. If the total assets cannot be determined on the basis of the data referred to in paragraph 2, the total value of the assets shall be determined on the basis of the most recent audited annual accounts prepared in accordance with International Financial Reporting Standards

(IFRS) as applicable within the Union in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council.<sup>16</sup>

4. If those annual accounts are not available, the relevant institution shall report on the basis of the annual accounts prepared in accordance with applicable national accounting laws.

#### *Article 4*

##### *Relevant exchange rate*

Relevant undertakings shall perform the calculation laid down in this Regulation converting any amount into the institution's reporting currency at the spot exchange rate prevailing at the date that amount is recorded. Relevant undertakings which do not report in euro shall compare the result of that calculation with the threshold referred to in Article 8a(1) of Directive 2013/36/EU, converting the threshold amount at the spot exchange rate prevailing at the reporting reference date.

### **Chapter 3**

#### **Branches of third country groups**

#### *Article 5*

##### *Activities of of branches of third-country groups*

Where the type of activities carried out is not identified, the total assets of each branch of the third-country group operating in the Union shall be considered for the calculation of the combined total assets in line with Article 10 of this Regulation as if these branches were authorised in the Union and carrying out activities referred to in points (3) and (6) of Section A of Annex I to Directive 2014/65/EU of the European Parliament and of the Council.

#### *Article 6*

##### *Criteria to measure the total value of assets of branches of third-country groups*

Assets of relevant third country branches shall be determined in line with the provisions regarding the statistical data reported pursuant to Regulation (EU) 1071/2013 (ECB/2013/33). For branches operating in non-euroarea, the same provisions shall apply with reference to the national currency.

### **Chapter 4**

#### **Definition of assets, scope of undertakings for the calculation of the threshold for the group test and calculation of the value of assets**

#### *Article 7*

##### *Calculation of total assets in accordance with Article 8a(1)(a) of Directive 2013/36/EU*

1. The relevant undertaking shall calculate the total value of assets pursuant to Article 8a(1)(a) of Directive 2013/36/EU in accordance with paragraphs 2 to 5 of this Article.

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<sup>16</sup> Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ L 243, 11.9.2002, p. 1).



2. Each relevant undertaking shall look at the individual value of the total assets in accordance with Article 3 of this Regulation.
3. If the individual value of the total assets is equal to or exceeds EUR 30 billion and the relevant undertaking is not part of a group, the relevant undertaking shall consider this as the total value of assets of the undertaking pursuant to Article 8a(1)(a) of Directive 2013/36/EU.
4. If the individual value of the total assets is equal to or exceeds EUR 30 billion and the relevant undertaking is part of a group, the relevant undertaking shall calculate the value of total assets pursuant to Article 8a(1)(a) of Directive 2013/36/EU by subtracting any intragroup exposures.
5. If as a result of the calculation under paragraph 4 of this Article, the total value of the consolidated assets is less than EUR 30 billion and the relevant undertaking is part of a group, the institution shall apply Article 9 of this Regulation.

#### *Article 8*

##### *Scope of undertakings for the calculation of the threshold in accordance with Article 8a(1)(b) of Directive 2013/36/EU*

For the purposes of the group test, the relevant undertakings shall include the following entities which are part of the group, defined as any group referred to in point (138) of Article 4(1) of Regulation (EU) No 575/2013 or in point (13) of Article 3(1) of Directive 2019/2034/EU or an investment firm group as defined in Article 4(1)(25) of Regulation (EU) No 2019/2033, as applicable, in the calculation of the thresholds referred to in point (b) of Article 8a(1) of Directive 2013/36/EU:

- (a) Relevant institutions, whereas the individual total assets as specified in Article 3 and Article 7(2) of this Regulation are less than EUR 30 billion;
- (b) Relevant institutions as specified in Article 7(5) of this Regulation;
- (c) Relevant subsidiaries in third countries, whereas individually have total assets of less than EUR 30 billion as specified in Article 3 of this Regulation;
- (d) Relevant third country branches.

#### *Article 9*

##### *Calculation of consolidated assets in accordance with Article 8a(1)(b) of Directive 2013/36/EU*

1. The relevant undertaking shall calculate the total value of the consolidated assets pursuant to Article 8a(1)(b) of Directive 2013/36/EU in accordance with paragraphs 2 to 3 of this Article.
2. Each relevant institution that is part of the same group shall look at the value of the individual total assets in accordance with Article 7 of this Regulation.
3. For the purposes of the calculation of the total value of consolidated assets, relevant undertakings shall consider the value of intragroup exposures as in the formula:

$$CA_u = \sum_{i=1}^N (IA - IE)_i + \sum_{j=1}^M CA_j$$

where:

- $CA_u$  = the total value of the consolidated assets of the relevant undertaking  $u$  pursuant to Article 8a(1)(b) of Directive 2013/36/EU;
- $i$  = an entity as defined in points a and c of Article 8 of this Regulation;
- $N$  = the number of entities defined in point a and c of Article 8 of this Regulation;
- $IA$  = individual assets, as defined in Article 4 of this Regulation, of the entities defined in points a and c of Article 8 of this Regulation;
- $IE$  = intragroup exposures as defined in Article 2 of this Regulation between the entities as defined in points a and c of Article 8 of this Regulation;
- $j$  = an entity as defined in point b of Article 8 of this Regulation;
- $M$  = the number of entities defined in point b of Article 8 of this Regulation;
- $CA_j$  = the value of the consolidated assets of the relevant undertaking  $j$  pursuant to Article 7(5) of this Regulation.

### Article 10

#### *Calculation of combined assets of third country groups in accordance with Article 4(1)(b) of Regulation (EU) No 575/2013*

Where the relevant undertaking is part of a third-country group, the relevant undertaking shall calculate the combined total value of the assets of all the undertakings of the group pursuant to point b) of Article 4(1) of Regulation (EU) No 575/2013 by including the total assets of each relevant third-country branch as in the formula:

$$CTA_u = CA + \sum_{j=1}^N TA_{TCBj}$$

where:

- $CTA_u$  = the combined total value of the assets of the relevant undertaking  $u$  as defined in point b) of Article 4(1) of Regulation (EU) No 575/2013;
- $CA$  = total value of the consolidated assets as defined in Article 9(3) of this Regulation;
- $TCBj$  = a relevant third-country branch  $j$  as defined in Article 2 and Article 6 of this Regulation;
- $N$  = the total number of relevant third-country branches  $j$ ; and

$TA$  = the value of total assets are defined in Article 7 of this Regulation.

### *Article 11*

#### *Average of monthly total assets criterion*

1. For the purposes of Article 8a(1) of Directive 2013/36/EU, for each month in the quarter, the relevant undertaking shall calculate the monthly total assets as a liner interpolation between the value of the assets at the end of that quarter and the value of the assets at the end of the previous quarter as in the formula:

$$MTA_{ut} = TA_{Q-1} + m * (TA_Q - TA_{Q-1})/3$$

where:

$MTA_{ut}$  = monthly total assets of relevant undertaking  $u$  in month  $t$ ;

$m$  = one of the three months of quarter  $Q$  and it can assume the values 1, 2 or 3;

$TA_Q$  = total assets of the entities defined in Article 8 of this Regulation calculated as in Article 7 or Article 9 or Article 10 of this Regulation at the end of the quarter  $Q$  of month  $t$ ; and

$TA_{Q-1}$  = total assets of the entities defined in Article 8 of this Regulation calculated as in Article 7 or Article 9 or Article 10 of this Regulation at the end of the previous quarter  $Q-1$  of month  $t$ .

The average of monthly total assets calculated over a period of 12 consecutive months shall be calculated as the average of  $MTA_t$  as defined in paragraph 1 of this Article over four consecutive quarters.

### *Article 12*

#### *Entry into force*

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission*  
*The President*

*For the Commission*  
*On behalf of the President*

[Position]

## 6. Draft RTS to specify the calculation of the fixed overheads requirement and to define the notion of a material change (Article 13 (4) of the IFR)

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**COMMISSION DELEGATED REGULATION (EU) No .../..****of XXX**

[...]

**supplementing Regulation (EU) 2019/2033 of the European Parliament and of the Council on prudential requirements of investment firms and amending Regulations (EU) No 575/2013, (EU) 600/2014 and (EU) No 1093/2010 with regard to regulatory technical standards for Own Funds Requirements for Investment Firms based on Fixed Overheads**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,  
Having regard to Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements for investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 806/2014 and in particular the fourth subparagraph of Article 13(4) thereof,

Whereas:

- (1) Given that not all investment firms are required to have audited financial statements, rules specifying own funds requirements for investment firms based on fixed overheads should allow investment firms to calculate fixed overheads requirements also on the basis of non-audited financial statements, where investment firms are not obliged to have audited financial statements. Further, where the audited financial statements do not cover a period of twelve months, a calculation should be performed to produce an equivalent annual amount, in order to ensure consistency with the requirement of Article 13(1) of Regulation (EU) 2019/2033.
- (2) Given that the differences between the gross and net profits with regards to a firm's financial situation are represented by the fixed costs of running the firm's business, the deduction from the total costs of an investment firm of the employees', directors' and partners' shares in profit referred to in Article 13(4) of Regulation (EU) 2019/2033 should be understood to refer to the net profits.
- (3) Moreover, since payment of staff bonuses and other remuneration may be deferred over time and could follow different agreement structures, these should be considered as dependent on net profit where this would have no impact on the firm's capital position, either due to payments having already been made or to the absence of the obligation of payment in case of absence of net profit.

- (4) Investment firms should include fixed costs of third parties in the calculation of their total expenses. However, where these costs are not fully incurred on behalf of the investment firms, these should be included up to the amount attributable to the investment firm.
- (5) Considering that not all investment firms use International Financial Reporting Standards (IFRS) and there are differences in the applicable accounting standards in the calculation of the total costs, elements to be deducted, in addition to those provided in Article 13(4) of Regulation (EU) 2019/2033, should be further specified in order to ensure comparability in the calculation of the fixed overheads requirements.
- (6) Consistently with the particularity of the business of commodity and emission allowance dealers, recognised in various provisions throughout Regulation (EU) 2019/2033, expenses related to raw materials should be deducted from the total expenses used in calculation the fixed overheads requirements.
- (7) Fixed overheads can evolve at a similar pace as the activities of the investment firm, which, as a result, should not be considered material changes for the purposes of Article 13(2) of Regulation (EU) 2019/2033. However, there may be circumstances where changes, such as shifts in the business models or mergers and acquisitions, may occur and result in significant variations in the projected fixed overheads. Therefore, rules specifying own funds requirements for investment firms based on fixed overheads should establish objective thresholds based on the projected fixed overheads for the purpose of specifying the notion of material change.
- (8) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (9) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010. The European Banking Authority has also consulted the European Securities Markets Authority (ESMA) before submitting the draft technical standards on which this Regulation is based,

HAS ADOPTED THIS REGULATION:

*Article 1*

*Calculation of the fixed overheads requirement referred to in Article 13(1) of Regulation (EU) 2019/2033*

1. For the purposes of Article 13(1) of Regulation (EU) 2019/2033, the ‘figures resulting from the applicable accounting framework’ shall refer to figures of an investment firm’s most recent audited annual financial statements after distribution of profits or in annual financial statements where audited statements are not available.
2. Where the investment firm's most recent audited financial statements do not reflect a twelve month period, the firm shall divide the amounts included in those statements by the number of months that are reflected in those financial statements and shall subsequently multiply the result by twelve, so as to produce an equivalent annual amount.

3. For the purposes of Article 13(4)(b) of Regulation (EU) 2019/2033 employees', directors' and partners' shares in profits shall be calculated on the basis of the net profits.
4. For the purposes of Article 13(4)(a) of Regulation (EU) 2019/2033, staff bonuses and other remuneration shall be considered to depend on the net profit of the investment firm in the respective year where both of the following conditions are met:
  - (a) the staff bonuses or other remuneration to be deducted have already been paid to employees in the year preceding the year of payment, or the payment of the staff bonuses or other remuneration to employees will have no impact on the firm's capital position in the year of payment;
  - (b) with respect to the current year and future years, the firm is not obliged to award or allocate further bonuses or other payments in the form of remuneration unless it makes a net profit in that year.
5. Where fixed expenses have been incurred on behalf of the investment firms by third parties, including tied agents, and these fixed expenses are not already included within the total expenses included in the annual financial statement referred to in paragraph 1, these shall be added to the total expenses of the investment firm. Where a break-down of the third party's expenses is available, an investment firm shall add to the figure representing the total expenses only the share of those fixed expenses applicable to the investment firm. Where such a break-down is not available, an investment firm shall add to the figure representing the total expenses only its share of the third party's expenses as it results from the business plan of the investment firm.
6. In addition to the items for deduction referred to in Article 13(4) of Regulation (EU) 2019/2033, the following items shall also be deducted from the total expenses, where they are included under total expenses in accordance with the relevant accounting framework:
  - (a) fees, brokerage and other charges paid to central counterparties, exchanges and other trading venues and intermediate brokers for the purposes of executing, registering or clearing transactions, only where they are passed on and charged to customers. These shall not include fees and other charges necessary to maintain membership or otherwise meet loss-sharing financial obligations to central counterparties, exchanges and other trading venues;
  - (b) interest paid to customers on client money, where there is no obligation of any kind to pay such interest;
  - (c) expenditures from taxes where they fall due in relation to the annual profits of the investment firm;
  - (d) losses from trading on own account in financial instruments;
  - (e) payments related to contract-based profit and loss transfer agreements according to which the investment firm is obliged to transfer, following the preparation of its annual financial statements, its annual result to the parent undertaking.

*Article 2*

*Calculation of the fixed overheads requirement referred to in Article 13(1) of Regulation (EU) 2019/2033 for commodity and emission allowance dealers*

Commodity and emission allowance dealers may deduct expenditure on raw materials in connection with an investment firm trading in derivatives of the underlying commodity.

*Article 3*

*The notion of material change for the purposes of Article 13(2) of Regulation (EU) 2019/2033*

A material change referred to in Article 13(2) of Regulation (EU) 2019/2033 shall be considered to have occurred where either of the following conditions are met:

- (a) a change, either in the form of an increase or in the form of a decrease of the business activity of the firm results in a change of 30% or greater in the firm's projected fixed overheads of the current year;
- (b) a change, either in the form of an increase or in the form of a decrease of the business activity of the firm results in changes in the firm's own funds requirements based on projected fixed overheads of the current year equal to or greater than EUR 2 million.

*Article 4*

*Entry into force*

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission  
The President*

*For the Commission  
On behalf of the President*

*[Position]*



## 7. Draft RTS to specify the methods for measuring the K-factors (Article 15(5), point a) of the IFR)

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**COMMISSION DELEGATED REGULATION (EU) No .../..****of XXX**

[...]

**supplementing Regulation (EU) 2019/2033 of the European Parliament and of the Council with regard to regulatory technical standards specifying the methods for measuring the K-factors referred to in Article 15 of that Regulation**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, Having regard to Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014<sup>17</sup>, and in particular the third subparagraph of Article 15(5) thereof,

Whereas:

- (1) Some of the K-factors do not require further specifications as Regulation (EU) 2019/2033 elaborates in detail the methods for measuring them; this is the case with the K-NPR, which is derived from Regulation (EU) No 575/2013 as well as with the K-CON and K-TCD, which use a simplified application of the corresponding requirements under that Regulation. However, in other cases such as AUM, CMH, COH, ASA and DTF, the methods for measuring those factors would benefit from further clarifications.
- (2) For the purposes of calculating the level of AUM and ASA, financial instruments should be valued at their fair value in accordance with applicable accounting standards. This is because it allows the reflection of the market value of the financial instruments, where there is one, but it also covers cases where there is no such market value readily available in the market, ensuring a consistent application of the measuring of the AUM and ASA.
- (3) Since the calibration of the CMH coefficient in Table 1 of Article 15 of Regulation (EU) 2019/2033 already takes into account the risk to customer associated with the management of that cash, the amounts included in the measuring of the CMH should not be included in the measuring of the AUM. Further, in order to avoid any double counting in the calculation of the capital requirements, the amounts already considered for the measuring of the CMH should not be included in the measuring of the ASA.

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<sup>17</sup> OJ L 314, 5.12.2019, p. 1.

- (4) The definition of CMH in Article 4(1)(28) of Regulation (EU) 2019/2033 together with recital 24 of that Regulation clarify the amounts to be considered for the measuring of CMH. Therefore, this Regulation should only further specify the remaining operational aspects of the method for measuring the CMH with the view to ensuring the robustness of the CMH figures, in particular by avoiding overreliance on external reporting and focusing on the investment firm's internal accounting records and figures used for the internal reconciliation.
- (5) The methods for measuring the amounts to be included as reception and transmission of orders and execution of orders in the COH should include specific rules for the case where market prices are not readily available because they are not contained in the orders. Such rules should reflect the differences between the case of execution of orders and the case of reception and transmission, as prices and timing at which the orders should be recorded for the measuring of COH may differ in each case. Further, in the case of reception and transmission, in particular, the transmitted orders are a better reference for the measuring than the received ones, as the received orders may fail to be transmitted.
- (6) Since an investment firm may provide the services referred to in points (7) and (8) of Annex I of Directive 2014/65/EU<sup>18</sup>, operating a MTF or an OTF as sole service or in addition to other services, rules specifying the methods for measuring the K-factors should ensure that an investment firm avoids to mistakenly count third party orders in the calculation of the K-factors, when acting in its capacity of operating a MTF or OTF, as these do not constitute services of execution of orders or services of reception and transmission.
- (7) Since the capital requirements for investment firms under Regulation (EU) 2019/2033 are based on the K-factors which cover all the services in Annex I of Directive 2014/65/EU, rules specifying the methods for measuring those K-factors should include rules adapting those methods in those cases where otherwise there could be double counting. This is the case, in particular, of certain ancillary services, which can be performed only in conjunction with the services referred to in Part A of Annex I of that Directive. Therefore, orders related to the ancillary service referred to in point (3) of section B of Annex I of Directive 2014/65/EU, which relate to advice on transactions between investors, in case of corporate finance or private equity transactions, should not be included in the measuring of the AUM, nor in that of the COH, as those K-factors already account for them.
- (8) Since Regulation (EU) 2019/2033 provides for two different coefficients for the measuring of COH in Table 1 of Article 15, one for cash trades and a separate one for derivatives, then further clarifications should be provided on how to allocate trades between the two classes of instruments and the valuation method to be used in each case. In particular, derivatives should be included in the measuring of K-factors based on the notional value and the cash trades at market value because the coefficients of the K-factors are calibrated on that basis.
- (9) As there are no rules in Regulation (EU) 2019/2033 specifying how the notional value of derivatives should be calculated for the purposes of measuring the DTF, rules specifying the methods for measuring the K-factors should include rules that set out that calculation. Given that Article 29(3) of Regulation (EU) 2019/2033 provides rules on how to calculate

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<sup>18</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 OJ L 173, 12.6.2014, p. 349.

the notional value of derivatives for the purposes of the calculation of the TCD, and in order to ensure consistency in the measuring of the TCD and the DTF, the same rules for measuring the notional value of derivatives should apply also for the measuring of the TCD.

- (10) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the Commission.
- (11) EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010<sup>19</sup>. The European Banking Authority has also consulted the European Securities Markets Authority (ESMA) before submitting the draft technical standards on which this Regulation is based,

HAS ADOPTED THIS REGULATION:

## SECTION 1

### Methods for measuring the Rtc K-factors

#### *Article 1*

#### *Methods for measuring the Rtc K-factors in the case of investment services and activities conducted using tied agents*

For the purposes of measuring its Rtc K-factors in accordance with Article 16 of Regulation (EU) 2019/2033, an investment firm shall include within each of AUM, CMH, ASA and COH referred to in, respectively, Articles 17, 18, 19 and 20 of that Regulation, any amounts that relate to the investment services and activities of the investment firm, carried out by any tied agents registered to act on its behalf.

#### *Article 2*

#### *Methods for measuring the AUM in cases of non-discretionary advisory arrangements of an on-going nature*

1. For the purpose of measuring its Rtc K-factors in accordance with Article 16 of Regulation (EU) 2019/2033, an investment firm shall not include within its AUM referred to in Article 17 of that Regulation any amounts of assets that relate to the advisory activities referred to in paragraph 3 of section B of Annex I to Directive 2014/65/EU.
2. Where an investment firm is providing non-discretionary advisory arrangements of an on-going nature to another financial entity that undertakes discretionary portfolio management, it shall include within its AUM referred to in Article 17 of Regulation (EU) 2019/2033 any amounts of assets that relate to those non-discretionary advisory arrangements.

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<sup>19</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

### *Article 3*

#### *Methods for measuring the AUM in case of discretionary portfolio management*

For the purpose of Article 17 of Regulation (EU) 2019/2033, the measurement of total monthly assets under management shall be made in accordance with all of the following:

- (a) the calculation shall include the value of financial instruments calculated at fair value in accordance with the applicable accounting standards;
- (b) financial instruments with a negative fair value shall be included in absolute value;
- (c) the calculation shall include cash except any amounts covered under CMH in accordance with Article 4.

### *Article 4*

#### *Methods for measuring CMH*

For the purposes of Article 18 of Regulation (EU) 2019/2033, the measurement of CMH shall be made in accordance with both of the following:

- (a) it shall be based on balances that the investment firm would use for its internal reconciliations;
- (b) it shall use the values contained in the investment firm's accounting records.

### *Article 5*

#### *Methods for measuring ASA*

For the purpose of Article 19 of Regulation (EU) 2019/2033, the measurement of total daily ASA shall be made on accordance with both of the following:

- (a) the calculation shall include the value of all client financial instruments safeguarded and administered, calculated at fair value in accordance with the applicable accounting standards;
- (b) the calculation shall exclude CMH referred to in Article 4

### *Article 6*

#### *Methods for measuring the execution of orders in COH*

1. For the purposes of calculating K-COH in accordance with Article 20 of Regulation (EU) 2019/2033 an investment firm shall include in the calculation of COH such an order from a client at the point at which it has confirmation that the execution has taken place and the price is known.
2. Where an investment firm executes client orders in the name of the client that are received from another investment firm, the executing investment firm shall calculate COH in accordance with both of the following:
  - (a) it shall include such orders within its total of orders measured for the purposes of execution of client orders;
  - (b) it shall exclude such orders from its total of orders measured for the purposes of reception and transmission of orders.

### *Article 7*

#### *Methods for measuring the reception and transmission of orders in the COH*

1. For the purposes of calculating K-COH in accordance with Article 20 of Regulation (EU) 2019/2033 where an investment firm is receiving and transmitting a client order, such an order shall be included at the point at which the investment firm transmits the order to another investment firm or executing broker.
2. An investment firm shall not include orders received or transmitted in the measurement of COH where it is bringing together two or more investors to bring about a transaction between those investors, such as in case of corporate finance or private equity transactions.
3. An investment firm shall include in the measurement of COH orders received and transmitted using the price contained in the orders. Where no price is contained in the orders, including where these are limit orders, the investment firm shall use the market price of the financial instrument at the day of transmission.
4. Third party buying and selling interests which come about due to the operation of a 'multilateral trading facility' or of an 'organised trading facility' as defined in points (22) and (23) respectively of paragraph 1 of Article 4 of Directive 2014/65/EU shall not be included in the measurement of COH.

### *Article 8*

#### *Methods for measuring cash trades for the purpose of COH*

1. For the purposes of measuring COH under Article 20 of Regulation (EU) 2019/2033 an investment firm shall include as cash trades any transactions where a counterparty undertakes to receive or deliver any of the following:
  - (a) transferable securities;
  - (b) money-market instruments;
  - (c) units in collective investment undertakings;
  - (d) exchange traded options.
2. Where the transferable security is an exchange traded option as referred to in paragraph 1(d), the investment firm shall use the option premium used for the execution of that exchange traded option.

### *Article 9*

#### *Methods for measuring derivatives for the purpose of COH*

For the purposes of measuring COH under Article 20 of Regulation (EU) 2019/2033 regarding derivatives, the notional amount of a derivative contract shall be determined according to the provisions of Article 29(3) of that Regulation.

## SECTION 2

### Measuring K-RtF

#### *Article 10*

##### *Methods for measuring cash trades for the purpose of DTF*

1. For the purposes of measuring DTF under Article 33 of Regulation (EU) 2019/2033 regarding cash trades, an investment firm shall include as cash trade any transaction where a counterparty undertakes to receive or deliver any of the following:
  - (a) transferable securities;
  - (b) money-market instruments;
  - (c) units in collective investment undertakings;
  - (d) exchange traded options.
2. Where the transferable security is an exchange-traded option referred to in paragraph 1(a), the investment firm shall use the options premium used for the execution of that exchange traded option.

#### *Article 11*

##### *Methods for measuring derivatives for the purpose of DTF*

For the purposes of measuring DTF under Article 33 of Regulation (EU) 2019/2033 regarding derivatives, the notional amount of a derivative contract shall be determined according to the provisions of Article 29(3) of that Regulation.

#### *Article 12*

##### *Entry into force*

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission*  
*The President*

*For the Commission*  
*On behalf of the President*

*[Position]*

**Question for public consultation**

**Question 1. Is the proposed articulation of the K-factors calculation methods, in particular between AUM and CMH and ASA, exhaustive or should any other element be considered?**



## 8. Draft RTS on the definition of segregated account (Article 15(5) point b) of the IFR)

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## COMMISSION DELEGATED REGULATION (EU) No .../..

of **XXX**

[...]

### **supplementing Regulation (EU) 2019/2033 of the European Parliament and of the Council with regard to regulatory technical standard to specify the notion of segregated accounts for the purposes of that regulation**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,  
Having regard to Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014<sup>20</sup>, and in particular subparagraph three of Article 15(5) and connection with point (b) of Article 15(5) thereof,  
Whereas:

- (1) Segregated accounts are defined in point (49) of Article 4 of Regulation (EU) 2019/2033 for the purposes of Table 1 in Article 15(2) of that Regulation, where reference is made to client money being deposited in accordance with Article 4 of Commission Delegated Directive (EU) 2017/593<sup>21</sup>. That Commission Delegated Directive aims at the protection of client money by specifying organisational requirements for investment firms. In particular, Article 2(1) of that Directive establishes requirements which relate to the concept of segregated accounts. Given the notion of segregated accounts referred to in point (b) of Article 15(5) of Regulation (EU) 2019/2033 has the same objective of protection of client money the organisational requirements referred to above should be met in the context of prudential requirements. Therefore, this Regulation should establish a subset of the same requirements as in the Commission Delegated Directive which are relevant for the notion of segregation.

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<sup>20</sup> OJ.....

<sup>21</sup> Commission Delegated Directive (EU) 2017/593 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits

- (2) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the Commission.
- (3) EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010<sup>22</sup>.

HAS ADOPTED THIS REGULATION:

*Article 1*

*Notion of segregated accounts for the purposes of point (b) of paragraph 5 of Article 15 of Regulation (EU) 2019/2033*

For the conditions that ensure the protection of client money in the event of failure of an investment firm, the notion of segregated accounts shall mean that the investment firm shall meet all of the following requirements:

- (a) keep records and accounts enabling them at any time and without delay to distinguish assets held for one client from assets held for any other client and from their own assets;
- (b) maintain their records and accounts in a way that ensures their accuracy, and in particular their correspondence to the funds held for clients and that they may be used as an audit trail;
- (c) conduct, on a regular basis, reconciliations between their internal accounts and records and those of any third parties by whom those assets are held;
- (d) take the necessary steps to ensure that client funds deposited are held in an account or accounts identified separately from any accounts used to hold funds belonging to the investment firm;
- (e) introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client assets, or of rights in connection with those assets, as a result of mis-use of the assets, fraud, poor administration, inadequate record-keeping or negligence.

**Question for public consultation**

**Question 2. Are the requirements for notion of segregated accounts sufficient? Are there issues on segregated accounts which need to be elaborated further?**

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<sup>22</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

*Article 2*

*Entry into force*

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission*  
*The President*

*For the Commission*  
*On behalf of the President*

*[Position]*

## 9. Draft RTS to specify adjustments to the K-DTF coefficients (Article 15(5) point c) of the IFR)

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**COMMISSION DELEGATED REGULATION (EU) No .../..****of XXX**

[...]

**supplementing Regulation (EU) 2019/2033 of the European Parliament and of the Council with regard to regulatory technical standard to specify adjustments to the coefficients for the daily trading flow (K-DTF)**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,  
Having regard to Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014]<sup>23</sup>, and in particular point (c) of Article 15(5) thereof,  
Whereas:

- (1) Given that the daily trading flow (DTF) is calculated based on the volume of transactions, the constraints that the default capital requirement for investment firms trading on own account, including market makers, bears the risk of a reduction on trading activities, leading to a risk of less market liquidity, with potential detriments to financial stability. Consequently, where circumstances lead to extreme volatility, the K-DTF coefficients should be adjusted in a way which incentivises trading activities. Where circumstances lead to lower volatility those consideration do not apply. Therefore, for the purposes of this Regulation the adjustments to the K-DTF coefficient should be calculated on the basis of the volumes of trades during circumstances that lead to extreme volatility.
- (2) If a situation of extreme volatility occurs, the coefficient referred to in Article 15 of Regulation Regulation (EU) 2019/2033 should be adjusted smaller than the one provided in Table 1 of the same article, in order for the K-DTF not to become a disincentive to trading.
- (3) For the reasons that stressed market conditions may last for an indeterminate period of time, including intra-day and even for as short a period as a matter of minutes, the adjustments to the coefficients shall be capable of reflecting the value of daily trading flow that takes place during each of these periods of different duration.

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<sup>23</sup> OJ.....

- (4) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the Commission.
- (5) EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010<sup>24</sup>,

HAS ADOPTED THIS REGULATION:

*Article 1*

*Adjustments to the K-DTF coefficients*

1. The adjustments to the K-DTF coefficients referred to in Table 1 of paragraph 2 of Article 15 of Regulation (EU) No 2019/2033 in the event, that in stressed market condition as referred to in Commission Delegated Regulation (EU) 2017/578<sup>25</sup> the K-DTF requirements seem overly restrictive and detrimental to financial stability as referred to in point c) of Article 15(5), shall be determined with the following formula:

- (a) for the coefficient of the K-DTF cash trades:

$$C_{adj} = C * (DTF_{excl} / DTF_{incl})$$

where:

$C_{adj}$  = adjusted coefficient

$C$  = coefficient in Table 1 of paragraph 2 of Article 15 of Regulation (EU) No 2019/2033

$DTF_{excl}$  = the daily trading flow (DTF) of derivatives measured in accordance with Article 33 of Regulation (EU) 2019/2033, excluding the value of any trade that occurred during periods of extreme volatility as set out in Article 2; and

$DTF_{incl}$  = the DTF of derivatives measured in accordance with Article 33 of Regulation (EU) 2019/2033, including the value of any cash trade that occurs during periods of exceptional circumstances as set out in Article 2.

- (b) for the coefficient of the K-DTF derivatives:

$$C_{adj} = C * (DTF_{excl} / DTF_{incl})$$

where:

$C_{adj}$  = adjusted coefficient

<sup>24</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

<sup>25</sup> Commission Delegated Regulation (EU) 2017/578 of 13 June 2016 supplementing Directive 2014/65/EU of the 13 June 2016, (OJ L 87, 31.3.2017, p.183).

C = coefficient in Table 1 of paragraph 2 of Article 15 of Regulation (EU) No 2019/2033

DTFexcl = the daily trading flow (DTF) of derivatives measured in accordance with Article 33 of Regulation (EU) 2019/2033, excluding the value of any trading that occurred during periods of extreme volatility as set out in Article 2; and

DTFincl = the total value of daily trading flow, DTF, of derivatives measured in accordance with Article 33 of Regulation (EU) 2019/2033, including the value of any trading cash trade that occurs during periods of exceptional circumstances as set out in Article 2.

2. The calculation of DTFexcl shall include only the value of daily trading flow that relates to financial instruments or underlyings of financial instruments traded on a trading segment within the relevant trading venue during a period for which the exceptional circumstances have been deemed to occur by that trading venue.

### *Article 2*

#### *Period of extreme volatility*

For the purposes of Article 1, periods of extreme volatility shall be those situations referred to in point (a) Article 3 of Commission Delegated Regulation (EU) 2017/578. Their start and end times shall reflect precisely the times when the trading venue made public the occurrence of such an exceptional circumstance under point (a) of Article 3 of Commission Delegated Regulation (EU) 2017/578 and the resumption of normal trading in accordance with Article 4 of that Regulation.

#### **Question for public consultation**

**Question 3. Is there any example of situations of market stress which would not be taken into account applying the proposed approach but would be relevant for the measurement of the K-DTF?**

### *Article 3*

#### *Entry into force*

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission*  
*The President*





*For the Commission  
On behalf of the President*

*[Position]*

## 10. Draft RTS to specify the calculation of the amount of the total margin for the calculation of K-CMG (Article 23(3) of the IFR)

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**COMMISSION DELEGATED REGULATION (EU) No .../..****of XXX**

[...]

**supplementing Regulation (EU) 2019/2033 of the European Parliament and of the Council with regard to regulatory technical standards for specifying the calculation of K-CMG**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,  
Having regard to Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014<sup>26</sup>, and in particular the third subparagraph of Article 23(3) thereof,  
Whereas:

- (1) For the purposes of specifying the calculation of the amount of the ‘total margin required’, referred to in Article 23(2) of Regulation (EU) 2019/2033, and in order to increase clarity and consistency in relation to its components, this Regulation should clarify that the amount of the total margin required includes any collateral in the collateral account required by the clearing member in accordance with its margin model.
- (2) In accordance with Article 23(2) of Regulation (EU) 2019/2033 total margin required on a daily basis is required for the calculation of the K-CMG. Clearing members may adapt their margin requirements within one day, e.g. during stressed market conditions, which would result in more than one margin requirement on one day. In order to avoid uncertainty about, which of those margin requirement to use and considering that for the calculation of the K-CMG the third highest amount during a period of three months is sought, this Regulation should specify that the daily amount of margins required should be the highest margin requirement of a given day.
- (3) Investment firms may use the clearing services of multiple clearing members. For cases where an investment firm uses K-CMG for positions that are subject to clearing by multiple clearing members, this Regulation should clarify that K-CMG should be calculated as the sum of the margins required by the individual clearing members. An investment firms should, therefore, first calculate the third highest daily amount of margin required by each clearing member, and then add those amounts to obtain the sum for all

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<sup>26</sup> OJ C 314, 5.12.2019, p. 1.

clearing members. Consequently, the calculation of K-CMG, in relation to the calculation of the amount of the total margin required, may be based on different reference dates in relation to different clearing members.

- (4) The application of the K-CMG on a portfolio basis, where the whole portfolio is subject to clearing or margining, is conditional to the criteria referred to in of Article 23(1) of Regulation (EU) No 2019/2033. Therefore, a portfolio of cleared positions assigned to one trading desk can make use of K-CMG while, at the same time, a portfolio of cleared positions assigned to another trading desk can make use of K-NPR. In order to prevent arbitrage, the use of K-CMG and K-NPR across trading desks should be consistent. Therefore, the same approach should be used for trading desks that are similar in terms of business strategy and trading book positions.
- (5) In relation to the conditions for the fulfilment of the provision that the choice for K-CMG has not been made with a view to engage in regulatory arbitrage of the own funds requirements in a disproportionate or prudentially unsound manner, this Regulation should prescribe that the competent authority assesses that an investment firm applies the K-CMG approach only if it is an appropriate methodology that reflects the nature of its trading book positions. It should also be required that the investment firm compares regularly its own risk assessment with the margins required by clearing members, for the purpose of assessing whether the margins required by the clearing members are still a good indicator of the level of risk to market of the investment firm. At the point of assessment by the competent authority, the investment firm should make a comparison between the capital requirements under K-NPR and K-CMG and should be able to adequately justify the difference between these capital requirements to its competent authority. When the trading desk is changing, e.g. because of a change in trading strategy, the difference between the capital requirements under K-NPR and K-CMG should also be justified by the investment firm.
- (6) A high frequency in switching between the use of K-NPR and K-CMG is a strong indicator for potential disproportionate or unsound use of own funds requirements. It is possible to prevent regulatory arbitrage by constraining the frequency of switching positions between the use of K-NPR and K-CMG. A requirement to make continuous use of one of the two methods for a trading desk for at least two years would be proportionate to address the risk of regulatory arbitrage. However, in exceptional circumstances (e.g. a business restructuring), the competent authority should allow an investment firm to change methods within this two year period.
- (7) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the Commission.
- (8) EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010<sup>27</sup>.

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<sup>27</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

HAS ADOPTED THIS REGULATION:

*Article 1*

*Definitions*

For the purposes of this Regulation, the following definition applies:

1. 'trading desk' means a well-identified group of dealers set up by the institution to jointly manage one or more portfolio(s) of trading book positions in accordance with a well-defined and consistent business strategy and operating under the same risk management structure.

*Article 2*

*Calculation of the amount of the total margin required*

1. The amount of the total margin referred to in Article 23(2) of Regulation (EU) 2019/2033 shall be the required amount of collateral in the collateral account comprising the initial margin, variation margins and other financial collateral, as required by the clearing member's margin model from the investment firm.
2. Fees paid by the investment firm to the clearing member for making use of its clearing member services shall not be considered as margins under paragraph 1.
3. Where the clearing member updates the total margin required once or more than once during a day, the total margin required on that day shall be highest of those amounts of total margins required by the clearing member during that day.

*Article 3*

*Method of calculation of K-CMG in case of multiple clearing members*

For the purposes of calculating the K-CMG as referred to in Article 23(2) of Regulation (EU) 2019/2033, where an investment firm makes use of the services of more than one clearing member, the investment firm shall calculate the K-CMG by first determining the third highest amount of total margins required on a daily basis by each clearing member separately over the preceding three months, then adding those amounts and multiplying the outcome by 1.3.

*Article 4*

*Prevention of arbitrage*

1. The conditions in point (e) of Article 23(1) of Regulation (EU) No 2019/2033 shall be deemed to be met, where the competent authority has positively assessed that all of the the following criteria are met:
  - (a) where the investment firm calculates K-CMG capital requirements on a portfolio of cleared positions assigned to one trading desk, it applies the same methodology to all the positions of that trading desk;
  - (b) the investment firm uses the K-CMG consistently across trading desks that are similar in terms of business strategy and trading book positions;
  - (c) the investment firm has policies and procedures in place showing that the choice of portfolio(s) subject to K-CMG would be appropriately reflecting the risks of an

- investment firm's trading book positions, including the expected holding periods, the trading strategies applied and the time it could take to hedge out or manage risks of its trading book positions;
- (d) the investment firm makes use of the outcome of the K-CMG calculation in its risk management framework and regularly compares the results of its own risk assessment to the margins required by clearing members;
  - (e) the investment firm has compared the capital requirements calculated by K-CMG with the capital requirements calculated by K-NPR for each trading desk at the point of the assessment by the competent authority, and the difference is justified taking into account the factors set out in paragraph 3.
2. For the purposes of point (a) and (b) of paragraph 1, the competent authority shall ascertain that the following conditions are met:
- (a) the investment firm uses the K-CMG calculation for a portfolio of positions assigned to a trading desk for a continuous period of at least 24 months or, the the business strategy or operations of that group of dealers has changed to the extent that they can be considered a different trading desk;
  - (b) the investment firm compares the capital requirements calculated in application of the K-CMG with the capital requirements calculated in application of the K-NPR in each of the following cases and the difference between them is justified taking into account the factors set out in paragraph 3:
    - i) the business strategy of a trading desk changes, leading to a change of 20 % or more of the capital requirements for that trading desk based on K-CMG approach;
    - ii) the clearing member's margin model changes, resulting in a change in the margins required of 10% or more for the same portfolio of underlying positions for a trading desk.

**Question for public consultation**

**Question 4. What would be appropriate thresholds or events that should trigger the comparison between the calculation under the K-CMG compared to the one under the K-NPR?**

**Question 5. Which other conditions should be considered to avoid double counting or to prevent regulatory arbitrage in the use of the K-CMG approach?**

3. For the purposes of point (b) paragraph 2 and point (e) of paragraph 1, the competent authority shall take into account the following factors in order to assess whether the difference in capital requirements calculated in application of the K-CMG and of the K-NPR is justified:
- (a) the reference to the relevant trading strategies,
  - (b) the firm's own risk management framework,
  - (c) the level of the firm's overall own funds requirements calculated in accordance with Article 11 of Regulation (EU) No 2019/2033,
  - (d) the results of the supervisory review and evaluation process, if available, and

(e) the level of surplus own funds held by the investment firm.

*Article 5*

*Entry into force*

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission*  
*The President*

*For the Commission*  
*On behalf of the President*

*[Position]*

## 11. Draft RTS on the criteria for subjecting certain investment firms to the CRR (Article 5 (6) of the IFD)

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**COMMISSION DELEGATED REGULATION (EU) No .../..****of XXX**

[...]

**supplementing Directive (EU) 2019/2034 of the European Parliament and of the Council with regard to regulatory technical standards to further specify criteria for the discretion of competent authorities to subject certain investment firms to the requirements of Regulation (EU) No 575/2013.**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,  
Having regard to Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU<sup>28</sup>, and in particular Article 5(6) thereof,  
Whereas:

- (1) Some investment firms present comparable risks to financial stability as credit institutions. In accordance with Article 5 of Directive (EU) 2019/2034, competent authorities have the option of requiring such investment firms to remain subject to the same prudential treatment as credit institutions that fall within the scope of Regulation (EU) No 575/2013 and to comply with prudential supervision under Directive 2013/36/EU.
- (2) Certain criteria that, in accordance with Directive (EU) 2019/2034, shall be taken into account by competent authorities when exercising the discretion that an investment firm should remain within the scope of Regulation (EU) No 575/2013 and Directive 2013/36/EU, should be further specified in this Regulation.
- (3) In particular, with reference to point (a) of paragraph 1 of Article 5 of Directive (EU) 2019/2034, it should be specified that if an investment firm carries out activities exceeding at least one out of four quantitative thresholds for OTC derivatives, financial instruments underwriting and/or placing of financial instruments on a firm commitment basis, granted credits or loans to investors, as well as debt securities

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<sup>28</sup> OJ L 314, 5.12.2019, p. 64–114

outstanding, those activities are carried out on such a scale that the failure or the distress of the investment firm could lead to systemic risk.

- (4) Furthermore, by reference to point (b) of paragraph 1 of Article 5 of Directive (EU) 2019/2034, cognisant of the overall theme of systemic risk in Article 5 and aware of the potential significant impact of a contagion effect across the financial sector, it should be further specified that an investment firm that is a clearing member as defined in point (3) of Article 4(1) of Regulation (EU) 2019/2033 shall be taken into account by competent authorities, when exercising the discretion that that firm should remain within the scope of Regulation (EU) No 575/2013 and Directive 2013/36/EU, if that firm is providing clearing member services to other financial institutions, which are not clearing member themselves.
- (5) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the Commission.
- (6) EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010<sup>29</sup>.

HAS ADOPTED THIS REGULATION:

#### *Article 1*

##### *Scale of activities*

For the purposes of point (a) of paragraph 1 of Article 5 of Directive (EU) 2019/2034, the activities of an investment firm shall be considered on such a scale that the failure or distress of the investment firm could lead to systemic risk where the investment firm exceeds any of the following thresholds:

- (a) total gross notional value of non-centrally cleared OTC derivatives of EUR 50 billion;
- (b) total value of financial instruments underwriting and/or placing of financial instruments on a firm commitment basis of EUR 5 billion;
- (c) total value of granted credits or loans to investors to allow them to carry out transactions of EUR 5 billion; and
- (d) total value of debt securities outstanding of EUR 5 billion.

#### *Article 2*

##### *Clearing member*

For the purposes of point (b) of paragraph 1 of Article 5 of Directive (EU) 2019/2034, an investment firm which is a clearing member as defined in point (3) of Article 4(1) of Regulation (EU) 2019/2033 shall be taken into account by competent authorities when

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<sup>29</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

exercising the discretion that that firm should remain within the scope of Regulation (EU) No 575/2013 and Directive 2013/36/EU, where the investment firm offers its clearing services to other financial sector entities which are not clearing members themselves.

*Article 3*

*Entry into force*

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission*  
*The President*

*For the Commission*  
*On behalf of the President*

*[Position]*

## 12. Draft RTS on prudential consolidation of investment firms groups (Article 7(5) of the IFR)

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**COMMISSION DELEGATED REGULATION (EU) No .../..**

**of XXX**

[...]

**supplementing Regulation (EU) No 2019/2033 of the European Parliament and of the Council with regard to regulatory technical standards on prudential consolidation of an investment firm group.**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,  
Having regard to Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on prudential requirements for investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014, and in particular Article 7(5) thereof,

Whereas:

- (1) The consolidated application of prudential requirements in accordance with Article 7 of Regulation (EU) No 2019/2033 is carried out solely at the highest level of the group within the Union, without sub-consolidation at lower levels of that group as is the case for banking groups in accordance with Part One, Title II, Chapter 2 of Regulation (EU) No 575/2013. Further, in the case of an investment firm group, the undertaking subject to the requirement to consolidate might, where it is an investment holding or a mixed financial holding company, be itself a non-supervised entity.
- (2) Despite these differences, there is a need to ensure consistency, both as regards the scope and as regards the methods of consolidation, where this is appropriate and proportional, taking into account the different characteristics of these groups.
- (3) The need to ensure consistency, to the extent appropriate, between the scope and methods of prudential consolidation in banking and investment firm groups is further reinforced for a level playing field to be maintained taking into account that the prudential consolidation of investment firms that are part of banking groups are consolidated is performed in accordance with the relevant provisions of Regulation (EU) No 575/2013.
- (4) Therefore, scope and the methods of consolidation specified in this Regulation build on Article 18 of Regulation (EU) No 575/2013 with adjustments necessary for investment firm groups.

- (5) In order to set out the scope of prudential consolidation of an investment firm group, there is a need to determine the links on the basis of which investment firms, financial institutions, ancillary services undertakings and tied agents related to a particular investment firm, investment holding company or mixed financial holding company will be included in that scope.
- (6) There is, therefore, a need to specify that, where an investment firm, an investment holding company or a mixed financial holding company (Union parent undertaking) is related to another investment firm, financial institution, ancillary services provider or tied agent (group undertaking), either as a parent undertaking or within the meaning of Article 22(7) of Directive 2013/34/EU that group undertaking comes under the scope of prudential consolidation.
- (7) Where two undertakings are related within the meaning of Article 22(7) of Directive 2013/34/EU, there is a need to determine the undertaking that should perform the consolidation (Union parent undertaking). Where a group comprises only one investment firm, then that firm should be the Union parent undertaking while in cases of more than one investment firms within an investment firm group, there is a need to set out which firm should be subject to requirement to prudentially consolidation (Union parent undertaking).
- (8) Ancillary services undertakings are undertakings, the principal activity of which consists of owning or managing property, managing data-processing services, or a similar activity, which is ancillary to the principal activity of one or more investment firms. Tied agents are natural or legal persons who, under the full and unconditional responsibility of only one investment firm on whose behalf they act, promote investment and/or ancillary services to clients or prospective clients, receive and transmits instructions or orders from the client in respect of investment services or financial instruments, place financial instruments or provide advice to clients or prospective clients in respect of those financial instruments or services. Having regard to the functional links between these undertakings and investment firms, there is a need to ensure that ancillary services undertakings and tied agents but also other financial institutions and investment firms will be included in the scope of consolidation of the Union parent undertaking, where it is established that the Union parent undertaking exercises over these other undertakings (group undertakings) significant influence even without participation or capital ties.
- (9) The functional relation between ancillary services undertakings, tied agents, other financial institutions and investment firms necessitates that where these undertakings have been placed under single management with means other than pursuant to a contract, clauses in memoranda or articles of association with a Union parent undertaking, they are also included in the scope of prudential consolidation.
- (10) There is also a need to ensure that where a Union parent undertaking has participation to or other capital ties with another investment firm, financial institution, ancillary services provider or tied agent that is, neither the subsidiary of that investment firm, investment holding company or mixed financial holding company, nor related to it within the meaning of Article 22(7) of Directive 2013/34/EU or with significant influence or single management links, still that group undertaking will come under the scope of prudential consolidation of the Union parent undertaking, where certain conditions are met.

- (11) To ensure effective application of the prudential requirements at the consolidated level, to prevent the arbitrage on Fixed Overheads Requirement (FOR) calculations that could occur by means of booking overheads in an ancillary services provider or another groups undertaking rather than in the investment firm itself, and to avoid double counting, full consolidation of all group undertakings included within the scope of consolidation should be applied as a general rule. In the absence of capital participation of the Union parent undertaking to the group undertaking within the consolidation method, full consolidation should be applied by means of the aggregation method set out in paragraph 9 of Article 22 of Directive 2013/34/EU.
- (12) The group supervisor should, however, be empowered to permit or require the use of a method other than full consolidation where full consolidation would not be appropriate for that particular investment firm group, taking into account the investment firms concerned and the importance of their activities in the relevant Member States. For this assessment to be made in a harmonized manner across the Union, there is a need to set out the key elements that the group supervisor should have regard to, when determining whether full consolidation is the appropriate method while it should also be specified that full consolidation should be applied where there are indicators that the Union parent undertaking is motivated to provide or has already provided financial assistance to the group undertaking (step-in risk).
- (13) Where the group supervisor considers that full consolidation is not appropriate, it can require or permit any other method of consolidation apart from the equity method, under which the Union parent undertaking reports its proportionate share of the equity of the group undertaking as an investment (at cost) while the profit and the loss from that undertaking increases the investment by an amount proportionate to the share that the Union parent undertaking holds in the group undertaking. The equity method should not be applied to an investment firm group, whose prudential consolidation should not be based on a 'balance sheet' approach. Under a 'balance sheet' approach, neither K-factors, FOR or permanent minimum requirement are used for determining own funds requirements. The profit and loss from the group undertaking to which the equity method would apply would not directly influence the requirements of K-factors, FOR or permanent minimum when treating the group as if it was a single investment firm.
- (14) There is a need to set out the conditions under which the group supervisor may permit or require proportional consolidation according to the share of capital held of participations in group undertakings, which are managed by a Union parent undertaking together with one or more undertakings not included in the consolidation (participating undertakings). The conditions of such proportional consolidation should be in line with the relevant conditions set out for banking groups in accordance with Article 18 of Regulation (EU) No 575/2013 and should also reflect IFRS 11 to the extent appropriate.
- (15) Proportional consolidation should be possible only where the liability of the Union parent undertaking is limited to the share of the capital it holds in the group undertaking, the other participating undertakings are financial sector entities subject to prudential supervision, the solvency of these participating undertakings is satisfactory and can be reasonably expected to remain so and the liability of the Union parent undertaking and the other participating undertakings has been established by

means of a legally binding and enforceable contract between that Union parent undertaking and all the other participating undertakings.

- (16) To ensure harmonisation across the Union, there is a need to set out common conditions that such contract should include and to also specify that the Union parent undertaking is obliged to submit without undue delay to the group supervisor, not only the contract, but also all necessary documents for the assessment of the participating undertakings' regulatory status, financial condition and solvency.
- (17) When calculating the K-DTF on a consolidated basis and in line with Article 24 of Regulation (EU) No 2019/2033, intragroup purchases and sales (trades) should be removed from the calculation. This is necessary to account for the fact that the daily trading flow (DTF) measured for calculating the K-DTF, being the sum of the absolute value of purchases and sales, does not prevent double counting of intragroup trading flows when aggregating DTF values of a group.
- (18) When a class 3 investment firm is part of an investment firm group falling under class 2, the Union parent undertaking of that group has to calculate K-factors based on the individual K-factors of the group undertakings included in the scope of consolidation. The class 3 IF shall therefore calculate K-factors in this case.
- (19) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (20) EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010].

HAS ADOPTED THIS REGULATION:

## **Chapter 1**

### **Definitions, scope and method of consolidation**

#### *Article 1*

#### *Definitions*

For the purposes of this Regulation, the following definitions shall apply:

1. "Union parent undertaking" means the Union parent investment firm, the Union parent investment holding company or the Union parent mixed financial holding company.
2. 'Capital ties' means the ownership, direct or indirect, of voting rights or capital of an undertaking.
3. "Group undertaking" means a subsidiary of the Union parent undertaking or an undertaking related to the Union parent undertaking in accordance with Articles 2 to 5.

#### *Article 2*

#### *Undertakings related within the meaning of Article 22(7) of Directive 2013/34/EU*

1. Where an investment firm, an investment holding company, a mixed financial holding company, any other financial institution, an ancillary services provider or a tied agent



are related with one another within the meaning of Article 22(7) of Directive 2013/34/EU and there is only one investment firm among these group undertakings, that investment firm shall be regarded as the Union parent undertaking of that investment firm group.

2. Where among the group undertakings referred to in the previous paragraph there are more than one investment firms authorized in the same or in different Member States, the investment firm with the largest balance sheet total shall be regarded as the Union parent undertaking of that investment firm group.
3. Competent authorities may, by common agreement, waive the criterion referred to in paragraph 2, where its application would not be appropriate for that particular investment firm group, taking into account the investment firms concerned and the importance of their activities in the relevant Member States and designate another group undertaking as the Union parent undertaking.

#### **Explanatory box for the consultation**

This article clarifies which entity should be responsible for the consolidation within the group in the absence of a parent-subsidiary relationship pursuant to Article 22(7). This is necessary to determine which entity is in charge of the consolidated reporting and compliance with the consolidated requirements.

This entity is responsible for the compliance with the obligations laid down in Parts Two, Three, Four, Six and Seven of Regulation (EU) 2019/2033 on the basis of the consolidated situation of the group, and is treated as a parent institution. In addition, the consolidating entity and other undertakings included in the scope of consolidation are subject to the requirements on the basis of their individual financial situation.

### *Article 3*

#### *Significant influence without participation or capital ties*

1. Where an investment firm, an investment holding company or a mixed financial holding company exercises significant influence over another investment firm, financial institution, ancillary services provider or tied agent that is, neither a subsidiary of that investment firm, investment holding company or mixed financial holding company nor related to it within the meaning of Article 22(7) of Directive 2013/34/EU, that investment firm, investment holding company or mixed financial holding company shall be regarded as the Union parent undertaking of that investment firm group.
2. The following circumstances shall be deemed as indicators that significant influence may be exercised:
  - (a) Appointment or ability to appoint a representative in the management body, either in the executive or in the supervisory function, of the group undertaking;
  - (b) Participation in the policy-making processes of the group undertaking, including participation in decisions about dividends and other distributions;
  - (c) Existence of material transactions between the two undertakings;
  - (d) Interchange of managerial personnel between the two undertakings;

- (e) Provision of essential technical information or critical services from one undertaking to the other;
- (f) Enjoyment of additional rights in the group undertaking, by virtue of a contract or of a provision in the articles of association or other constitutional documents of that other undertaking, that could affect the management or the decision-making of that undertaking.
- (g) The existence of share warrants, share call options, debt instruments that are convertible into ordinary shares or other similar instruments that are currently exercisable or convertible and have the potential, if exercised or converted, to give the Union parent investment firm voting power or to reduce another party's voting power over the financial and operating policies of the group undertaking.

#### **Explanatory box for the consultation**

According to IAS 28 *Investments in Associates and Joint Ventures*, "significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies". In addition, IAS 28.5 states that "If an entity holds, directly or indirectly (e.g. through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the entity holds, directly or indirectly (e.g. through subsidiaries), less than 20 per cent of the voting power of the investee, it is presumed that the entity does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence."

The definition of significant influence in absence of participations or capital ties given in these draft RTS is guided by the definition of significant influence included in IAS 28.

#### *Article 4*

##### *Single management other than pursuant to a contract, clauses in memoranda or articles of association*

1. Where an investment firm, an investment holding company or a mixed financial holding company has been placed under single management, other than pursuant to a contract, clauses of memoranda or articles of association, with another investment firm, financial institution, ancillary services provider or tied agent (group undertaking) that is, neither the subsidiary of that investment firm, investment holding company or mixed financial holding company, nor related to it within the meaning of Article 22(7) of Directive 2013/34/EU or of Article 3, that investment firm, investment holding company or mixed financial holding company shall be regarded as the Union parent undertaking of that investment firm group.
2. The following circumstances shall be deemed as indicators that the situation referred to in the previous paragraphs may exist:
  - (a) two or more group undertakings are controlled by the same natural person; or by the same group of natural persons; or by an entity or the same group of entities that do

not otherwise belong to that investment firm group; or by an entity or the same group of entities that are not established in a Member State.

- (b) the majority of the management body, either in its executive or in its supervisory function of two or more group undertakings is composed of people appointed by the same entity or entities, by the same natural person or by the same group of natural persons, even if they do not necessarily consist of the same people.
- (c) In any case, the occurrence of a situation in which two or more group undertakings are placed under single management shall be based on a case-by-case assessment by the competent authorities, aimed at verifying that in practice there is effective coordination of the financial and operating policies of the abovementioned group undertakings.

#### *Article 5*

##### *Participations or capital ties other than those referred to in Articles 2 to 4*

1. Where an investment firm, an investment holding company or a mixed financial holding company has participation to or other capital ties with another investment firm, financial institution, ancillary services provider or tied agent that is, neither the subsidiary of that investment firm, investment holding company or mixed financial holding company, nor related to it within the meaning of Article 22(7) of Directive 2013/34/EU or of Articles 3 and 4, that investment firm, investment holding company or mixed financial holding company shall be regarded as the Union parent undertaking of that investment firm group.
2. For the purpose of establishing the existence of a participation or of a capital tie referred to in the previous paragraph, the overall ownership structure of the group undertaking shall be assessed, having regard in particular as to whether shares or participating interests and voting rights, including potential voting rights in accordance with Article 3(2)(g), are distributed across a large number of shareholders or whether the Union parent investment firm is the main investor.

#### *Article 6*

##### *Full consolidation*

1. The Union parent undertaking shall carry out a full consolidation of all investment firms, financial institutions, ancillary services providers and tied agents that are their subsidiaries, undertakings related within the meaning of Article 22(7) of Directive 2013/34/EU or group undertakings as set out in Articles 3 to 5.
2. For the purposes of the previous paragraph, the Union parent undertaking shall apply Article 22 (9) of Directive 2013/34/EU as appropriate.
3. Without prejudice to Article 7, the group supervisor may permit following a request from the Union parent undertaking, or require on its own initiative, the use of a method other than full consolidation where full consolidation would not be appropriate for that particular investment firm group, taking into account the investment firms concerned and the importance of their activities in the relevant Member States.

4. To make the assessment referred to in the previous paragraph, the group supervisor shall have regard to the following:
- (a) whether the Union parent undertaking acts as sponsor by managing or advising the group undertaking, placing the group undertaking's securities into the market, or providing liquidity and or credit enhancements to that undertaking, or to undertakings where the Union parent undertaking is an important investor in its debt or equity instrument, or where there is other contractual and non-contractual involvement exposing the Union parent undertaking to the risks or to equity-like returns from the assets of the group undertaking or related to its performance;
  - (b) whether the Union parent undertaking is effectively involved in the decision-making process of the group undertaking or exercises influence over that undertaking;
  - (c) whether the Union parent undertaking receives critical operational services from the group undertaking that cannot be replaced in a timely fashion without excessive cost;
  - (d) whether the credit rating of the group undertaking is based on the parent entity's own rating;
  - (e) whether specific features relating to the composition of the investor base of the undertaking exist, with particular reference to whether the other investors in the undertaking have a close commercial relationship with the Union parent undertaking, their ability to bear losses or their ability to dispose of their financial instruments;
  - (f) whether the group undertaking and the Union parent undertaking have a common customer base or are involved in the commercialisation of each other's products;
  - (g) whether the Union parent undertaking and the group undertaking have the same brand name;
  - (h) whether the Union parent undertaking has already provided financial support to the group undertaking in case of financial difficulties.

#### **Explanatory box for public consultation**

##### **Entities 'managed on a unified basis'**

Article 22(7) of Directive 2013/34/EC (Accounting Directive) refers to the case where:

- a) two or more undertakings which are not related, as described in paragraphs 1 or 2 of Article 22, are managed on a unified basis in accordance with a contract, or a memorandum or articles of association; or
- b) the administrative, management or supervisory bodies of two or more undertakings which are not related, as described in paragraphs 1 or 2 of Article 22, consist in the majority of the same persons in office during the financial year and until the consolidated financial statements are drawn up.

The situation of entities 'managed on a unified basis' in accordance with Article 22(7)(a) of Directive 2013/34/EC could happen, for instance, where the undertakings:

- a) are managed as a single unit;
- b) share a single interest;

- c) are fully owned, controlled and/or managed by the same natural person(s) (i.e. as the natural person is not included in the scope of prudential consolidation).

The situation of entities which are managed in major part by the same persons in office during the financial year and until the consolidated financial statements are drawn up in accordance with Article 22(7)(b) of Directive 2013/34/EC could happen, for instance, when the persons in office have executive functions giving them the ability to control and manage the affairs of these undertakings (e.g. Directors or members of the Board).

IFRS 3 Business Combinations does not specify a method to prepare consolidated financial statements where no parent-subsiary relation exists and different practices may exist

The following steps need to be followed for consolidating undertakings managed on a unified basis, or which the administrative, management or supervisory bodies of the undertakings consist in the majority of the same persons in office during the financial year and until the consolidated financial statements are drawn up:

- a) Application of uniform accounting policies;
- b) Aggregation of assets, liabilities, equity, income and expenses;
- c) Elimination of cross-holding participations (and the proportion which they represent of the capital and reserves of the undertaking according to the rules of the Accounting Directive), if any;
- d) Elimination of assets and liabilities, profit and losses, income and expenses related to intragroup transactions.

**Example of the use of the aggregation method**

The aggregation method is proposed to be used as the method of prudential consolidation of undertakings managed on a unified basis or by the same persons as in these cases, no parent-subsiary relationship exists.

The aggregation method is applied on the three components of the own funds requirements of the individual undertakings which are part of the group.

The following example refers to a case where undertakings A and B are 100% owned by a natural person or a non-EU parent. The next steps are followed:

- a) All permanent minimum capital requirements of the group undertakings are aggregated.
- b) Individual expenditures are aggregated after elimination of intragroup expenses in the individual expenditure accounts.
- c) Individual K-factors are aggregated after elimination of intragroup activities.

**Question for public consultation**

**Question 6. Do you have any comment on the elements included in this Consultation Paper for the application of the aggregation method?**

## Article 7

### *Proportional consolidation*

1. The group supervisor may permit following a request from the Union parent undertaking, or require on its own initiative, proportional consolidation according to the share of capital held of participations in investment firms, financial institutions, ancillary services undertakings or tied agents (group undertakings) managed by a Union parent undertaking together with one or more undertakings not included in the consolidation (participating undertakings):
  - (a) where the liability of the Union parent undertaking is limited to the share of the capital it holds;
  - (b) these participating undertakings are financial sector entities subject to prudential supervision;
  - (c) the solvency of these participating undertakings is satisfactory and can be reasonably expected to remain so.
2. The liability of the Union parent undertaking and the other participating undertakings shall be established by means of a legally binding and enforceable contract between that Union parent undertaking and all the other participating undertakings of the group undertaking.
3. The contract shall meet all of the following conditions:
  - (a) The limitation of the liability of the parties shall be clearly established in the contract and shall be defined as a percentage of the total shareholding.
  - (b) The contract shall clearly state that any potential losses arising from the subsidiary will be borne by the shareholders or members proportionately to the share of capital held by each of them at such point in time.
  - (c) The contract shall clarify that any changes in the share of capital of the shareholders or the members are subject to the explicit consent of all the shareholders or members
  - (d) The contract shall specify that should the subsidiary be recapitalised, the consolidating entity shall timely inform the competent authority about the progress made in the recapitalisation process. Each shareholder or member shall contribute to the recapitalisation in proportion to its current share of the capital of the subsidiary.
4. There shall be no other agreements or side-agreements in the articles of association or separate memoranda between some or all of the shareholders or members of the subsidiary, or between some or all of the shareholders or members of the subsidiary and any third party that override or undermine any of the conditions set out in the previous paragraph.
5. The Union parent undertaking shall submit without undue delay to the group supervisor the contract referred to in paragraphs 2 and 3, any change thereto referred to in paragraph 4 as well as all necessary documents for the assessment of the participating undertakings' regulatory status, financial condition and solvency in accordance with points (b) and (c) of paragraph 1.

### Explanatory box for public consultation

The draft RTS are in line with provisions in CRR II.

Article 18(4) of Regulation (EU) No 575/2013 as amended by Regulation (EU) No 2019/876<sup>30</sup> allows competent authorities to permit the application of proportional consolidation on a case-by-case basis for subsidiaries if certain conditions are fulfilled. This is an exception to the default treatment of full consolidation covered in Article 18(1).

This paragraph of the mentioned Article 18(4) requires the application of proportional consolidation where participations in an institution, financial institution and ancillary services undertaking are managed by an undertaking included in the consolidation together with other participating undertakings not included in the consolidation. This provision has been adapted in this CP to clarify the conditions to apply proportional consolidation in the case of investment firms groups, which includes the unanimous consent of the parties sharing control.

Article 26 of Directive 2013/34/EC allows the use of proportional consolidation when an undertaking included in a consolidation manages another undertaking jointly with one or more undertakings not included in that consolidation. Proportional consolidation shall be used in these instances when the criteria included in this Article are met.

In addition, the draft RTS includes the possibility to apply proportional consolidation in some circumstances:

- a) When an undertaking is managed together but no unanimous consent is required in that respect, and there is an agreement between the shareholders to support it jointly. This may e.g. be relevant for investment firms that cooperate regarding specific services and therefore own certain undertakings together.
- b) If there is strong evidence that the investment firms will support the undertakings in proportion to their investment.

### Questions for public consultation

**Question 7. Do you currently use the method of proportional consolidation for the consolidation of subsidiaries in accordance with Article 18(4) of Regulation (EU) No 575/2013? If proportional consolidation is used, please explain if the conditions included in this Consultation Paper are met.**

**Question 8. Do you have any comments on the conditions established in this Consultation Paper to apply proportional consolidation to investment firms groups under Regulation (EU) No 2019/2033?**

## Chapter 2

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<sup>30</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0876&from=EN>

## **Prudential consolidation of own funds requirements**

### *Article 8*

#### *Consolidation of own funds requirements*

1. The amount of own funds of a Union parent undertaking on a consolidated basis may not fall below the highest of the following:
  - (a) the fixed overheads requirement calculated in accordance with Article 9;
  - (b) the permanent minimum capital requirement in accordance with Article 10; or
  - (c) the K-factor requirement calculated in accordance with Article 11.
2. Where the Union parent undertaking meets on a consolidated basis the conditions for qualifying as a small and non-interconnected investment firm set out in Article 12(1) of Regulation (EU) 2019/2033, the amount of its own funds on consolidated basis may not fall below the highest of the amounts specified in points (a) and (b) of paragraph 1.
3. The application of Paragraph 2 is without prejudice of the requirement to calculate a K-factor requirement.
4. The Union parent undertaking shall notify the group supervisor as soon as it becomes aware that it no longer satisfies or will no longer satisfy the requirements of paragraphs 1 or 2.

### *Article 9*

#### *Consolidated fixed overheads requirement*

1. The consolidated fixed overheads requirement shall amount to at least one quarter of the fixed overheads of the Union parent undertaking of the preceding year on a consolidated basis. The Union parent undertaking shall use expenditure figures, when available, resulting from the applicable accounting framework on a consolidated basis.
2. Where the consolidated expenditure of the Union parent undertaking is not available under the applicable accounting framework, then the consolidated fixed overheads requirement shall amount to:
  - (a) the expenditures of the Union parent investment firm at the individual level;
  - (b) the expenditures of the group undertakings that are fully consolidated; at the individual level and
  - (c) the expenditures at the individual level of the group undertakings that are consolidated proportionally, in proportion to the rights in its capital held by the parent undertaking included in the consolidation.
3. The expenditures of tied agents shall be included in the group consolidated expenditures figures only if the investment firms of the group do not already include them.

### *Article 10*

#### *Consolidated permanent minimum capital requirement*

1. The consolidated permanent minimum capital requirement shall amount to the sum of:



- (a) The minimum capital requirement of the Union parent investment firm at the individual level;
  - (b) the permanent minimum capital requirement at the individual level of all group undertakings that are fully consolidated; and
  - (c) the permanent minimum capital requirement at the individual level of those group undertakings that are consolidated proportionally, in proportion to the rights in its capital held by the Union parent undertaking and included in the consolidation.
2. For the purposes of paragraph 1, the individual permanent minimum capital requirements of group undertakings established in third countries shall be the permanent minimum requirements applicable had they been authorised in the Union.

### *Article 11*

#### *Consolidated K-factor requirement*

1. The group consolidated K-factor requirement shall be calculated by adding together all different K-factors requirements calculated on a consolidated basis in accordance with paragraph 2 and on the basis of the methods set out in paragraph 3.
2. The different K-factor requirements of fully consolidated group undertakings shall be included in full in the group consolidated K-factor requirement and the different K-factor requirements of proportionally consolidated entities shall be included in proportion to the rights in its capital held by the Union parent undertaking included in the consolidation.
3. The coefficients set out in Table 1 of Article 15 of Regulation (EU) 2019/2033 shall be applied to the consolidated metrics in order to calculate the K-factor requirement for each metric on a consolidated basis.
  - (a) The following metrics shall be calculated on a consolidated basis by aggregating the relevant metric for each undertaking that is included within the scope of the consolidation group: CMH, ASA, and COH.
  - (b) The DTF of the group shall be obtained by adding the DTF of each individual undertaking in the consolidation group after netting of intragroup trading flows.
  - (c) The AUM of the group shall be obtained by adding together:
    - i) the AUM of the MiFID entities and of third-country entities that would have been MiFID entities had they been authorised in the Union; and
    - ii) the MIFID part of the AUM of asset management companies and of third-country entities that would have been asset management companies had they been authorised in the Union.
  - (d) The consolidated NPR and TCD shall be obtained by applying the rules in Articles 22 and 26 of Regulation (EU) 2019/2033 on a consolidated basis.
  - (e) The consolidated CMG shall be obtained by aggregation of the CMG of each individual undertaking in the consolidation group that is approved to use K-CMG. Where K-CMG has not been approved for an individual undertaking in the

consolidation group, K-NPR shall be calculated for that undertaking and aggregated to the consolidated K-factor requirement.

- (f) To the end of calculating the consolidated CON, the exposure value of the group shall be the aggregation of the individual exposures. The limit of the group with regard to the concentration risk and the exposure value excess of the group are obtained using the methods described in Article 37(1) and 37(2) of Regulation (EU) 2019/2033 respectively.
4. The K-factor requirements of tied agents shall be included in the group consolidated K-factor requirements only if the investment firms of the group do not already include them.

**Question for public consultation**

**Question 9. The methods for calculating the K-factors in a consolidated situation may allow for further specifications. Is there any K-factor for which the calculation in the context of the consolidated basis would require further specifications? What aspects should be considered?**

**Chapter 3**  
**Entry into force**

*Article 12*

*Entry into force*

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission*  
*The President*

*For the Commission*  
*On behalf of the President*

*[Position]*

## 13. Accompanying documents

### 13.1 Draft cost-benefit analysis / impact assessment

133. The IFR, IFD and CRD require the EBA to develop a series of draft RTS related to the prudential treatment of investment firms, including: a) 2 RTS related to the reclassification of an investment firm as credit institution; b) 6 RTS related to the prudential requirements for investment firms at solo level; and c) 1 RTS related to the prudential requirements for investment firms on a consolidated basis. Table 1 provides a list of the aforementioned RTS, along with a description of the mandate.

Table 1 List of IFR/IFD/CRD mandates covered in the cost-benefit analysis

Regulation Art. (Par.)	Type of Level 2 product	Mandate description
CRD 8a(6)(a)	RTS	Specify the information to be provided for the authorisation of credit institution
CRD 8a(6)(b)	RTS	Specify the methodology for calculating the thresholds referred in CRD 8a(1) (EUR 30 bn total assets)
IFR 13(4)	RTS	Supplement the calculation of the fixed overheads requirement
IFR 15(5)(a)	RTS	Specify the methods for measuring the K-factors
IFR 15(5)(b)	RTS	Specify the notion of segregated account
IFR 15(5)(c)	RTS	Specify the adjustments to the K-DTF coefficients under stressed market conditions
IFR 23(3)	RTS	Specify the calculation of the amount of the total margin, the method of calculation of K-CMG and the criteria for avoiding regulatory arbitrage
IFD 5(6)	RTS	Specify further the criteria set out in IFD Art(5)(1)(a) and (b) to subject certain investment firms to the CRR
IFR 7(5)	RTS	Specify the details of the scope and methods of prudential consolidation

134. Article 10(1) of the Regulation (EU) No 1093/2010 (EBA Regulation) provides that any draft RTS developed by the EBA shall be accompanied by an analysis of ‘the potential related costs and benefits. This analysis should provide an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.

135. This section presents the cost-benefit analysis of the main policy options included in this CP. The analysis is high level and qualitative nature.
136. In parallel with the consultation, the EBA is launching a data collection to assess the impact of the provisions proposed in these draft RTS. The data may also be used to adjust and/or extend these provisions in the final draft RTS.

#### A. Background and Problem identification

137. The EU population of investment firms is both large and extremely diverse. According to 2015 EBA Report on investment firms, there are around 2500 investment firms authorised under the MiFID in the EU.<sup>31</sup> All these firms vary greatly in terms of size, business model, risk profile, complexity and interconnectedness, ranging from one-person companies to large internationally active groups.
138. Currently, the prudential treatment of investment firms is set out in the CRD/CRR framework. Depending on the services and activities they provide or perform or their size, some investment firms are exempt from prudential regulation, some are subject to lighter prudential regulations, and others are subject to the full CRD/CRR rules. While this ensured a level playing field between investment firms and credit institutions conducting the same investment services and/or activities, the bank-centric nature of the CRD/CRR made the framework less relevant for the specific risks posed by investment firms. Moreover, the continuous developments to strengthen the prudential regulation for banks made the framework overly complex and burdensome for many smaller and less sophisticated investment firms.
139. As a result, the European Commission put forward a proposal for a new tailored prudential framework for investment firms in the form of a Regulation (IFR) and a Directive (IFD).

#### B. Policy objectives

140. The objectives of the draft RTS are to set common requirements for the prudential categorisation and calculations of capital requirements for investment firms. In particular, these draft RTS aim to supplement at a technical level the provisions of the IFD/IFR and contribute in achieving legal clarity.
141. Generally, the draft RTS aim to create a level playing field, promote convergence of investment firms practises and enhance comparability of own funds requirements across the EU. Overall, the draft RTS are expected to promote the effective and efficient functioning of the EU's investment firm sector.

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<sup>31</sup> [EBA/Op/2015/20 Report on investment firms. The figure excludes the number of firms based in the UK.](#)

### C. Baseline scenario

142. The baseline scenario is the scenario against which the impact is assessed. The baseline scenario is the current situation, where investment firms are subject to the CRD/CRR requirements, as well as the current RTS thereof.
143. Currently, the prudential framework applied to investment firms depends on the firm's categorisation within the CRD/CRR framework. This categorisation is primarily determined by the MiFID investment services and activities the firm offers and undertakes, as well as its ability to hold money and securities belonging to its clients. The 2015 EBA Report on investment firms identified at least 11 different prudential categories, ranging from no capital requirements to the application of the full CRD/CRR.

### D. Options considered, Cost-Benefit Analysis and preferred options

144. This section would discuss separately the main policy options considered in each draft RTS included in this CP.

#### Draft RTS on the information to be provided for the authorization of credit institutions (Article 8a(6) point a) of the CRD)

145. Currently, investment firms are authorized to provide investment services and activities under the MiFID. The information provided in the application for the authorization of investment firm is diverse across the EU and differs from the one provided for the authorization of credit institutions.
146. Under the new framework, investment firms that will qualify as credit institutions according to point (1)(b) of Article 4(1) of the CRR are required to submit an application for authorisation as credit institutions when reaching certain quantitative thresholds. Article 8a(6)(a) of the CRD mandates the EBA to specify the information to be provided to the competent authorities in the application for this authorisation.
147. The EBA has already developed a similar RTS dealing with the information to be provided to the competent authorities in the application for the authorisation of credit institutions (RTS 'EBA/2017/08' submitted to Commission in 2017 by the EBA – not yet adopted formally). These RTS include a pre-defined list of information to be provided in an application by entities seeking to obtain the authorisation referred to in Article 8(1) of the CRD. An example of such information consists of identification details and historical information of the applicant credit institution, including its existing licensing, activities proposed, current financial situation, programme of operations, as well as initial capital. Moreover, the RTS introduced some flexibility, where NCAs are allowed to request additional information or waive the request of information subject to specified conditions. However, these RTS did not take into consideration the specificities of the investment firms' business model that would fall under the definition of credit institutions or any information collected as part of prior licences granted by a competent authority to them (e.g. MiFID).

148. The objective of these draft RTS is to harmonise the requirements relating to the submission of applications for authorisation of credit institutions. Operationally, the RTS and the respective ITS would specify a detailed list of information to be provided to the competent authorities in the application for the authorisation of credit institutions according to point (1)(b) of Article 4(1) of the CRR.

#### Reliance on the existing RTS 'EBA/2017/08'

149. The RTS is relevant to the credit institutions as defined in point (2)(b) of Article 4(1) of the CRR. The EBA has considered the following options.

#### **Option 1a: Rely on the existing RTS 'EBA/2017/08'**

#### **Option 1b: Develop a new proposal**

150. Option 1a builds on the existing RTS 'EBA/2017/08', which deals with the information required for the authorization of credit institutions whose business consists also of taking deposits or other repayable funds from the public and granting credits for their own account but aims to expand their scope to account for the specificities of investment firms. Under this option, the RTS would request the same information to be provided to the competent authorities in the application for the authorization of credit institutions as requested in RTS 'EBA/2017/08'. In addition, they would allow competent authorities to request additional information where needed in order to be in a position to thoroughly assess the applicant credit institution.
151. This option takes advantage of the already existing provisions, which have proved to work well. In this way, it ensures consistency and harmonisation of the authorisation information required for applicant credit institutions across Member States. At the same time, it ensures the necessary flexibility, by allowing competent authorities to request additional information where necessary.
152. Under Option 1b, the EBA would develop a very new proposal. This could be a potential source of inconsistencies with the already existing RTS and would require competent authorities to rely on different information for very similar authorisations.
153. Option 1a has been retained.

#### Draft RTS on the calculation of the threshold referred to in Article 4(1)(1b) CRR (Article 8a(6) point b) of the CRD)

154. Investment firms are currently subject to the CRD/CRR. This framework is largely based on the Basel standards, which have been designed for banks. As a result, they only partially address the specific risk inherent to the activities of investment firms. However, some investment firms provide 'bank-like' services and activities and in a sense pose similar risk as those of credit institutions. Furthermore, systemic investment firms can be large enough to represent a threat to financial stability like significant credit institutions.

155. To account for these risks, the new framework includes certain types of investment firms in the definition of a credit institution, which will remain subject to the CRD/CRR. The new definition covers investment firms that are authorised for dealing on own account and/or underwriting/placing of financial instruments on a firm commitment basis and their consolidated assets is equal to or exceeds EUR 30 billion threshold either at individual or group level.
156. When reaching the threshold, the investment firms are required to submit an application for authorisation as a credit institution in accordance with Article 8 of the CRD. Article 8a(6)(a) of the CRD requires the EBA to specify the methodology for calculating these quantitative thresholds at individual and group level.
157. The objective of these draft RTS is to supplement at a technical level the provisions of the CRD and previous RTS in order to harmonise the criteria under which an investment firm has to apply for an authorisation as a credit institution.

#### Intragroup exposures and other consolidation adjustments

158. When an investment firm is part of a group, the RTS prescribes that the total value of the consolidated assets pursuant to Article 8a(1)(b) of the CRD is calculated as follows:
- a) at the individual level, as the total value of the individual assets, adjusted for intragroup exposures and other consolidation adjustments;
  - b) at the group level, as the sum of the total value of the assets at individual level over all entities within the scope of the group test, adjusted for intragroup exposures and other consolidation adjustments.

159. The EBA has considered two interpretations of intragroup exposures.

#### **Option 1a: Narrow interpretation of intragroup exposures**

#### **Option 1b: Broad interpretation of intragroup exposures**

160. Option 1a accounts as intragroup exposures only those exposures that are among relevant entities (i.e. relevant institutions, relevant third country branches and relevant subsidiaries in third countries). This option aims to avoid double counting of assets.
161. Under Option 1b, all exposures among entities within the group would be considered as intragroup exposures. These includes exposures with entities that are in the group but are not relevant entities (i.e. are not within the scope of Article 8a(1)(b) group test). This option aims to isolate the contribution of each individual relevant entity to the group figures.<sup>32</sup>
162. Option 1a is consistent with rest of the methodology by only considering relevant entities. It can reduce arbitrage opportunities where intragroup exposures among non-relevant entities are artificially inflated to reduce the threshold. However, it requires counterparty-by-

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<sup>32</sup>For this purpose, under this option the consolidated assets are also adjusted for other consolidation adjustments which occur between all the entities in the group.

counterparty intragroup figures, which may not be readily available. On the other hand, the notion of intragroup exposures under Option 1b is in line with other pieces of regulation (e.g. CRR) where the term intragroup refers to all exposures among entities belonging to the same group. However, there is the potential risk of overcorrection due to intragroup exposures, reducing the total assets to an undesirable level.

163. Option 1a has been retained.

#### Draft RTS to specify the calculation of the fixed overheads requirement and to define the notion of a material change (Article 13 (4) of the IFR)

164. Under the CRR, only investment firms which are subject to Article 95 or 96 are required to calculate their own funds requirements based on fixed overheads. Under Article 97 of the CRR, the fixed overhead requirement (FOR) is for the relevant firms to hold eligible capital of at least one quarter of the fixed overheads of the preceding year.

165. The EBA has already developed the RTS to specify the calculation of the fixed overheads requirements under the CRR.<sup>33</sup> However, these RTS were developed having in mind only a specific subset of investment firms, which either have limited authorisation to provide investment services or only perform deals on own account to execute clients orders or only perform deals on own account and do not have external clients neither they hold client money/securities.

166. In the IFR/IFD, FOR is one of the major component of the capital requirements calculation and serves as a floor to the capital requirements for all investment firms. Small and non-interconnectedness investment firms would be subject to the maximum of the FOR and the permanent minimum capital requirements, while all other firms would be subject to the maximum of the FOR, the permanent minimum capital requirements and the K-factor requirement. Only investment firms that are subject to the CRR would no longer be subject to the FOR.

167. The objective of these draft RTS is to supplement at a technical level the provisions of the IFD/IFR and clarify how an investment firm should calculate its fixed overheads and what constitutes a material change in the activities of an investment firms.

#### Deductions

168. Article 13 (4) of the IFR lists a number of deduction items that at least needs to be included in the draft RTS FOR. However, this list is not necessarily exhaustive and the EBA could consider further deduction items. The EBA considered the following options related to deduction items:

**Option 1a: Include only the list of deductions items listed in Article 13 of the IFR**

**Option 1b: Supplement the above list with additional deduction items**

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<sup>33</sup> [RTS on own funds requirements for investment firms based on fixed overheads](#)



169. The EBA is proposing to add six additional deductions and clarify some of the existing deductions. This is to take into account the broader role that FOR has under the new regime and the fact that all investment firms, including trading firms need to calculate it.
170. First, the EBA proposes to include in the deduction items any losses from trading in financial instruments. Losses from trading activity are not a fixed overhead, and a firm winding-down may reduce or stop its activity entirely. Such losses should already be deducted from own funds, and as the FOR is generally only calculated annually, based upon the previous year's financial statements, any losses from trading financial instruments that form part of any expenditure in that previous year's financial statements should not also be counted towards expenditure/fixed overheads in the subsequent (i.e. current) financial year. Otherwise, this would lead to 'double counting' and unnecessarily penalise such investment firm. In addition, these losses do not constitute an item that requires being supported further in the current financial year by own funds, as it will not represent a new expense incurred should the investment firm wind-down or otherwise seek to exit the market.
171. Second, the EBA proposes to deduct from total expenses expenditures from taxes to the extent that they fall due on annual profits of the investment firm. This aims to account that a firm that is winding-down is unlikely to make profits and as such has to pay income tax on net profits.
172. Third, the EBA proposes to add in the deduction items fees, brokerage and other charges paid to central counterparties, exchanges and other trading venues and intermediate brokers for the purposes of executing, registering or clearing transactions, only where they are passed on and charged to customers. These shall not include fees and other charges necessary to maintain membership or otherwise meet loss-sharing financial obligations to central counterparties, exchanges and other trading venues, which are considered to count among the fixed costs of an investment firm. Moreover, the EBA suggests deducting from total expenses any interest paid to customers on client money, where there is no obligation of any kind to pay such interest. These two deduction items are also covered in the current RTS on FOR.
173. In addition, the EBA proposes to include in the deduction items payments related to contract-based profit and loss transfer agreements according to which the investment firm is obliged to transfer, following the preparation of its annual financial statements, its annual result to the parent undertaking. Depending on the national accounting system, these contract based transfer profits could be considered as an expense, although they are an alternative way to distribute profits. Given that the FOR is designed to ensure that the investment firm has enough money to run the business during the wind down period, transferring profits are not considered among the relevant costs. They constitute variable costs and depend on the fact that the investment firms has made a profit. If there is any profit at the end of the winding down period, it may transferred. If there is a loss at the end of the winding down period, the parent undertaking is obliged to compensate. As result, there is economically no need to provide for this risk.

174. Lastly, the EBA suggests deducting from the total expenses used in calculation the fixed overheads requirements expenses related to raw materials consistently with the particularity of the business of commodity and emission allowance dealers.

175. Option 1b has been retained.

#### Draft RTS to specify the methods for measuring the K-factors (Article 15(5), point a) of the IFR)

176. According to the IFR, all investment firms that are not small and non-interconnected are required to calculate the K-factor capital requirements. Article 15(5) of the IFR requires the EBA to specify the methods for measuring these K-factors. It should be noted that IFR already prescribes certain provisions of how to measure K-factors. Moreover, a separate mandate specifically for K-CMG exists under Article 23(3) of the IFR.

177. The objective of these draft RTS is to complement at a technical level these provisions and clarify further the scope of the K-factors. These clarifications will ensure a consistent calculation of K-factors across investment firms and enhance the level playing field in the EU.

#### K-AUM: Methods for measuring the AUM in case of discretionary portfolio management

##### **Option 1a: Allow offsetting of positions in financial instruments**

##### **Option 1b: Do not allow offsetting of positions in financial instruments**

178. Investment firms are required to calculate the value of assets under management (AUM) based on the fair value of the financial instruments in accordance with the applicable accounting standards. This fair value can be negative, for example for derivatives positions.

179. Under option 1a, investment firms can calculate AUM by offsetting positive and negative positions. However, the purpose of K-AUM requirements are to capture the risk of harm clients from an incorrect discretionary management of client portfolios or poor execution. Such operational risk could be diluted under this option because for example a firm with higher volumes of financial instruments may end up having lower K-AUM requirements, simply because some of them have negative values (and are therefore offset by positions with positive values), which lowers the AUM metric. This risk may be amplified in cases where an investment firm uses derivatives or other means of leverage for client portfolios. As a result, while this option would be the simplest it would also be the least prudent.

180. On the other hand, option 1b would be able to capture such operational risk. Under this option, investment firms are required to include the financial instruments with a negative fair value in absolute value. As a result, AUM would capture the actual volume of discretionary portfolio management irrespective of whether the financial instrument has a positive or negative value.

181. Option 1b has been retained.

#### Draft RTS on the definition of segregated account (Article 15 (5) point b) of the IFR)

182. Under the K-factor requirement, the investment firm can assign different coefficient to K-CMH depending on whether the client money are held on segregated accounts or not. Segregated accounts are considered safer because the client's money are separated from the investment firm's own money and in the event of the firm's default is easier for the client to retrieve them back. As a result, client money on segregated accounts receive a lower coefficient (0,4%) compared to non-segregated accounts (0,5%).
183. Article 5(15) of the IFR requires the EBA to specify the notion of segregated accounts for the purposes of this regulation for the conditions that ensure the protection of client money in the event of the failure of an investment firm.
184. The objective of these draft RTS is to harmonise the notion of segregated accounts for the purpose of calculating the K-factor requirements across the EU.

### Segregated account conditions

185. Segregated accounts are already defined in point (49) of Article 4(1) of the IFR for the purposes of Table 1 set out in Article 15(2) of the IFR thereof where a reference is made to client money being deposited in accordance with Article 4 of the Commission Delegated Directive (EU) 2017/593. That Commission Delegated Directive aims at the protection of client money by specifying organizational requirements for investment firms.
186. Given the notion of segregated accounts referred to in point (b) of Article 15(5) of the IFR has the same objective of protection of client money, the organisational requirements referred to above should be met in the context of prudential requirements.
187. Therefore, these draft RTS have established a subset of the same requirements as in the Commission Delegated Directive, which are relevant for the notion of segregation. In particular, Article 2(1) of that Directive establishes requirements, which relate to the concept of segregated accounts.
188. Additional provisions included in the Commisison Delegated Directive have been considered, but have not been retained for two main reasons. First, they were not relevant for the notion of segregation and the conditions that ensure the protection of client money in the event of the failure of an investment firm. Second, they allowed Member States to prescribe national-specific requirements, where the provisions of Article 2(1) of that Directive could not be met due to the applicable law of the jurisdiction. While these requirements aim to have an equivalent effect in terms of safeguarding clients' rights and meet the same objectives of Article 2(1), they can impair the harmonisation of the notion of segregated accounts for the purposes of calculating the K-factor requirements and create an unlevel playing field across EU.

[Draft RTS to specify adjustments to the K-DTF coefficients \(Article 15\(5\) point c\) of the IFR\)](#)

189. Under the K-factor requirement, investment firms are required to capitalize the operational risk stemming from their daily trading flow, which could result from inadequately or failed internal processes, people and system or from external events. DTF captures the volume of transactions – both cash and derivatives trades – the investment firm concluded for its own account or for its clients on its own name. The K-DTF capital requirement is linear to this volume of trades.
190. In the event of stressed market conditions, as referred to in Commission Delegated Regulation 2017/578, investment firms are allowed to apply an adjustment to the K-DTF coefficients when the K-DTF requirements seem overly restrictive and detrimental to financial stability. The rationale behind such adjustment is to avoid situations where investment firms are faced with unusually high capital requirements due to stressed market conditions, which can force them to reduce their trading activities and consequently market liquidity. Article 15(5) of the IFR requires the EBA to specify such adjustments.
191. The objective of these draft RTS is to harmonise the way investment firms can adjust the K-DTF coefficients in case of stressed market conditions across the EU. Operationally, the RTS provides a formula, which investment firms can use to calculate the adjusted coefficients.

#### Period of extreme volatility

192. The Delegated Regulation 2017/578 sets out the detailed obligation for investment firms to enter into a market making agreement, its content as well as obligations upon trading venues for having market making schemes in place. Under such agreement, investment firms are obliged to provide liquidity on a regular and predictable basis. However, under exception circumstances, such obligation shall not apply. These exceptional circumstances include situations of extreme volatility, war, industrial action, civil unrest or cyber sabotage, disorderly trading conditions, situations where the investment firm's ability to maintain prudent risk management practices is prevented due to among others technological and/or risk management issues or inability of hedging, and situations of suspension of non-equity instruments.
193. The EBA has assessed whether an adjustment to the K-DTF coefficients is desirable under all of these circumstances or only a subset of those. In particular, the draft RTS specifies that the adjustment coefficient should be based on the DTF after excluding the value of any trade that occurred during periods of extreme volatility.

**Option 1a: Consider as period of extreme volatility a subset of 'exceptional circumstances' as set out in the MiFID Delegated Regulation (EU) 2017/578**

**Option 1b: Consider as period of extreme volatility all the 'exceptional circumstances' as set out in the MiFID Delegated Regulation (EU) 2017/578**

194. Under Option 1a, the EBA has considered whether only situations of extreme volatility situations (Article 3(a)) of the Regulation 2017/578 should be considered as a period of extreme volatility for the purpose of adjusting K-DTF. This situation appears to be the most directly relevant to financial stability considerations.

195. The other situations (Article 3 (b) to (e)) of the Regulation 2017/578 appear to either prevent the trading venue from operating effectively, or the investment firm is prevented from doing so. In such circumstances, it is unlikely that trading volumes/values would be so unusual as to lead to an overly high/restrictive K-DTF requirement (and ones that would also affect the DTF average calculation).
196. Option 1a has been retained.

#### Draft RTS to specify the calculation of the amount of the total margin for the calculation of K-CMG (Article 23(3) of the IFR)

197. An investment firm can calculate the RtM K-factor requirement using K-CMG instead of K-NPR under certain conditions and upon the approval of its competent authority. K-NPR relies on the market risk approaches prescribed in the CRR and CRR II while K-CMG is based on the amount of total margin required by the clearing member from the investment firm.
198. Article 23(3) of the IFR requires the EBA to specify the calculation of the amount of the total margin required, the method of calculation of K-CMG, in particular in the case where K-CMG is applied on a portfolio basis, and the criteria to avoid regulatory arbitrage.
199. The objective of these draft RTS is to harmonise the way investment firms calculate K-CMG across the EU and establish minimum requirements ensuring that the choice for K-CMG has not been made with a view to engage in regulatory arbitrage.

#### Portfolio interpretation

200. K-CMG can be calculated for all positions that are subject to clearing, or on a portfolio basis, where the whole portfolio is subject to clearing or margining. Given that there is no definition of 'portfolio' in IFD/IFR the EBA has considered the following options:

#### **Options 1a: Align the interpretation of a 'portfolio' with the notion of 'trading desk' in point (144) of Article 4(1) of the CRR II.**

#### **Option 1b: Allow for a flexible definition of a 'portfolio' subject to supervisory approval**

201. The CRR II, following the FRTB standards, introduced an alternative internal model approach. Investment firms should ask permission to use this approach at the trading desk level, where a trading desk means a well-identified group of dealers set up by the institution to jointly manage a portfolio of trading book positions in accordance with a well-defined and consistent business strategy and operating under the same risk management structure.
202. Option 1a considers that each trading desks constitutes a whole portfolio for which K-CMG can be calculated. By aligning the notion of a portfolio with these trading desks, it would allow some trading desks to apply for K-CMG and others not (i.e. use the K-NPR). The advantage this option is that trading desks clearly identify and separate part of the trading business, which are mostly aligned with the day-to-day practice of trading business.

203. Option 1b provides for a more flexible approach, where an investment firm could determine the choice of the portfolio subject to supervisory approval. This option would require the competent authority to assess individually whether the allocation of cleared positions to a portfolio is appropriate for the purposes of calculating the K-CMG and has not been made with a view to engage in regulatory arbitrage. This would create additional burden to the competent authority and potential inconsistencies in the definition of 'portfolio' across EU, given that competent authorities may have different practices in assessing and approving such allocation.

204. Option 1a has been retained.

#### Draft RTS on the criteria for subjecting certain investment firms to the CRR (Article 5 (6) of the IFD)

205. Some investment firms present comparable risks to financial stability as credit institutions. Article 5(1) of the IFD allows competent authorities to apply the CRR to an investment firm that: a) performs the activities of dealing on own account or underwriting; and b) has total assets above EUR 5 billion; and c) poses systemic risk or is a clearing member or is of the size, nature scale and complexity of activities justifies such treatment.

206. Article 5(6) of the IFD requires the EBA to further specify the criteria on systemic risk and clearing member. However, no mandate is provided to specify the criterion on the size, nature scale and complexity of activities. This provides the discretion to the competent authorities to subject other investment firms to the CRR requirements should they consider this is justified in light of the size, nature, scale and complexity of the activities of the investment firm concerned. Given that this discretion provides competent authorities with considerable degree of flexibility in reflecting national specificities, these draft RTS has given a greater emphasis on simplicity and harmonisation.

207. The objective of these draft RTS is to provide a set of common criteria to subject an investment firm to the CRR. Operationally, the draft RTS would facilitate competent authorities in deciding which investment firm should be subject to the CRR by setting up precise quantitative criteria and the respective methodology.

#### Quantitative criteria for investment firms posing systemic risk

208. The EBA has developed a list of quantitative criteria for identifying investment firms posing systemic risk. To assess the levels of such risk, the EBA has considered two types of thresholds.

##### **Option 1a: Use absolute thresholds**

##### **Option 1b: Use relative thresholds**

209. Under Option 1a, competent authority would need to check if the investment firm exceeds one or more absolute thresholds, to assess if it can apply the CRR to that particular firm. This option has the advantage of being simple, harmonized, and requiring limited amount of data.

210. Option 1b follows a similar approach as the O-SII methodology, which is also based on the relative size of an individual firm compared to the total size of banks and/or investment firms in a Member State. This option has the benefit of taking into account the heterogeneous market landscape across the EU. Under this option, a question arises whether the reference group (i.e. what will be the scope of the denominator of the relative threshold) is both banks and investment firms or solely investment firms. In former case, the competent authority would need to have data for both banks and investment firms, which may be unlikely in the cases where there is a different supervisory authority responsible for banks and investment firms in a Member State. In case the reference group is only investment firms, there is the risk that in Member States with few investment firms, some investment firms are exceeding the thresholds even if they do not pose a systemic threat to the domestic economy. In any case, Option 1b is considered to be more burdensome and result in higher administrative costs for both competent authorities and investment firms.
211. Given that the benefits of Option 1b to reflect the specificities of each Member State's investment firm sector can be achieved by the national discretion provided in point (c) of Article 5(1) of the IFD, the EBA is proposing to use only absolute thresholds to avoid unnecessary complexity and reduce the administrative burden for competent authorities.
212. Option 1a has been retained.

#### Clearing member criterion

213. Article 5(6) of the IFD requires the EBA to further specify the criteria of being a clearing member for the purposes of subjecting an investment firm to the CRR. The EBA has considered the following options as further criteria for the purposes of meeting point (b) of Article 5(1) of the IFD:

##### **Option 2a: Specify a quantitative threshold**

##### **Option 2b: Clarify the conditions in which a clearing member could represent a systemic threat**

214. Under Option 2a, the draft RTS could set a minimum threshold for the amount of clearing business that needs to be exceeded before investment firms will be considered as meeting the criteria under point (b) of Article 5(1) of the IFD. However, the EBA has considered that an investment firm that was able to become a clearing member of a CCP should already have a sufficient amount of clearing positions to make them systemically relevant, and thus a quantitative threshold may be less appropriate for this purpose.
215. Option 2b would distinguish between clearing members that offer their clearing services to other financial institutions that are not clearing member themselves. This option takes into account that clearing members that clear positions for other financial sector entities, which are not clearing members themselves, are more interconnected with the financial sector and therefore pose greater systemic threat.
216. The EBA considered that the aspect of interconnectedness was more important than a quantitative threshold for the purposes of subjecting an investment firm to the CRR.

217. Option 2b has been retained.

#### Draft RTS on prudential consolidation of investment firms groups (Article 7(5) of the IFR)

218. Under the CRR, the EU parent investment firms and parent investment firms in a Member state (including investment firms controlled by parent investment holding company or a parent mixed financial holding company) are required to comply with prudential requirements on the basis of their consolidated situations. For investment firm groups, Article 15 of the CRR provides a derogation to the application of own funds requirements on a consolidated basis, provided certain conditions are met. Investment firms should carry out a full consolidation of all institutions and financial institutions that are its subsidiaries or, where relevant, the subsidiaries of the same parent investment holding company or parent mixed financial holding company. Subject to the competent authority's permission and certain conditions, they can also carry out on a case-by-case basis proportional consolidation.
219. Under the IFR, investment firms are required to comply with capital requirements on both an individual and a consolidated level. In particular, Union parent investment firms, Union parent investment holding companies and Union parent mixed financial companies shall comply with capital requirements based on their consolidated situation. Unlike the CRR, the consolidation under IFR is carried out solely at the highest level of the group within the Union, without sub-consolidation at lower levels of that group (e.g. at the Member State level).
220. The capital requirements under the CRR are based on balance sheet items. As a result, the consolidation of entities for accounting and prudential purposes are similar in nature. However, the K-factor capital requirements under IFR rely mainly on management data (e.g. K-DTF uses daily trading flow) instead of accounting data. This makes the consolidated balance sheet of the group less effective for representing its total investment services and activities business. Moreover, the permanent minimum capital requirement is a fixed amount. Only the fixed overhead requirement is based accounting data (i.e. expenditure data).
221. Article 7(5) of the IFR requires the EBA to specify the details of the scope and methods for prudential consolidation of an investment firm group, in particular for the purpose for calculating the fixed overheads requirement, the permanent minimum capital requirement, the K-factor requirement based on the consolidated situation and the details of including minority interests.
222. The objective of these draft RTS is to harmonise the way investment firm groups calculate their consolidated prudential requirements across the EU.

#### Consolidated permanent minimum capital requirement

**Option 1a: Calculate consolidated permanent capital requirement as if the group is treated single 'enlarged' investment firm**

**Option 1b: Calculate consolidated permanent capital requirement by aggregating the individual permanent capital requirement of the group entities**



223. Option 1a treats the consolidated group as one 'enlarged' investment firm. Under this option, the consolidated permanent capital requirement would be calculated as the permanent capital requirement that would be required if the group as a whole had been authorized as a single investment firm. Mathematically, the consolidated permanent capital requirement is equal to the maximum of the individual permanent capital requirement of the group's investment firms.
224. On the other hand, under Option 1b, the consolidated permanent capital requirement would be calculated as the sum of all the individual permanent capital requirement (or equivalent requirements for non-investment firms) for each entity in the group. This option takes a more prudent approach and requires the group to hold sufficient capital to support the authorisation of each entity in its group. On the other hand, it can penalise investment firms that are organised as a group relative to single entities that have the same size and type of activities.
225. Option 1b has been retained.

#### K-factors capital requirement consolidation

**Option 2a: Calculate consolidated K-factors requirements as if the group is treated one 'enlarged' investment firm**

**Option 2b: Calculate consolidated K-factors requirements by aggregating the individual K-factors requirements of the group's entities**

226. Under Option 2a, the relevant K-factors would be calculated based on the total amount of each relevant metric as if it had all been undertaken by a single 'enlarged IF'. However, such total amount may not be readily available to the investment firm, as many of the K-factors do not rely on balance sheet items or exposures. As such, the consolidated financial statements are not useful for this purpose.
227. Under Option 2b, the total amount of each relevant metric would be calculated by summing up the amount of the relevant metric for each entity in the group. This amount would be zero for the entities that do not undertake the relevant business. This can be considered as an 'aggregation consolidation', although in this case, due to the nature of the metrics, it would still be a prudential consolidation that treats the group as if it was a single investment firm and hence valid. Such technique is currently used under the CRR for market risk via Article 325(1) where the conditions in paragraph 2 of that article are not met and a consolidated entity is not granted permission to offset positions between different legal entities within a consolidation group. Option 2b is simpler and more appropriate for the nature of the metrics in question.
228. Option 2b has been retained. To deal with potential double counting of intragroup trading flows when aggregating DTF values of a group, the RTS allows removing intragroup trades from the calculation of K-DTF on a consolidated basis.

## 13.2 Overview of questions for consultation

- Question 1.** Is the proposed articulation of the K-factors calculation methods, in particular between AUM and CMH and ASA, exhaustive or should any other element be considered?
- Question 2.** Are the requirements for notion of segregated accounts sufficient? Are there issues on segregated accounts which need to be elaborated further?
- Question 3.** Is there any example of situations of market stress which would not been taken into account applying the proposed approach but would be relevant for the measurement of the K-DTF?
- Question 4.** What would be appropriate thresholds or events that should trigger the comparison between the calculation under the K-CMG compared to the one under the K-NPR?
- Question 5.** Which other conditions should be considered to avoid double counting or to prevent regulatory arbitrage in the use of the K-CMG approach?
- Question 6.** Do you have any comment on the elements included in this Consultation Paper for the application of the aggregation method?
- Question 7.** Do you currently use the method of proportional consolidation for the consolidation of subsidiaries in accordance with Article 18(4) of Regulation (EU) No 575/2013? If proportional consolidation is used, please explain if the conditions included in this Consultation Paper are met.
- Question 8.** Do you have any comments on the conditions established in this Consultation Paper to apply proportional consolidation to investment firms groups under Regulation (EU) No 2019/2033?
- Question 9.** The methods for calculating the K-factors in a consolidated situation may allow for further specifications. Is there any K-factor for which the calculation in the context of the consolidated basis would require further specifications? What aspects should be considered?