Discussion paper on the call for advice on the investment firms prudential framework

Public hearing
20 June 2024

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Commission call for advice and workplan

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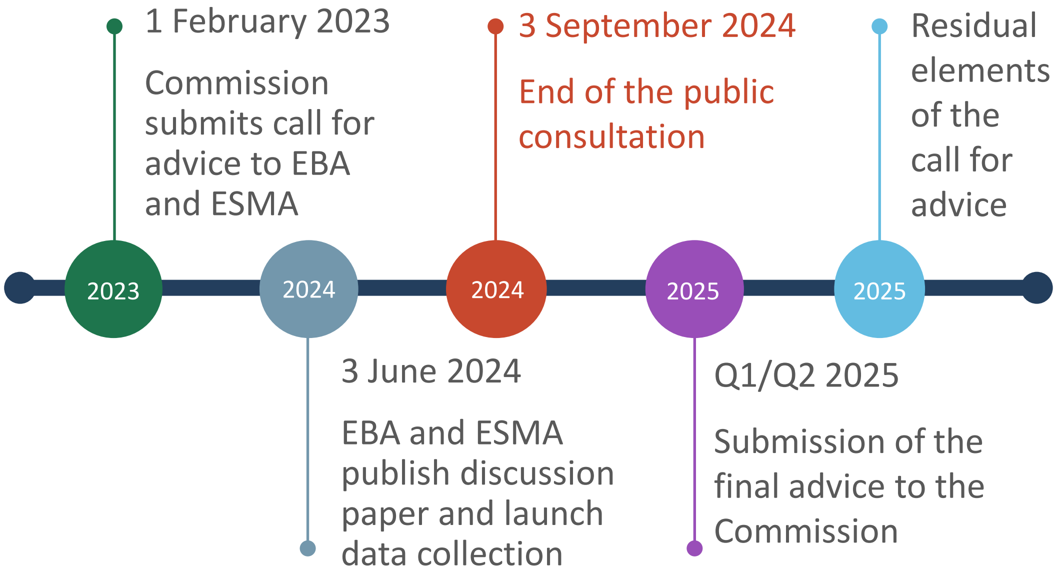
Commission’s call for advice and workplan

Background

1. The prudential framework for investment firms is outlined IFR and IFD
2. The framework has been applicable since 26 June 2021
3. Article 60 of IFR and Article 66 of IFD the Commission to submit two reports to the European Parliament and the Council and, if appropriate, a legislative proposal
4. In preparing these reports, the Commission is required to consult with the EBA and ESMA

Workplan



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Content of the discussion paper

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Categorisation of investment firms

- **Effectiveness of the categorisation of investment firms**
  - In light of the constant interactions with stakeholders in the investment firms' ecosystem, it is apparent to the EBA that the IFR/IFD framework is working well and is effectively tailored to the size and activities of investment firms

- **Consistency of the threshold**
  - Harmonisation of the scope of the thresholds based on the EUR 30 bn threshold
  - Harmonisation of the notions of 'total value of assets' vs 'total value of consolidated assets', 'consolidated assets' vs 'combined assets'

- **Additional issues**
  - Categorisation of "Class 1 minus" firms
  - Monitoring of the thresholds
  - Notification requirement from the EBA to IFs surpassing the threshold

Conditions for investment firms to qualify as small and non-interconnected

- **Discussion on the conditions for qualifying as a "Class 3" IF**
  - The usefulness, calibration and scope of calculation of the quantitative conditions in Article 12(1) of the IFR, i.e. points (h) and (i)

- **Transition of IFs between "Class 3" and "Class 2" categories**
  - Lack of a transitional period regarding the application of prudential requirements corresponding to the categorisation as Class 2
  - The frequency of the migration of IFs between the two categories

Fixed overheads requirements (FOR)

- **Three months wind-down period:**
  - Whether the three-month period is still appropriate for all types of investment firms or some type of firms need a longer period
- **Deductibles related to specific business models:**
  - Whether it necessary to differentiate the deductibles by activity or by business model for the purpose of calculating the FOR
- **Expenses related to tied agents:**
  - Whether the expenses related to tied agents material for the calculation of the FOR require a dedicated treatment for their calculation
- **Expenditures related to non-MiFID activities:**
  - Whether the FOR should be calculated distinguishing the costs related to non-MiFID activities
- **Expenses related to exchange rate differences:**
  - Whether the expenses related to fluctuation of exchange rates should be included in the list of deductions for the calculation of the FOR

Review of existing K-factors

- **K-COH** may be reviewed to include the placing of financial instruments without firm commitment, to clarify the treatment of the name give-up operations (the institution puts two counterparties to the transaction in touch with each other without interposing itself and just receives a commission), and the treatment of market making activities.

- The definition of **K-AUM** may be amended in order to clarify the definition of ongoing advice and the treatment of the delegation.

- The **K-DTF** can result in either low amounts of capital requirements, or to counterintuitive results if compared across investment firms. The K-DTF may be recalibrated or reviewed in order to take into account these cases.

- The IFR limits the application of the **K-CON** only to financial instruments in the trading book of an investment firm, leaving out of scope non-trading book instruments. The design of K-CON currently explicitly ignores significant concentration risks that are not part of the trading book.

- On **K-CMG**, it is worth analysing instances when the losses exceeded the corresponding K-CMG.

Risks not covered by existing K factors

- **Non-trading book positions**
  - The current K-factor regime does not envisage any capital requirement for non-trading book exposures like loans to customers, illiquid financial assets, etc. A specific K-factor may be considered.
- **Non-trading book positions in crypto-assets**
  - A dedicated k-factor on holdings of crypto-assets in the non-trading book may be introduced.
- **Operational risk for firms calculating the K-DTF**
  - K-DTF may result in significantly low own funds requirements. Several alternatives are discussed in the DP. One would be to use the standardised approach and refer only to the category ‘trading and sales’.
- **Investment firms operating trading venues**
  - For the MTFs that only facilitate transactions via a system, without receiving, transmitting or executing the transaction, a different K-factor would need to be considered.
- **Investment firms providing other prudentially regulated or non-regulated services**
  - Investment firms are authorised or permitted to provide services and activities not covered by the prudential requirements of the IFD and IFR, e.g. crypto assets and crowdfunding services

Implications of the adoption of the Banking Package

- **Introduction of the fundamental review of the trading book (FRTB)**
  - The CRR3 introduces the FRTB as a Pillar 1 requirement for credit institutions and class 1 minus investment firms. The FRTB may be introduced for class 2 investment firms on a mandatory or voluntary basis, or may be forbidden in continuity with the current framework.

- **Introduction of the revised credit valuation adjustment (CVA) framework**
  - The CRR3 introduces a revised framework for CVA that replaces the methodologies currently available in the CRR2. For class 2 investment firms, it may be envisaged to introduce the revised methodologies (for all of them or only for those subject to the FRTB), or to retain the current IFR methodology.

- **Definition of trading book**
  - The definition of the trading book may be aligned to the CRR3 (boundary of the trading book).
  - For non-trading firms, some derogation may be envisaged when they invest own funds and liquidity in specific financial instruments.

Liquidity requirements

- **Level of liquidity requirements**
  - appropriateness and granularity of the liquidity requirements
  - current liquidity requirements lead to investment firms having a sufficiently prudent level of liquid assets and whether the one-month time horizon is sufficient

- **Exemption under Article 43** of the IFR for small and non-interconnected investment firms
  - assumption that all investment firms, including the small and non-interconnected ones, should have some liquid assets available, no matter how small, to always ensure an orderly wind-down

- **Third country service and liquidity providers**
  - whether and to what extent the liquidity profiles of investment firms are affected by their activities in third countries or their dependencies on third country service and liquidity providers

- **Other technical amendments**
  - list of high-quality liquid assets
  - fine tuning of definitions

Prudential consolidation

- **Finetuning of definitions in the IFR**
  - Definition of Investment Holding Company
  - Intermediate Investment Holding Company
  - Definition of Union parent investment firm
  - Ancillary services undertakings and potential for regulatory arbitrage to avoid consolidation

- **Comparison to the CRR**
  - Alignment with Article 18 of the CRR

- **Group capital test**
  - Clarification on the scope of application of the GCT

- **Consolidation of CFSPs**
  - Amendment of the definition of “consolidated situation”?

Interactions of IFD and IFR with other regulations

- **Interaction with the AIFM and UCITS Directives**
  - In certain cases, an asymmetric treatment as compared to investment firms providing the same MiFID services
  - The scale of the top-up services is not always warranting categorising them as ancillary to the main business of the entity

- **Interaction of MiCAR and IFD/ IFR**
  - An investment firm may provide crypto-asset services equivalent to the investment services and activities for which it is specifically authorised under MiFID, provided that it notifies the competent authority in accordance with Article 60(3) and (7) of MiCAR.
  - Capital requirements under IFR/IFD and interaction with crypto-assets services providers may need review (PMC, K-factors K-COH, K-AUM, K-CMH, K-ASA and K-NPR)
  - Review of SREP guidelines to cover those activities

Remuneration and its governance

- IFD includes requirements on remuneration for Class II investment firms
- Class 1- firms are subject to CRD requirements
- Class 3 firms are only subject to MiFID requirements on remuneration
- Different frameworks exist under UCITS Directive, AIFMD and CRD

The intention is to analyse any negative impact on the level playing field of remuneration provisions in the area of investment services:

- Scope of application of the requirements – impact on staff recruitment and retention
- Criteria for the identification of risk takers (identified staff)
- Different approaches to derogations (pay out in instruments/deferral)
- Different requirements on disclosures and transparency

Other elements

- **Extending reporting requirements to financial information**
  - Competent authorities report that such information is of interest for supervisory purposes.
  - In several instances, financial reporting is therefore required based on national laws to supplement the IFR requirements.
  - However, reporting that information is not a requirement neither under the IFD nor the IFR.
- **Commodity markets and large dealers**
  - ESMA's technical advice on Section 5 of the CfA will be delivered to the Commission by the end of the year, focussing on providing insights on EU energy derivative markets and market participants.
- **ESG**
  - The EBA advice is already included in the ESG report developed in accordance with the mandate of Article 34 of the IFR.
- **Investment policy disclosures**
  - Already covered by the relevant RTS

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Data collection

Process and timeline

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Data collections overview

- In parallel with the DP, the EBA and ESMA have launched an ad-hoc data collection addressed to:
    - Competent authorities
    - Investment firms
    - UCITS management companies and AIFMs
- Data cover a range of topics like categorization, FOR, existing and new K-factors, prudential consolidation remuneration and governance
- Investment firms and UCITS/AIFM should get in touch with their competent authority to discuss process for submitting the templates

Data collections scope and submission deadlines

Three parallel data collections

NCA	Investment firms	UCITS/AIFM
Scope: EEA competent authorities	**Scope**: EEA investment firms (individual) and EEA investment firm groups (consolidated)	**Scope**: EEA UCITS management companies/AIFM providing discretionary portfolio management and additional non-core services
Deadlines: 26 July 2024 (first submission) and 30 August 2024 (second submission)	**Deadlines:** 19 July 2024 (first submission) and 23 August 2024 (second submission)	**Deadlines:** 19 July 2024 (first submission) and 23 August 2024 (second submission)

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Questions ?

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References

- Calls for advice (link)
- The EBA and ESMA invite comments on the review of the investment firms prudential framework - news item (EBA website / ESMA website)
- Discussion Paper Call for advice on the investment firms prudential framework (link)
- Submit your response (link)

Thank you!

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