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EBA proposes new prudential capital framework for MiFID Investment Firms

How will the EBA's Recommendations redraw investment management business in the EU-27 and what can stakeholders do to stay ahead of the curve?

On 29 September 2017, the European Banking Authority (**EBA**) published its long awaited "Recommendations" on new rules (the **September Opinion**)[1] that, once finalised by the European Commission (the **EC**), are set to introduce a "new simpler and more risk-sensitive" prudential capital regime for MiFID investment firms. The EBA's September Opinion and its specific Recommendations build on the EBA's initial responses in 2015 and specifically answers the EC's call for advice that was submitted 13 June 2016.

This Client Alert highlights the September Opinion's Recommendations and its proposals to establish a more tiered and proportionate[2] prudential capital regime for those "**Investment Firms**" as such term is used in the context of the CRD IV/CRR Framework and ultimately the MiFID II/MiFIR Framework that starts in earnest from 3 January 2018. This means the new regime would, if enacted, apply to those existing regulated entities as well as those new Investment Firms that are brought into scope due to MiFID II changes.

In concrete terms the EBA's September Opinion, as further explored below and in the Annex hereto, calls upon the EC to do two things in respect of Investment Firms:

1. create classes of Investment Firms. These are:
   a. Class 1 = those that undertake bank like activity and to which the full CRD IV/CRR Framework should be applied;
   b. Class 2 = other non-systemic Investment Firms whose activity places these above quantitative and qualitative thresholds that are used to categorise Class 3 entities;
   c. Class 3 = smaller and non-interconnected entities; and

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[1] See: http://www.eba.europa.eu/-/eba-issues-opinion-on-the-design-of-a-new-prudential-framework-for-investment-firms

[2] Applying a greater degree of proportionality in regulatory reform is now a key priority for policymakers when advancing supervisory convergence across the EU. See specifically statements from Roberto Gualtieri, MEP, Chair of the Committee on Economic and Monetary Affairs (ECON), European Parliament in Keynote Speech given at the ESMA Annual Conference on 17 October 2017 in Paris. This also assists in the overarching aim to get to desired 'end-state' of how financial services are regulated across the EU, with a much more 'level playing field' driven by a Single Market built upon a Single Rulebook that is much more uniform.

2. set capital requirements in a manner that is more proportionate to the risks specific to the Class of Investment Firms. This is achieved by reference to specific methodology of so-called "K-Factors" and may translate into many firms needing to raise capital to meet such new relevant regulatory capital requirements.

Supervisory objectives

The practical aim of this new regime is to ensure that the prudential i.e. the regulatory capital regime applicable to Investment Firms "better captures and regulates risks[3] that are specific to MiFID business". Such a new regime equally aims to differentiate itself from the current regulatory capital rules as they apply to the supervision of the prudential regulation of the EU's banking sector, including as applied in the Eurozone-19's Banking Union.

As with any regulatory change, the supervisory reality might turn out to be quite different from what policymakers intended. Moreover, further policymakers could join the fray. Importantly, the EBA is not the typical gatekeeper for shaping supervisory policy and how the EU's Single Rulebook for financial services applies to MiFID Investment Firms. That task usually falls to its sister pan-EU authority, the European Securities and Markets Authority (**ESMA**). However, the EBA, as supervisory "subject matter expert" amongst its peer policymakers does lead on prudential capital policymaking and thus it is the EBA that is in the lead on advising the EC on these proposed reforms.

It remains to be seen whether ESMA might also choose to get involved at an EU-27 level. Should ESMA get involved, the proposed set of rules could change even further. Irrespective of ESMA's involvement, it is also conceivable that certain Class 1 Investment Firms that undertake "banking sector comparable activities" may come under more centralised with supervision possibly led by an EU or Eurozone i.e., Banking Union authority, as opposed to supervision, including in relation to prudential regulation, being led by national authorities.

Whilst most of the proposed Recommendations apply to all Investment Firms, some apply specifically only to those that are "Commodity Derivatives Investment Firms" (**CDIF**s) i.e., as such term is used within the meaning of the MiFID II/MiFIR Framework. At present, the Recommendations of the September Opinion do not apply to funds and their managers that fall within the AIFMD or UCITS Frameworks. That being said, the September Opinion's proposal on coverage will impact any group that includes one or more Investment Firms.

In summary, if these new proposed prudential capital rules are set to enter into force, probably by way of an EU Regulation, then Investment Firms, including their counterparties, may want to take note of the (economic and regulatory) costs. Those considerations are however not self-contained. Rather, they will have a host of spillover effects including in what this might mean for various financial models and financing needs. However, these proposals may also present opportunities to streamline or optimise financing prior to the relevant changes taking affect.

[3] including an ability to account for an orderly wind down.

What is certain is that any change in the prudential regulation of Investment Firms will likely redraw the map for existing as well as new market participants. These potential changes come on top of any MiFID II/MiFIR readiness preparation and implementation that already are impacting "change the business" along with "run the business" workstreams as well as strategic projects for Investment Firms.

How do the K-Factors redraw the landscape?

The contents of the September Opinion are detailed. The scope of the proposed application is, absent certain transition periods, quite vast. The current proposed regime does not have any form of "grandfathering". Consequently, the new proposed prudential capital rules that are introduced are likely to be of relevance to those Investment Firms within the EU-27, including the Eurozone-19 and ultimately those relocating, whether from the UK or elsewhere, to the EU.

A move to a much more tiered and proportionate capital regime will potentially be costly by driving-up regulatory capital needs. It will equally place a greater emphasis on firms and their risk controls so as to minimise individual risk types with an aim to reduce their risk capital. This is especially the case given the importance Investment Firms' exposures to certain risks will play in calculating regulatory capital needs in this new regime. These risk types are referred to in the Recommendations as "K-Factors" and are based on both quantitative and qualitative considerations. Further coverage from our Eurozone Hub will follow as the K-Factor methodology and coefficients are finalised.

Depending on what "Class" an Investment Firm will fall into, and the Class allocation is driven by both the type of MiFID Investment Activity (i.e., qualitative consideration) and the K-Factor values (i.e., quantitative considerations) will trigger the relevant amount of regulatory capital levels. For many firms, the increase, especially for so called "exempt CAD" advisory firms such as those relocating from the UK, the regulatory capital could go from EUR 5,000 to 75,000. For the breadth of other Investment Firms, the increases could go from EUR 50,000 to 75,000 possibly 150,000 up to a maximum of EUR 5 million for so-called Class 1 Investment Firms and/or credit institutions.

In short, K-Factors will likely be costly in terms of additional regulatory capital, but the investment in systems and resources needed to identify, mitigate and manage risks generally as well as those specifically relevant to the K-Factors. In the interim, the table below provides a simplified overview of the relation between risk type and K-Factor:

September Opinion proposed risk type	Overall K-Factor(s) - *relevant components and coefficients not discussed*	Description
Risk to Customers (RtC)	**K-AUM**	Assets under management - under both discretionary portfolio management and non-discretionary (advisory) arrangements.
	K-CMH	Client money held.
	K-ASA	Assets safeguarded and administered. - See observations

		below.
	K-COH	Client orders handled - execution only in name of customer and reception and transmission of orders.
Risk to Market (RtM)	**K-NPR**	Net position risk - based on the market risk requirements of the CRR II Proposal and made appropriate for investment firms (only applicable to trading book positions).
Risk to Firm (RtF)	**K-DTF**	Daily trading flow - value of transactions where the firm is trading on own name (only applicable to trading book positions).
	K-TCD	Trading counterparty default - based on the BCBS proposals for counterparty credit risk and simplified for investment firms (only applicable to trading book positions). Takes into account OTC derivatives (presume this is ought to be MiFID II instruments), "long-settlement transactions" (undefined), "repurchase transactions" (repurchase and reverse repurchase transactions but not those that are Securities Financing Transactions for the purposes of the same named Regulation), and "securities or commodities lending or borrowing transactions (again - no clarity on whether these include Securities Financing Transactions for the purposes of the same named Regulation).
	K-CON	Concentration - taking inspiration form the CRR large exposures regime for trading book and simplified for investment firms (only applicable to trading book positions).

Whilst the September Opinion is a final component of what has been a long journey to deliver the desired supervisory goal, some parts of the EBA September Opinion could have benefitted from a greater review. This is especially true in terms of the EBA not considering as fully as it could the interoperability of the proposed regime with concepts across other parts of EU and national regulatory regimes that the September Opinion's proposals do not amend. In short, any final rules and new prudential regime might merit a further detailed review from affected stakeholders whilst policymakers influences and shapes the legislative process in this area. However, that consideration should not preclude affected stakeholders from taking preparatory action on how to forward-plan, irrespective of transition periods in the legislation (if any).

How does this interlink with BREXIT and Investment Firms' preparations?

Many Investment Firms may want to consider varying their permissions or apply for new permissions prior to these new rules taking effect and the prudential capital regime possibly making business "more expensive". These rules should also be read in conjunction with our Eurozone Hub's coverage on various supervisory principles on relocation[4] (**SPoR**s) as collectively these developments will affect BREXIT-proofing plans in terms of strategy as well as which legal entities will do what where and with whom.

This is the case not only for those standalone Investment Firms that are subject to ESMA's SPoRs and the ESMA SSOs, but also to those Investment Firms that are part of a group with a banking licence and subject to EU-27 relevant supervisory expectations. More importantly these considerations also apply within the Eurozone-19 and firms will need to assess how these changes interact with the supervisory priorities and expectations of the Banking Union and its Single Supervisory Mechanism (**SSM**) led by the European Central Bank.

Key takeaways and impacts in the September Opinion

An EBA Opinion is a formal legal instrument. The September Opinion comes in at 16 pages and sets out 62 general and specific "Recommendations". These should be read together with the key takeaways from the 144 page Annex to the September Opinion. The Annex to the September Opinion provides the relevant context as to the rationale on why a specific policy objective and a Recommendation was made. Analysis of these takeaways and their likely impact are summarised in Annex A to this Client Alert.

How can affected Investment Firms stay ahead of the curve?

The general MiFID II/MiFIR Framework coming into force, the changes to the CRD IV/CRR Framework as well the SPoRs will keep Investment Firms extremely busy. The final version of the proposed framework that is likely to emerge from the September Opinion is a further game changer. Thus, sourcing and allocating committed resources will be a priority and one that will help market participants to stay ahead of the curve.

Setting-up dedicated internal project teams and early channels of communication to counsel should ease the compliance burden. It will also help scenario plan all various impacts of the K-Factors and how to calibrate risk controls to reduce both conduct of business but more directly the prudential capital charges.

Linking these priorities into BREXIT-proofing workstreams, might mean that Investment Firms may wish to consider retaining appropriate legal and regulatory specialists, both within internal and external project teams that can draft, implement and ensure compliance with EU, Eurozone, respective national levels as well as third-country regimes. This dedicated workstream, whilst needing to be interoperable with regulatory authorisation applications and relocation workstreams, might be beneficial in running separately so as to ensure it has a sufficient degree of independence and an ability to challenge assumptions made by those advising on the relocation plans.

[4] See a full list of our Client Alert series on the SPoRs available on our Baker McKenzie homepage: Baker McKenzie Insights

So any chance that this will all go away? Quite unlikely. This workstream has been a longstanding supervisory priority and one that also delivers on the overarching convergence goals. That being said, the EU legislative process takes time. The timeline is likely to be protracted as a lot of the fine details are ironed out in the Regulatory Technical Standards. As other regulatory reform projects have shown, forward-planning helps stay ahead of the curve and can be done with a view to what already exists in other areas where similar regulatory/supervisory concepts exist.

So will supervisors have enough resources to police? One point that is not clear from the September Opinion is whether the reference to "competent authorities" is deliberate. Typically in EU regulatory parlance the reference to competent authorities refers to these as those national bodies. If this oversight is deliberate then is this a nod towards centralised oversight of Investment Firms by a pan-EU authority rather than national supervisors? Given that the September Opinion takes a forward-looking view on a number of developments is this the anchoring of concepts pending institutional reform of supervisors and their mandates? As above, if other policymakers and supervisors enter the fray, any final regime building on the September Opinion's Recommendations could change further.

Moreover it is worth noting that in the margins of the ESMA Annual Conference on 17 October 2017 in Paris, statements indicated a policy consideration whereby Class 1 Investment Firms, possibly some Class 2 Investment Firms could become subject to centralised supervision at some future undefined date. That would be a massive change and reintroduces wider questions on whether a single Capital Markets Union supervisor comparable to the Banking Union and its SSM might be a longer-term supervisory policy goal in delivery or merely at the planning stage. Indeed, the EBA's General Opinion on Supervisory Principles on Relocations[5], which is aimed at improving supervisory convergence in light of BREXIT, specifically calls for Class 1 Investment Firms to be subject to centralised supervision and proposes that the ECB-SSM is in the lead.

In conclusion, the September Opinion is the beginning of the end of a long process to make Investment Firms subject to prudential regulatory capital levels that are more reflective of their actual and potential risk profile. It comes on top of a full agenda and merits early action especially if this workstream is a building block for more wide-spread change that remains on the policymakers' agendas as they progress the completion of the Single Market, the Single Rulebook and delivery of the Capital Markets Union.

[5] See a full list of our Client Alert series on the SPoRs available on our Baker McKenzie homepage: Baker McKenzie Insights

Annex A

The following table sets out an overview of the key takeaways from each of the Recommendations in the September Opinion and the likely impact on relevant Investment Firms.

EBA's September Opinion and the Recommendations to EC		
# and RAG	**Key takeaways**	**Impact on relevant Investment Firms**
1 R	Development of a consolidated EU-27 version of the "Single Rulebook" applicable to all Investments Firms other than those that are designated as "Class 1" (see below) and which is separate to that applied to credit institutions.	For groups that include affected Investment Firms this new regime will have spillover effects for treasury planning. Consolidated supervision will thus differ between those groups that have only one or more Investment Firms and those that also include one or more credit institutions.
2 G	Transition arrangement(s) (applicable up to three years) for individual and consolidated capital requirements available to certain Investment Firms in limited circumstances.	Entities that might be able to apply for waivers and transitional arrangements may need to start putting together "packs" to evidence the strength of relevant safeguards and why they should benefit from such arrangements.
3 A	Introduction of a new MiFID Investment Firm categorisation distinguishing between those that are: ▪ **Class 1:** systemic Investment Firms which are exposed to the same types of risks as credit institutions and to which the full CRD IV/CRR Framework should be applied; ▪ **Class 2:** other non-systemic Investment Firms which where above specific thresholds should be subject to a more tailored prudential regime based on "K-Factors" (see below); and ▪ **Class 3:** relevant for small and non-interconnected Investment Firms providing limited services and thus to whom a proportionate application of the prudential capital regulatory regime	Affected Investment Firms will need to assess which Class they fall in and weigh-up the cost of compliance of running as a Class 1 firm versus the investment in systems and controls to ensure one remains a Class 2 or Class 3 Investment Firm.

	should be made applicable.	
4 **Unknown**	The EBA will develop Regulatory Technical Standards and criteria in order to identify Class 1 Investment Firms.	Further coverage on these items will follow from our Eurozone Hub once the technical details are available.
5 **A**	The following thresholds determine whether Investments Firms are capable of qualifying as Class 3 Investment Firms instead of Class 2 or Class 1 Investment Firms. If an Investment Firm can satisfy one or more of the following (on a consolidated basis unless stated otherwise) they will qualify as a Class 3 Investment Firm: ▪ assets under management (**K-AUM**) for both discretionary and non-discretionary portfolio management is higher than EUR 1.2 billion; ▪ client orders handled (**K-COH**) is higher than EUR 100 million a day for cash trades and/or higher than EUR 1 billion (notional) for derivatives; ▪ assets (we presume client assets) that are safeguarded and administered (on a solo basis) are higher than zero (**K-ASA**); ▪ client money held (on a solo basis) is higher than zero (**K-CMH**); ▪ K-NPR or K-CMG, K-DTF or K-TCD (each calculated on a solo basis) are higher than zero;	Investment Firms may need to consider putting in place controls to ensure they are capable of flagging when they near a relevant threshold.

	▪ balance sheet total is higher than EUR 100 million; and ▪ total gross revenues is higher than EUR 30 million.	
6 G	All Investment Firms that are not Class 1 or Class 3 should be categorised as Class 2 Firms.	Same consideration as with Recommendation 5.
7 A	All Investment Firms must meet their prudential requirements on an on-going basis. A breach of the exemptions in Recommendation 5 will require the firm to be automatically recategorised unless the threshold breach is in respect of assets under management or client orders handled, which shall result in having a three-month grace period before being recategorised.	Same consideration as with Recommendation 5.
8 R	▪ Consolidated supervision of Investment Firms for prudential capital purposes will be permitted if the following is true: ▪ the group does not include any credit institutions or Class 1 Investment Firms; ▪ consolidated supervision will look at all Investment Firms, MiFID, "any other prudentially regulated entity", financial institutions and should included tied agents where they are owned by the Investment Firm; ▪ the parent company should always be subject to a group capital test to add a group capital test to ensure control of leveraging and to ensure that the ultimate parent company located in an EU Member State should have appropriate control functions to manage sources of capital, funding and liquidity of all regulated entities within the group.	The change here to what can be consolidated and quite possibly that the scope of consolidation goes beyond EU entities is worth noting.
9 A	▪ Competent authorities, ought to be able to exercise the power to require capital	The power to consolidate follows the ethos of existing powers as say those applied by the Banking Union's Single

	requirements on a consolidated basis to an Investment Firm- Only Group where: ▪ the structure applied has been deliberately chosen to avoid appropriate capital charges; ▪ the individual Investment Firms are interconnected and there risk contributions would be material if their individual risk profiles were aggregated; or ▪ the group consists of multiple investment firms that deal on own account or execute customers' orders on their own name, which are so inter-connected, so that it would be prudent to consolidate their supervision.	Supervisory Mechanism in relation to the Eurozone's banking sector.
10 A	Certain investment firms that contain a credit institution or a Class 1 firm, may allow for prudential capital waivers for the Class 2 and Class 3 components of the group;	Similar to current rules/principles.
11 A	Subject to centralised liquidity management functions and concentration limits, competent authorities may waive individual entities from liquidity requirements and these are met at a consolidated or sub-consolidated level.	Similar to current rules/principles.
12 R	The new prudential capital regime should have only one single definition and composition of regulatory capital for all types of Investment Firms and aligned with the CRD IV /CRR Framework.	Further coverage on this from our Eurozone Hub will follow as this change develops.
13 R	CET 1 capital should constitute at least 56% if capital requirements. Additional Tier 1 is eligible up to 44% of capital requirements, Tier 2 capital is eligible up to 25% of capital requirements.	Whilst this change will be driven by firm specific attributes, the possibility of increased capital requirements and blend of types/tiers of regulatory capital may move many to explore existing or source fresh financing channels.
14 A	The use of prudential filters should be aligned with the approach proposed in EBA/Op/2014/05 which recommends	This will be driven by firm specific decisions but may prompt early

	no deviation from the proposed prudential treatment established at the international level.	scenario and impact planning.
15 G	Investment Firms should always be required to deduct items in full referred to in Arts. 37 to and including 47 of CRR when calculating their regulatory capital. Non-significant holding in financial sector entities should be exempted if held for "trading purposes".	The definition of what will satisfy "trading purposes" will follow similar regulatory developments in other fields and may merit redocumenting trading arrangements as well as policies of risk and control functions.
16 G	The new prudential regime will include a mechanism to recognise less common legal forms of Investment Firms (such as limited liability partnerships, partnerships and sole traders). This aims to provide an easier method of recognising loss absorbing capabilities of various financial instruments issued by such entities.	This is a very welcome development and will allow for more flexibility.
17 A	Minimum Capital Requirements (**MCR**) for Investment Firms for initial authorisation should be aligned with on-going capital requirements.	This may make meeting MCRs more costly from the outset.
18 A	Class 2 and Class 3 Investment Firms will have a specific level (to be defined) of Initial Capital Requirements (**ICR**).	This concept, whilst echoing the current position to a degree, contradicts the context of the principle introduced in Recommendation 17.
19 R	Investment Firms will need to meet the Permanent Minimum Capital (**PMC**) requirements and the minimum level of Fixed Overhead Requirements (**FOR**) on an ongoing basis. The September Opinion states that "PMC and FOR will be set as a minimum to the capital requirements for all Investment Firms."	The changes proposed in Recommendation 19 to and including 27 will increase the regulatory costs considerably for most Investment Firms.
20 R	ICR is proposed to be set at: ▪ EUR 750,000 for Investment Firms undertaking any of the following one or more MiFID II activities: – dealing on own account; – underwriting/placing of financial instruments – operating a MTF – operating an OTF ▪ EUR 75,000 for firms that are not permitted to hold client money or securities belong to their client and are permitted	

	to provide one or more of the following MiFID II activities – reception and transmission of orders – execution of orders on behalf of clients – portfolio management – investment advice – placing financial instruments on a firm commitment basis; and ▪ EUR 150,000 for all other Investment Firms.	
21 R	Recommended setting of PMC: ▪ Class 1 Investment Firms = EUR 5 million; and ▪ all other Investment Firms = to ICR level.	
22 R	Class 3 Investment Firms may be eligible to benefit from a five year phased transitional period to allow them to move to PMC and FOR requirements.	
23 R	FOR levels will be set to at least 25% of the fixed overheads of the previous year using the methodology in Commission Delegated Regulation 488/2015.	
24 R	MCRs for Class 2 Firms should be the higher of the following requirements: ▪ PMC; ▪ FOR; or ▪ those based on the K-Factor formula (see below).	
25 R	MCR for Class 3 Firms should be the higher of the PMC or the FOR.	
26 R	The total capital requirements for Class 2 Investment Firms should consider: ▪ risk to customer levels (**RtC**); ▪ risks posed to the market should they fail (**RtM**); and ▪ any risks to the firm itself (**RtC**).	
27 R	The methodology for calculating capital requirements in this new prudential	

	regime thus bases itself on: "K-Factors Capital Requirements" = RtC+ RtM + RtF	
28 R	This Recommendation details the K-Factors relevant for RtC. These cover those introduced in Recommendation 5 and specifically K-AUM, K-CMH, K-ASA and K-COH.	The Recommendations from 28 to and including 36 detail how the paradigm of calculating regulatory capital will change. On the one hand this might lead to more regulatory capital needed and on the other hand will require allocation of costs and resources to monitor the various quantitative and qualitative factors that shape the K-Factors.
29 R	The EBA recommends that a harmonised definition be introduced to make it clear that the K-CMH factor include all client money held regardless of the legal arrangements on asset segregation or the accounting treatment under national law of client money held by an Investment Firm.	
30 R	Introduces the K-Factors relevant for RtM calculations. These include: ▪ the net position risk for Investment Firms measured by reference to (net open) position end of day and in accordance with the proposed methodology of CRR II[6] (**K-NPR**); ▪ K-NPR should only apply to the "trading book" as such term is used in the CRR II proposal; and ▪ the K-NPR factor should apply to underwriting positions held in in the trading book and the requirements of Art. 345 are to be applied.	
31 R	RtF calculations assess the following metrics in calculating the K-Factors: ▪ trading counterparty default requirement (**K-TCD**); ▪ daily trading flow (value of transactions where the firm is trading in their own name) and capture of the relevant operational risk (**K-DTF**); and	

[6] European Commission, Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012, 23.11.2016, COM(2016) 850 final – see: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2016:0850:FIN

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	▪ risk capture of single name concentration and relevant requirements (**K-CON**).	
32 R	Investment Firm - specific characteristics may justify the introduction of some adjustments of K-NPR such as removing thresholds for using the Simplified Standardised Approach.	
33 R	The EBA points to the BCBS workstream on the use of a reduced sensitivities-based method.	
34 R	This Recommendation introduces the following formula: "K-Factors Capital Requirements" = Sum a_i *K_i where K_i are the K-Factors and a_i the coefficients (ranging from 0.01% to 0.45%) are specified in the table on page 10 of the September Opinion.	
35 R	If a number of preconditions are met and if the competent authority decides, then the RtM factor can alternatively to Recommendation 30 be set as: max(K-NPR, K-CMG). The metric K-CMG i.e., clearing member guaranteed would be the highest total intraday margin posted by the trading firm with the (general) clearing member in a previous period (e.g. three months).	
36 R	The K-Factors should be subject to a 'smoothing mechanism', in order to aid capital planning and to avoid 'cliff effects'. Such mechanism should be based on rolling averages and a deferral period between the date of capital requirements and the date of their application. The extent of such smoothing may vary by individual K-Factor, the volatility and the risk posed in the RtC, RtM or RtF etc.	
37 A	The Liquidity Coverage Ratio pursuant to Commission Delegated Regulation (EU) 2015/61 (the **LCR CDR**), but at present not the Net Stable Funding Ratio (**NSFR**), should be applied to all Class 1 Investment Firms	In future the NSFR may be rolled out to all Class 1 Investment Firms.
38 A	Class 2 and 3 Investment Firms are expected to have internal rules and	For smaller firms, irrespective of their Class in the new regime, this will

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	processes that allow them to monitor, measures and manage exposures and liquidity needs to ensure there resources are adequate.	translate into costs and allocation or resources.
39 R	Class 2 and 3 Investment Firms should hold liquid assets liquid to one-third of the FOR level.	For many this will possibly merit a recalibration of FOR levels.
40 R	Eligible liquid assets should meet the liquidity requirements applicable to those that are "high quality liquid assets" (**HQLA**) of Level 1, 2A and 2B assets as set out in the LCR CDR.	This might cause Investment Firms to need to source additional capital by either raising new or transforming existing assets into HQLA.
41 R	Haircuts should be applied to the market value of assets held by Investment Firms for the purposes of meeting minimum liquidity requirements and aligned with the levels in the LCR CDR. Unencumbered own cash of the firm should, according to this Recommendation, receive a 0% haircut.	Further coverage on this development will be made available as and when the various haircuts and liquidity requirements (incl. coefficients) proposed by the new regime are finalised.
42 R	The level of liquidity requirements are proposed to be adjusted by deducting 1.6% of the total amount of guarantees provided to customers from the sum of liquid assets.	
43 A	Specifically for Class 3 Investment Firms, any trade debtors, fees or commissions receivable within 30 days would, subject to certain preconditions, be able to meet minimum liquidity requirements.	One should probably expect further clarification as to what exactly might qualify as receivables.
44 G	During exceptional and unexpected circumstances and subject to a regulatory notification requirement, all Investment Firms are permitted to monetise their liquid assets to cover their liquidity assets even if this causes the amount of liquid assets to fall below minimum liquidity requirements.	It remains to be seen what circumstances will be permitted to allow the application of this fire sale derogation.
45 A	All Investment Firms will be required to monitor their concentration risk including in respect of their RtC.	For a number of firms, this might prompt a need to revisit their own policies and procedures including ability to report.
46 A	Class 2 Investment Firms are recommended by the EBA to report to competent authorities their concentration risk levels in respect: ▪ of default risk for individual counterparties on an	

	aggregate basis; ▪ institutions where client money is held; ▪ institutions where securities (but strangely not where client assets?) are held; ▪ institutions where the own cash (but not other funds) is deposited; and ▪ risk from earnings.	
47 **A**	Class 3 Investment Firms will not be subject to concentration risk reporting requirements.	
48 **A**	Class 2 Investment Firms with a trading book exposure arising from its MiFID II activity dealing on own account or trading on own name when executed client orders will also have the following concentration risk limits: ▪ maximum exposure limit of 25% of capital; ▪ counterparty exposures to one or more credit institutions or Investment Firms or a group thereof should not exceed the higher of 25% of capital or EUR 150 million; and ▪ counterparty exposures to connected clients that are not credit institutions or investment firms should not exceed 25% of capital. When the EUR 150 million level is higher than 25% of capital, than the limit of counterparty exposures shall not exceed 100 percent of capital. The limits laid down in respect of the above may be exceeded if the additional capital requirements of K-CON are met.	Affected firms will need to assess the degree of their actual and potential concentration risk exposure.
49 **Unknown**	Pillar 2 capital requirements will continue to be applied to introduce firm specific capital requirements.	The impacts of this development will be, as presently, quite firm driven. Specialist advice should be taken.
50	Pillar 2 methodology will be harmonised	Further coverage will be made available

A	by issuance of further Regulatory Technical Standards aiming at achieving supervisory convergence.	from our Eurozone Hub once the Regulatory Technical Standards and the "simplified reporting framework" are finalised.
51 A	Class 2 and 3 Investment Firms will be able to benefit from a "simplified reporting framework". Class 1 Investment Firms are envisioned to be subject to the same reporting framework as credit institutions.	
52 A	This Recommendation sets out the reporting requirements proposed by the EBA for the Class 2 and 3 Investment Firm "Simplified Reporting Framework".	This list is not comprehensive of all other standing and/or event driven reporting requirements. The impacts will be specific to the nature and type of firm and its regulated business activity.
53 A	Pillar III public disclosure requirements will still play a role for Class 2 Investment Firms who will need to disclose level of capital and their capital requirements. Class 3 Investment Firms are set to be excluded from reporting requirements for the purposes of this new prudential capital regime.	As with considerations above, indirect costs of ensuring the correct Class allocation will drive the Pillar III disclosure issue.
54 (CDIFs only) R	CDIFs will be subject to the proposed new prudential regulatory regime.	This may introduce a number of issues on setting adequate capital levels.
55 (CDIFs only) R	The new prudential capital regime will be tailored to the specifics of CDIFs and their business activities.	
56 (CDIFs only) R	CDIFs will benefit from a transitional regime that is driven by the finalisation of the MiFID II/MiFIR Framework's rules applicable to CDIFs.	
57 (CDIFs only) A	The EBA recommends that CDIFs might benefit from exemptions from certain prudential requirements in relation to those positions that are "…objectively measureable as reducing risks directly related to commercial activities."	This proposed exemption mirrors a similar "hedging" and "end-user" exemption in the EU's regulatory framework in EMIR. As with EMIR, focus will lie both on supervised and supervisors defining what activity will satisfy the qualitative criteria.
58 (CDIFs only) G	Governance and remuneration requirements contained in Art. 109 CRD IV remain applicable to all Investment Firms. That being said: ▪ Class 2 and 3 Investment Firms may apply "…a lighter governance framework…" (undefined) than those that are Class 1 Investment Firms;	This is a welcome development that could open up easier and more proportionate compliance on rules on remuneration.

	▪ Art. 74 CRD IV's provisions will only apply to Class 1 and will not apply to Class 2 and 3 Investment Firms; ▪ Class 2 Investment Firms that hold client assets will need to comply with Art. 76 CRD IV; ▪ Member States and competent authorities will have discretion as to whether Class 2 Investment Firms will need to create relevant committees (risk, nomination and remuneration) as required in the CRD IV/CRR Framework. For Class 1 Investment Firms, they will need to continue to comply and Class 3 Investment Firms are deemed out of scope of this requirement; ▪ All Investment Firms that deal on own account and which are also allowed to hold client assets will need to comply with Art. 83 CRD IV on market risks; ▪ Class 2 Investment Firms and their supervisors will need to comply with Art. 85 CRD IV; and ▪ Country by country reporting for purposes of Art. 89 CRD IV will only be recommended for Class 2 Investment Firms.	
59 G	Class 1 Investment Firms will need to fully comply with the CRD IV/CRR Framework on remuneration. Class 2 and 3 Investment Firms may apply a lighter touch regime (including with respect to disclosure and variable remuneration i.e. bonus components), with Class 2 Investment Firms applying similar requirements to Art. 92 to and including 94 CRD IV and focus on their material risk takers and Class 3 Investment firms only requiring to apply the MiFID II/MiFIR Framework rules on remuneration.	
60	The EBA recommends that the new	Further coverage on this will be made

Unknown but likely to be **A**	prudential capital regime also include a macroprudential supervisory element and interface with existing or new tools.	available from our Eurozone Hub as this workstream continues to develop.
61 Unknown but likely to be **A**	This Recommendation assesses whether a tiered approach should be adopted in respect of the macroprudential interface.	
62 No present impact	As with other EU legislative and regulatory regime, this Recommendation calls upon the EC or indeed the EBA to undertake a review process three years after the application of the new regime.	No present impact.

Hot Topics

If you would like to receive more analysis from our wider Eurozone Group or in relation to the topics discussed above or in the text of the September Opinion, then please do get in touch with any of our Eurozone Hub key contacts below.

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