Deloitte.

Regulatory News Alert

Investment firm's prudential treatment

30 October 2018

Introduction and context

On 27 September, the ECON committee of the European Parliament issued draft reports on the Commission proposals for a directive and regulation on the prudential supervision and requirements for investment firms a model in some respects equivalent to the approach used for banks.

These two drafts were initially issued by the Commission on December 2017.

Content of the Commission proposal

Under the Commission proposals, three different classes of investment firms should be created and each would have a different prudential treatment with increasing capital requirements.

The class assigned to the investment firm, will determine among others the liquidity, reporting and governance requirements will be applicable to them.

- **Class 1**: Large/systemic investment firms which **would have to comply with the full CRR/CRD package** (incl. level 2 measures and guidelines)
- **Class 2**: *Other non-systemic investment firms* which would apply ratio depending the fulfilment of thresholds on specific part of their activities
- **Class 3**: *Small and not inter-connected investment firms*, which would fall under a **simplified prudential regime**.

The ratio considered for class 2 are the following:

- Risk to customers factors:

  - **K-AUM** : Assets under management –under discretionary and non-discretionary arrangements

  - **K- CMH** : Client money held

  - **K-ASA** : asset safeguarded and administered

  - **K-COE** : Customers' orders executed (incl. execution only operations)

Deloitte.

- Risk to market factors:

  - **K- NPR**: Net position risk based on CRR market risk requirements with some adaptation to the specificities of investment firms

  - **K-DTF** : Daily trading flow

- Risk to firms factors:

  - **K-TCD** : Trading counterparty default (simplified assessment than the CRR CCR)

  - **K-CON** : Concentration risk (CRR large exposure regime)

Amendment made by the Parliament

The draft report proposes several amendments to the Commission's proposals, particularly, what the Parliament wants:

- Enable NCA (national competent authorities) to subject an investment firm below a certain asset threshold to class 3 prudential requirements when the failure of the firm may pose a systemic risk
- Extend the period during which thresholds must be exceeded before moving an investment firm to a higher class
- Increase the number of investments that should be subject to the lowest requirements
- Strengthen the rules on equivalence for third country investment companies
- Ask investment firms to set up an EU subsidiary if they wish to provide typical bank like services

The Parliament also wishes to encompass other regulatory considerations into the investment firm prudential regime:

Sustainable finance

- The Parliament wants to include ESG factors in the provisions of the proposals.
- ESG factors shall be taken into consideration in the risk- mitigating arrangements of the investment firms and a specific more favourable prudential treatment should be applied to assets exposed to activities associated with environmental or social objectives.

Cybersecurity

- The Parliament also wants to entice investment firms to reduce risks posed to the security of their network and information systems to ensure confidentiality, integrity and availability of the processes and data, in some form applying an operational risk on top of capital requirements.

Remuneration policy

- The Parliament wish to incorporate gender equality rules to the remuneration policies of investment firms as is currently the case under both MIFID II and CRD/CRR.

Next steps

Once the Parliament votes the two texts in plenary session and the Council agrees on its own version of the texts, the trilogue phase will start. Depending on the respective positions, this might take some time to reconcile the different versions into the final applicable one.

How Deloitte can help?

Deloitte can help you assess the necessary prudential capital for your institution; help you in designing the optimal models.

Deloitte can also help you with its RegWatch Kaleidoscope service to stay ahead of the regulatory curve to better manage and plan upcoming regulations.

Your contacts

Laurent Berliner
Partner – EMEA FSI Risk Advisory Leader
Tel : +352 45145 2328
lberliner@deloitte.lu

Simon Ramos
Partner – IM Advisory & Consulting Leader
Tel : +352 45145 2702
siramos@deloitte.lu

Arnaud Duchesne
Director – Advisory & Consulting
Tel : +352 45145 4852
aduchesne@deloitte.lu

Benoît Sauvage
Senior Manager – RegWatch, Strategy and Consulting
Tel : +352 45145 4220
bsauvage@deloitte.lu

Deloitte Luxembourg
560, rue de Neudorf
L-2220 Luxembourg

Tel: +352 451 451
Fax: +352 451 452 401
www.deloitte.lu

Designed and produced by MarCom at Deloitte Luxembourg