Regulatory News Alert
One-step closer to the new capital requirement framework for investment firms
09 January 2019

Context and objectives

On 7 January 2019, EU ambassadors endorsed the Council's position on a package of measures, composed of a regulation and a directive, setting out a new regulatory framework for investment firms. This marks a clear evolution towards the introduction of EU capital requirements for investment firms inspired by the banking regulation.

The EU framework governing the authorization and conduct of investment firms is set out in Directive 2014/65/EU ("MiFID 2") and Regulation (EU) No 600/2014 ("MiFIR") with the prudential rules being a part of the wider EU prudential framework, which mainly applies to banks. Therefore, prudential requirements for investment firms are currently set out in Directive 2013/36/EU and Regulation (EU) No 575/2013 on capital requirements for banks and investment firms (also known as “CRD IV/CRR”).

If there was a trend to impose more robust capital requirements for non-bank entities, it was also obvious that standards intended for banks were not fully applicable to the specificities of investment firms. For this reason, the EU conducted a review of these rules in order to understand if they are appropriate for investment firms, or if a new, more targeted set of rules is required.

From March 2017 until December 2017, the EU Commission worked on a proposal for directive and regulation to design a prudential regime for investment firms merging MIFID II and CRD framework.

With that purpose in mind, prudential standards aim to minimize the spread of risks across firms and the economy by requiring that investment firms manage their business risks adequately to avoid potential failure. Hence, the new regime will increase the capital needs for the firms concerned. According to a set of factors that combine the complexity of the business model with size and other operational risks.

In addition, the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) are working with the European Commission on the review of the prudential rules for investment firms. The two authorities are collecting data and have published reports and other documents on the issue.
Where we stand today?

Based on the text agreed on 7 January, investment firms would be subject to the same principles and key measures, in particular regarding capital holdings, reporting, corporate governance and remuneration. However, the set of requirements they would need to apply would be characterized according to their size, nature and complexity. The regulation creates four classes of firms:

- **The largest firms would be subject to the full banking prudential regime** and would be supervised as credit institutions:

  **Investment firms that provide "bank-like" services**, such as dealing on own account or underwriting financial instruments, and whose **consolidated assets exceed EUR 15 billion** would **automatically be subject to CRR/CRD4**;

  **Investment firms engaged in "bank-like" activities with consolidated assets between EUR 5 and EUR 15 billion** could be requested to apply CRR/CRD4 by their supervisory authority, in particular if the firm's size or activities would involve risks to financial stability.

- **Smaller firms** that are not considered systemic would enjoy a new bespoke regime with dedicated prudential requirements. These would, be generally different from those applicable to banks, but competent authorities could allow continuing applying banking requirements to certain firms, on a case-by-case basis, to avoid disrupting their business models. The text also **provides for a 5-year transitional period** to give companies enough time to adapt to the new regime.

The Council text **further strengthens the equivalence regime, as set out in MIFID2/MIFIR that would apply to third country investment firms**. It outlines in great depth some of the requirements for giving them access to the single market and grants additional powers to the Commission. In particular, in case the activities performed by third country firms are likely to be of systemic importance, or to prevent regulatory arbitrage.

Next steps

The Parliament voted on its position on this file 24 September 2018. Negotiations between the Council and the Parliament are therefore ready to start and should probably close before the recess of the EU Parliament at the end of April 2019 still to be approved this year.

How Deloitte can help you?

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