

Regulatory News Alert

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Opinion of the European Banking Authority on a new prudential regime for investment firms

On 29 September 2017, the European Banking Authority (EBA) issued its opinion on the design of a new prudential regime for investment firms. This addresses the view among EU regulators that the current CRD IV prudential regime is not appropriate for the majority of investment firms.

In a previous report published on 15 December 2015, the EBA had already stressed the necessity to make a distinction between those investment firms for which the CRD and CRR provide appropriate prudential requirements and the investment firms for which those requirements are not appropriate. For the latter, the EBA recommended that a specific prudential regime should be designed.

Three classes of investment firms subject to different remuneration rules

The EBA's proposal for remuneration rules under a new regime is based on three different classes of firms:

	Class 1	Class 2	Class 3
Description	Firms with the same type of risks as credit institutions	Non-systemic firms that do not fall into Class 1 or 3 firms	Small and non-interconnected investment firms providing limited services
Identification criteria	Dedicated Level 2 Regulatory Technical Standards to be developed	Does not meet Class 1 criteria, however exceeds any of the categorization thresholds (see below)	Does not exceed any of the categorization thresholds (see below)
Remuneration rules	Full application of CRD IV requirements	Partial application of CRD IV requirements	MiFID II requirements only

Categorization criteria

Investment firms that do not exceed any of the following categorization thresholds should be classified as Class 3 firms:

1. €1.2 billion assets under management
2. Client order handled – €100 million per day (cash trades) and €1 billion per day (derivatives)
3. No assets safeguarded and administered
4. No client money held
5. Balance sheet total – €100 million
6. Total gross revenues – €30 million

Any investment firms exceeding one threshold are categorized as Class 2 firms.

What is meant by partial application of CRD IV rules?

For identified material risk takers within Class 2 firms, the EBA suggests that the remuneration rules should be similar to the requirements set out in Articles 92 to 94 of Directive 2013/36/EU (CRD IV).

However, the EBA's proposals contain specific remuneration recommendations for Class 2 firms:

- **Cap on variable remuneration**

The EBA advises the Commission that it should take into account all the advantages and disadvantages of a bonus cap when proposing a remuneration framework for Class 2 firms.

- **Pay-out in instruments**

The EBA proposes to simplify payment in instruments for Class 2 firms, which will be able to use a mix of instruments, where appropriate, but also have the possibility to pay the entirety of the variable remuneration in one category of instrument. Furthermore, waivers should be available for small Class 2 firms and staff that received a low level of remuneration.

- **Proportionality principle**

The EBA proposes that Class 2 firms should be able to apply the proportionality principle on an individual and firm-wide basis, hence neutralizing some requirements, however, the EBA has not provided any recommendations on either an individual De Minimis or a firm-wide threshold.

- **Disclosure**

Class 2 firms should be subject to simpler and less granular disclosure requirements, though the collection of data on high earners by Member States and its publication by the EBA is still recommended.

What about Class 2 or 3 firms belonging to a Banking Group?

For Class 2 and 3 firms that are part of a banking group, the EBA recommends that the remuneration requirements of CRD IV should still apply on a consolidated basis to all identified staff whose professional activities have a material impact on the risk profile of the group. For staff in Class 2 and 3 firms who do not have a material impact on the group's risk profile, the CRD IV requirements should no longer apply.

Next steps on European level

We understand that the Commission intends to complete its development of proposed legislation for a new prudential framework for investment firms by the end of 2017.

As with other European Directives, this new framework will need to go through the full European legislative process before it becomes effective.

What about Luxembourg?

Similar to the opinion issued by the EBA, we observe three categories of investment firms in Luxembourg. This was clarified by the publication of CSSF circular 17/658, which (i) adopts the EBA guidelines on sound remuneration principles and (ii) maintains until further notice the application of CSSF circular 10/497 specific to Investment firms.

- **What does it mean?**

In Luxembourg we do the distinction between three types of Investment firms:

	Class 1	Class 2	Class 3
Framework	CRR	Non-CRR	
	Similar activities than Credit Institutions	Activities go beyond those of Class 3	Only authorized to provide the service of investment advice and/or to receive and transmit orders from investors without holding funds or securities belonging to their clients.
Remuneration rules	Full application of CRD IV requirements	Application of CSSF circular 10/497	Application of CSSF circular 10/437
Proportionality	11/505 – Neutralization of Bonus Cap not possible	11/505 Annex B – No Bonus Cap applicable under 10/497	N/A

Additional info

Please click the following link for more details:

<http://www.eba.europa.eu/-/eba-issues-opinion-on-the-design-of-a-new-prudential-framework-for-investment-firms>

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