

Deloitte.



The impact of the new
IFD/IFR regime
An article series with five
different perspectives

Article 4



MAKING AN
IMPACT THAT
MATTERS
since 1845

IFR Consolidation – All For One And One For All

Is your investment firm part of a larger group? Then you may be in scope for prudential consolidation under the new IFD/IFR regime. This fourth article of [our series](#) on the new prudential framework provides an easy-read deep-dive on this topic. Which supervisory options are available to you?

1. What is prudential consolidation?

Prudential consolidation means supervisors not only look at one single investment firm for the compliance with new IFD/IFR prudential requirements, but also at other entities in a group. This may apply to parent undertakings, but also to other subsidiaries in the group, or subsidiaries of the investment firm. The Investment Firm Regulation (IFR)¹ mainly sets out terms on the application level of the new prudential requirements, while the Investment Firm Directive (IFD)² covers more general terms on consolidated supervision.

2. When does consolidation apply to me?

The general application level for investment firms under IFR is to comply with the requirements on an *individual* basis.³ However, there are several exemptions and situations possible that result in different application levels and calculation methods. We will dig deeper into this in the next paragraphs.

Class 3 firms related to a Credit Institution

To start with the first exemption, small and non-interconnected investment firms (also known as class 3 firms) do not have to comply with the requirements individually when they are a subsidiary and fall under CRR consolidated supervision of a credit institution (bank) or (mixed) financial holding company (see Figure 1). Please take note that there are several other conditions to take into account, such as supervisory consent.

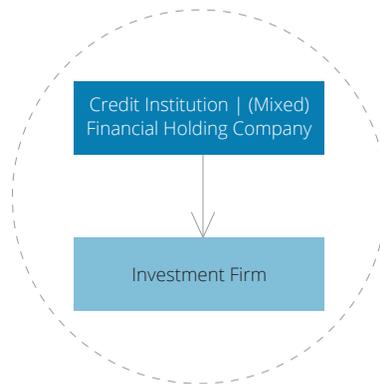


Figure 1. Class 3 investment firm is subsidiary in a group under CRR consolidation

In case a credit institution (bank) is part of the group, the IFR consolidation regime will not apply as it remains under the CRR consolidation regime to ensure stability of the financial system.⁴

Class 3 firms part of an investment firm group

There is a second group of firms that is exempted from complying with the IFR requirements on an individual basis. These are class 3 firms that are subsidiaries in an *investment firm group* supervised under IFR consolidation.⁵ Class 3 firms do not have to (among others) calculate its individual own funds requirement and hold sufficient liquid assets next to the consolidation entity at top-parent level.⁶ By comparison, class 2 firms (e.g.

firms that hold client funds or who trade on a daily basis), and their top-parent undertaking will both have to comply.

Other investment firm group structures

Other investment firm groups that fall under IFR prudential consolidation are not exempted from complying with the rules on an individual basis. For these groups, consolidation only takes place at the highest level. Figure 2, 3 and 4 depict the different variants of investment firm groups that fall under IFR consolidation. These are:

- Union parent investment firms (Figure 2). For Union parent investment firms, the top parent company must be a regulated EU investment firm itself;

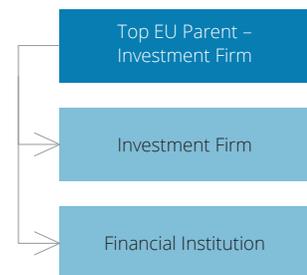


Figure 2. Union Parent Investment Firm Consolidation Group

- Union parent investment holding companies (Figure 3). Union parent investment holding companies are themselves a financial

1 Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms ("IFR").
 2 Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms ("IFD").
 3 Article 5 IFR. The general application level (individual compliance) does not apply to IFD, as application levels in IFD differ per section or specific article 2.
 4 Article 7 (1) IFR and consideration 41 IFR.
 5 Several additional conditions apply to this second exemption.
 6 See however below paragraph on liquidity exemptions.

institution and have exclusively or mainly investment firms or financial institutions as subsidiaries (but at least 1 investment firm)⁷;

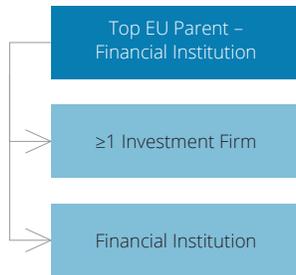


Figure 3. Union Parent Investment Holding Company Consolidation Group

Union parent mixed financial holding companies (Figure 4). The last variant of investment firm groups that fall in scope of IFR consolidation are the Union parent mixed financial holding companies. The top-level parent entity is itself *non-regulated* but is part of a financial conglomerate that operates mainly in the financial sector (investment/banking sector and insurance sector).

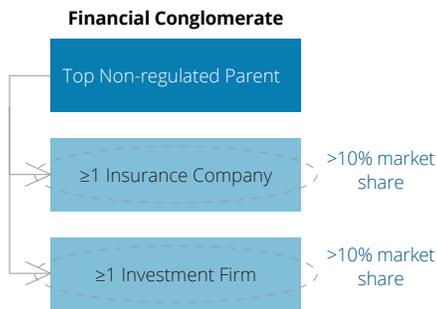


Figure 4. Union Parent Mixed Financial Holding Company Consolidation Group

An interesting fact is that, different from CRR, no sub-consolidation on lower levels in the consolidation group is possible. This means that the top parent (holding) has to comply with the IFR provisions, which could itself be a non-regulated entity. Take note that the scope of prudential consolidation must be determined per individual case.

3. What are the consequences?

Main IFR Consolidation Requirements

The consolidation requirements set by IFR can impact investment firms in multiple ways:

- **Capital**

The parent firm might need to hold more own funds at a consolidated level than the subsidiary firms need to hold individually. This can occur when, for example, concentration risks to an individual counterparty are higher at group level. As investment firms domiciled in Europe may have to apply and consolidate capital requirements of 3rd country subsidiaries, this may cause significant competitive disadvantages compared to firms domiciled in Asia, the US or post-Brexit UK;

- **Data**

The top parent must have access to all required data to calculate own funds and liquidity requirements and to disclose and report correctly. Therefore, the parent firm must ensure that all required (historical) data is available for its subsidiary firms in scope and that a monitoring process is in place to monitor risk exposures over time;

- **Reconciliation of accounting standards**

The requirements set by IFR also apply to undertakings established in 3rd countries, which, were they established in the EU, would fulfil the definitions of investment firm, financial institution, ancillary services undertaking or tied agent.⁸ Reconciliation of accounting standards might therefore be necessary to be able to correctly calculate the capital and liquidity requirements and to meet disclose and reporting requirements;

- **Organizational structure & Internal controls**

The IFR requires parent firms and their subsidiaries to set up a proper organizational structure and appropriate internal control mechanisms in case of prudential consolidation.⁹ This is to ensure that the data

required for consolidation is duly processed and forwarded. Also subsidiaries who do not fall in scope of the IFR have to implement sufficient consolidation arrangements, processes and mechanisms;

- **IFD application level**

Furthermore, the internal governance, transparency, risk management and remuneration requirements in IFD should both be applied on individual and consolidated basis¹⁰, unless one of the exceptions on prudential consolidation applies (such as the Group Capital Test, see the paragraph below).

The parent firm is allowed to request the regulator to apply proportional consolidation, according to the share of capital held of participations in investment firms, financial institutions, ancillary services undertaking or tied agents managed with one or more firms (participating firms) not included in the consolidation.

4. Are there any consolidation options in the Netherlands?

IFR provides several alternative options to the full IFR consolidation:

1. Group Capital Test

The Dutch Supervisor (DNB) may allow a Group Capital Test for groups that are sufficiently simple, provided there are no significant risks to clients or market arising from the group as a whole (that would otherwise require supervision on a consolidated basis).

To meet the group capital requirements of the Group Capital test, a parent firm needs to hold at least enough own funds instruments¹¹ to cover the sum of the following:

a) The sum of the full book value of all of their holdings, subordinated claims and instruments in investment firms, financial institutions, ancillary services undertakings and tied agents in the investment firm group; and

⁷ It may not be a financial holding company in the sense of the CRR.

⁸ Article 4(11) IFR.

⁹ Article 7(1) IFR.

¹⁰ Article 25(4) IFD & article 3:269 Dutch Financial Supervision Act (Wft).

¹¹ The own funds of investment firms should consist of common equity Tier 1 capital, additional Tier 1 capital and Tier 2 capital as defined in the CRR, Article 9(1) IFR.

b) The total amount of all of their contingent liabilities in favor of investment firms, financial institutions, ancillary services undertakings and tied agents in the investment firm group.

Investment Firms can already apply for the Group Capital Test at DNB.

2. Dutch Liquidity Exemptions

The IFR contains options for supervisory authorities to exempt certain small and non-interconnected investment firms and certain parent holdings from the IFR liquidity requirement.¹² DNB has however indicated that it intends not to grant these exemptions in the Netherlands. Nevertheless, it is possible to request a temporarily lower required

amount of liquid assets in exceptional circumstances.¹³ Also, investment firms supervised on consolidated basis under CRR or IFR can request to not having to comply with the liquidity requirements on an individual level.¹⁴

3. CRR Opt-in

Finally, DNB provides a possibility to Dutch investment firms to apply the CRR regime instead of the IFD/IFR regime on a voluntarily basis. There are some strict conditions for this, to avoid e.g. regulatory arbitrage.

5. Next Steps

Investment firms should individually determine whether their group falls within the

scope of prudential consolidation of IFR or any other prudential framework. It is important to determine the links between the different entities to be able to set the right scope. Also, the right Union parent undertaking should be appointed for the prudential consolidation. If the parent undertaking is subject to prudential consolidation of IFR, it must assess whether all required data is widely available in order to compute and monitor the consolidated capital and liquidity requirements.

When your investment firm group wishes to apply for the Group Capital Test or other calculation methods, it can already prepare and file the application at DNB. You could jump the line with an early submission.

Contact us:



Marieke van Eenennaam

Partner

mvaneennaam@deloitte.nl
+31882888707

Marieke is partner at Deloitte Risk Advisory and responsible for Deloitte offerings in the asset management market segment.



Sjoerd Kampen

Director

skampen@deloitte.nl
+31683555111

Sjoerd is Director at Deloitte Risk Advisory and focuses on financial risk management for financial institutions.



Renate Kramers

Junior Manager

rkrammers@deloitte.nl
+3188 288 5780

Renate is Junior Manager at Deloitte Risk Advisory and focuses on regulatory risk management in the financial services industry.

¹² Article 43(1) IFR and article 7(4) IFR.

¹³ Article 44 IFR.

¹⁴ Under some additional requirements, see article 6(3) IFR.

Deloitte.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited (“DTTL”), its global network of member firms, and their related entities. DTTL (also referred to as “Deloitte Global”) and each of its member firms are legally separate and independent entities. DTTL does not provide services to clients. Please see www.deloitte.nl/about to learn more.

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our network of member firms in more than 150 countries serves four out of five Fortune Global 500® companies. Learn how Deloitte's approximately 264,000 people make an impact that matters at www.deloitte.nl.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the “Deloitte network”) is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.