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COM(2017) 790 final

2017/0359 (COD)

Proposal for a

**REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**on the prudential requirements of investment firms and amending Regulations (EU) No 575/2013, (EU) No 600/2014 and (EU) No 1093/2010**

(Text with EEA relevance)

{SWD(2017) 481 final}

## EXPLANATORY MEMORANDUM

### 1. CONTEXT OF THE PROPOSAL

#### • **Reasons for and objectives of the proposal**

The EU needs stronger capital markets in order to promote investment, unlock new sources of financing for companies, offer households better opportunities and strengthen the Economic and Monetary Union. The Commission is committed to putting in place all the remaining building blocks in order to complete the Capital Markets Union (CMU) by 2019<sup>1</sup>.

Investment firms provide a range of services that give investors access to securities and derivatives markets (investment advice, portfolio management, brokerage, execution of orders etc.). Investment firms and the services they provide form a vital cog in a well-functioning CMU. They play an important role in facilitating savings and investment flows across the EU, with various services used to support effective capital allocation and risk management.

There are investment firms in all Member States. According to information compiled by the European Banking Authority (EBA), there were 6 051 investment firms in the European Economic Area (EEA)<sup>2</sup> at the end of 2015. These include firms providing a limited set of services to retail customers in the main through to those offering a number of services to a broad range of retail, professional and corporate clients.

Based on information from the EBA, around 85 % of EEA investment firms limit their activities to:

- offering investment advice;
- receiving and transmitting orders;
- managing portfolios; and
- executing orders.

Acting as an important hub for capital markets and investment activities, the UK has the largest number of EEA investment firms, with roughly half of them based there, followed by Germany, France, the Netherlands and Spain. Most EEA investment firms are small or medium-sized. The EBA estimates that some eight investment firms, largely concentrated in the UK, control around 80 % of the assets of all investment firms in the EEA.

As one of the new priority actions to strengthen capital markets and build a CMU, the Commission therefore announced in its Mid-Term Review of the Capital Markets Union Action Plan<sup>3</sup> that it would propose a more effective prudential and supervisory framework

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<sup>1</sup> See ‘Communication on the Mid-Term Review of the Capital Markets Union Action Plan’, COM(2017) 292 final, 8 June 2017; and, ‘Communication on Reinforcing integrated supervision to strengthen Capital Markets Union and financial integration in a changing environment’, COM(2017) 542 final, 20 September 2017.

<sup>2</sup> EBA report on investment firms, response to Commission’s call for advice of December 2014 (EBA/Op/2015/20), Table 12: Population of investment firms, by category, by country, p. 96. <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-20+Report+on+investment+firms.pdf>

<sup>3</sup> COM(2017) 292 final.

for investment firms, calibrated to the size and nature of investment firms, in order to boost competition and improve investors' access to new opportunities and better ways of managing their risks. In view of the pivotal role played by UK investment firms in this area to date, the UK's decision to withdraw from the EU further underlines the need to update the regulatory architecture in the EU in order to support this development.

The proposals covering this Regulation and the accompanying Directive ('the proposals') were included in the 2017 Commission Work Programme as a REFIT exercise. They aim to ensure that investment firms are subject to capital, liquidity and other key prudential requirements and corresponding supervisory arrangements that are adapted to their business yet sufficiently robust to capture the risks of investment firms in a prudentially sound manner in order to protect the stability of the EU's financial markets. The proposals are the outcome of a review mandated by Articles 493(2), 498(2), 508(2) and 508(3) of Regulation (EU) No 575/2013 (Capital Requirements Regulation, or CRR)<sup>4</sup> which, together with Directive 2013/36/EU (Capital Requirements Directive IV, or CRD IV)<sup>5</sup>, constitute the current prudential framework for investment firms. When agreeing these texts, co-legislators decided that the framework for investment firms should be reviewed given that its rules are largely geared to credit institutions.

Unlike credit institutions, investment firms do not take deposits or make loans. This means that they are a lot less exposed to credit risk and the risk of depositors withdrawing their money at short notice. Their services focus on financial instruments – unlike deposits, these are not payable at par but fluctuate according to market movements. They do however compete with credit institutions in providing investment services, which credit institutions can offer to their customers under their banking licence. Credit institutions and investment firms are therefore two qualitatively different institutions with different primary business models but with some overlap in the services they can provide.

Investment firms have been subject to EU prudential rules alongside credit institutions since 1993, the year in which the first EU framework governing the activities of investment firms entered into force. Now replaced by the Markets in Financial Instruments Directive (MiFID)<sup>6</sup> and, as of January 2018, by MiFID II / MiFIR<sup>7</sup>, this framework sets out the conditions for authorisation and organisational and business conduct requirements under which investment services can be provided to investors as well as other requirements governing the orderly functioning of financial markets.

The prudential framework for investment firms in the CRR/CRD IV works in conjunction

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<sup>4</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1-337).

<sup>5</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338-436).

<sup>6</sup> Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1-44).

<sup>7</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349-496) and Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (OJ L 173, 12.6.2014, p. 84-148).

with MiFID. Typically, prudential requirements on financial institutions are designed to (i) ensure that they have sufficient resources to remain financially viable and to carry out their services through economic cycles; or (ii) enable an orderly wind-down without causing undue economic harm to their customers or to the stability of the markets they operate in. As a result, they should aim to reflect the risks that different financial institutions face and pose, be proportionate to the likelihood of the risks occurring, and broadly strike a balance between ensuring the safety and soundness of different financial institutions and avoiding excessive costs which could hinder them from carrying out their business in a viable way.

Systemic investment firms, a number of which are identified as global, or other systemically important institutions under Article 131 of CRD IV should still be subject to the CRR/CRD IV framework, including the amendments proposed by the Commission on 23 November 2016<sup>8</sup>, in accordance with the revised approach for identifying them in the proposals. This is because these firms typically incur and underwrite risks on a significant scale throughout the single market. Their activities expose them to credit risk, which is mainly in the form of counterparty credit risk as well as market risk for positions they take on own account, whether for their clients or themselves. They therefore constitute a greater risk to financial stability given their size and interconnectedness. In light of these risks and in order to ensure a level playing field, such systemic investment firms should be treated as credit institutions.

As announced in the Commission Communication of September 2017 on the review of the European Supervisory Authorities<sup>9</sup> (ESAs), this would also imply among other things that their operations in Member States participating in the Banking Union are subject to direct supervision by the ECB in the Single Supervisory Mechanism. At present, these firms are largely concentrated in the UK but are in the process of considering plans to relocate parts of their operations to the EU-27, notably to Member States participating in the Banking Union. While this covers only a small number of firms, they nevertheless represent a sizeable share of the total assets and business volume of all investment firms in the EU.

For other investment firms, the fact that the current prudential framework focuses on credit institutions and the risks they face and pose rather than investment firms is more problematic. The services provided by these firms and the risks they can create are, to a large extent, not explicitly addressed by the existing rules. Of the eight investment services that investment firms are authorised to perform under MiFID<sup>10</sup>, only (i) dealing on own account; and (ii) underwriting or placing instruments on a firm commitment basis have clear corresponding requirements under the CRR. For the other investment services (reception and transmission of orders, execution of orders, portfolio management, investment advice, placing instruments without a firm commitment basis, operation of a multilateral trading

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<sup>8</sup> In line with the second set of advice from EBA of October 2016 (Opinion of the European Banking Authority on the First Part of the Call for Advice on Investment Firms, <https://www.eba.europa.eu/documents/10180/1639033/Opinion+of+the+European+Banking+Authority+on+the+First+Part+of+the+Call+for+Advice+on+Investment+Firms+%28EBA-Op-2016-16%29.pdf>), the Commission proposed in November 2016 that investment firms identified as global or as other systemically important institutions (G-SIIs, O-SIIs) in accordance with Article 131 of the Capital Requirements Directive should still be subject to the revised Capital Requirements Regulation. In March 2017, there were eight investment firms in this group, all based in the UK. The Commission also proposed that other investment firms could be unaffected by these changes. See: Commission proposals to revise the Capital Requirements Regulation and Directive of 23 November 2016, [https://ec.europa.eu/info/law/banking-prudential-requirements-directive-2013-36-eu/upcoming\\_en](https://ec.europa.eu/info/law/banking-prudential-requirements-directive-2013-36-eu/upcoming_en)

<sup>9</sup> COM(2017) 542 final.

<sup>10</sup> MiFID II will add the investment service ‘operation of an organised trading facility’ to this list.

facility), such requirements are missing and result in approximate coverage of the risks involved. While limited in some cases, the risks inherent in these activities for the firm and, as a consequence, for the firm's clients and the wider markets they operate in are therefore not captured in a targeted way.

This gives rise to three main problems, which are assessed in the staff working document accompanying the proposals.

First, while the framework caters to some extent to the different types of business profiles of investment firms in the form of exemptions, it is a source of considerable regulatory complexity for many firms in general. Second, its detailed requirements and exemptions constitute a crude and risk-insensitive proxy for the actual risks incurred and posed by investment firms, which differ from those of banks. Third, due to its inherent complexity and lack of risk sensitivity, its implementation by Member States gives rise to fragmentation in the overall regulatory landscape for investment firms, with scope for harmful regulatory arbitrage. This could threaten the integrity and functioning of the single market.

The objectives of the proposals are to address the problems of the existing framework while facilitating the take-up and pursuit of business by investment firms where possible. Specifically, they set out a prudential framework that is better adapted to their business models. They consist of more appropriate and risk-sensitive requirements for investment firms, better targeting the risks they actually pose and incur across different types of business models. Finally, they constitute a more streamlined regulatory toolkit to enable prudential supervisors to carry out their oversight effectively.

As mandated by the Articles of the CRR, the review of the prudential framework for investment firms has been carried out in consultation with EBA, the European Securities and Markets Authority (ESMA) and the national competent authorities represented in these ESAs. Following a first call for advice by the Commission in December 2014, EBA published its first report on the current prudential framework for investment firms, calling for changes to the current approach for all but the largest and most systemic investment firms in December 2015<sup>11</sup>. Following a second call for advice by the Commission in June 2016, EBA published a discussion paper for consultation focusing on a potential new prudential regime for the vast majority of investment firms in November 2016<sup>12</sup>. Taking account of the feedback and the additional data it had gathered from investment firms together with national competent authorities, EBA published its final recommendations in September 2017<sup>13</sup>. The proposals build on these recommendations in all key respects except for the identification of systemic investment firms, for the reasons explained in the accompanying staff working document and summarised under the section on 'impact assessment' below.

- **Consistency with existing policy provisions in the policy area**

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<sup>11</sup> EBA report on investment firms, response to Commission's call for advice of December 2014 (EBA/Op/2015/20), <http://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-20+Report+on+investment+firms.pdf>

<sup>12</sup> Designing a new prudential regime for investment firms (EBA/DP/2016/02), <https://www.eba.europa.eu/documents/10180/1647446/Discussion+Paper+on+a+new+prudential+regime+for+Investment+Firms+%28EBA-DP-2016-02%29.pdf/cf75b87e-2db3-47a3-b1f3-8a30fa6962da>

<sup>13</sup> EBA opinion on the design of a new prudential framework for investment firms (EBA/Op/2017/11), <http://www.eba.europa.eu/documents/10180/1976637/EBA+Advice+on+New+Prudential+Framework+on+Investment+Firms+%28EBA-Op-2017-11%29.pdf>

This proposal complements the ongoing review of the CRR/CRD IV regime for credit institutions following the proposals adopted by the Commission on 23 November 2016, which allowed all non-systemic investment firms to opt out of its revised provisions<sup>14</sup>. This option was introduced in recognition of the fact that these revised provisions were not designed with most investment firms in mind and they would have created further complexity in the existing rulebook. The review of the prudential regime for most investment firms also put forward in this proposal was already well underway at the time, and subjecting them to an even more complex regime for a brief period pending the application of the new regime was considered disproportionate. This proposal therefore creates a new regime for the majority of investment firms by carving them entirely out of the CRR/CRD IV framework and leaving only systemic investment firms within the scope of the latter, including its revised provisions, in accordance with the revised approach for identifying them in this proposal.

The proposal is also consistent with MiFID and MiFID II / MiFIR. By setting prudential requirements that are tailored to the business and risks of investment firms, it clarifies when and why these requirements apply. As such, it overcomes some cases of arbitrary application of prudential requirements in the current framework, which arise because they are set first and foremost in relation to investment services listed in MiFID rather than the actual build-up of risks in the type and volumes of business conducted by investment firms.

MiFID II and MiFIR were adopted in the wake of the financial crisis and cover securities markets, investment intermediaries and trading venues. The new framework reinforces and replaces the current MiFID I framework. In light of the revision of the prudential framework for investment firms, it is also necessary to ensure that third-country firms providing services cross-border in the EU do not enjoy a more favourable treatment than EU firms in terms of prudential, tax and supervisory requirements. This proposal would undertake targeted changes to the existing equivalence regime for third-country firms under Articles 46 and 47 of MiFIR to maintain a level playing field between EU firms and third-country firms.

- **Consistency with other Union policies**

Investment firms play an important role in facilitating investment flows across the EU. Accordingly, the review also forms part of the Commission initiatives to ensure a strong and fair single market with a well-functioning financial system and CMU in order to mobilise investments and boost growth and jobs<sup>15</sup>. A more suitable prudential and supervisory framework with lower compliance costs for investment firms should help (i) improve the overall conditions for businesses; (ii) boost market entry and competition in the process; and (iii) improve investors' access to new opportunities and better ways of managing their risks.

The revised approach for identifying systemic investment firms that should remain under the CRR/CRD IV framework is also consistent with the objective of avoiding loopholes in the functioning of the Banking Union. Recent structural market developments indicate that third-country banking groups have increasingly complex structures in the EU, operating through entities that escape supervision by the ECB under the Single Supervisory Mechanism. As outlined in the Commission Communication of October 2017 on completing the Banking

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<sup>14</sup> Commission proposals to revise the Capital Requirements Regulation and Directive of 23 November 2016, [https://ec.europa.eu/info/law/banking-prudential-requirements-directive-2013-36-eu/upcoming\\_en](https://ec.europa.eu/info/law/banking-prudential-requirements-directive-2013-36-eu/upcoming_en)

<sup>15</sup> Communication on the Mid-Term Review of the Capital Markets Union Action Plan, June 2017 (COM(2017) 292), [https://ec.europa.eu/info/publications/mid-term-review-capital-markets-union-action-plan\\_en](https://ec.europa.eu/info/publications/mid-term-review-capital-markets-union-action-plan_en)

Union<sup>16</sup>, ensuring that systemic investment firms remain in the CRR/CRD IV in accordance with the approach for identifying them in this proposal also brings them under the prudential supervision by banking supervisors and, for their operations in Member States participating in the Banking Union, under the prudential oversight of the ECB.

## **2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY**

### **• Legal basis**

The Treaty on the Functioning of the European Union confers on the European institutions the competence to lay down appropriate provisions which have as their object the establishment and functioning of the internal market (Article 114 TFEU). This includes legislation dealing with prudential rules and other rules for providers of financial services, in this case the provision of investment services. The provisions of this proposed Regulation replace those in Regulation (EU) No 575/2013, which are also based on Article 114 TFEU, as they relate to investment firms.

### **• Subsidiarity**

The proposal revises and simplifies the existing EU rules that govern the prudential treatment of investment firms in order to (i) better accommodate and address risks in their business models; (ii) improve the level playing field among firms; and (iii) enhance supervisory convergence. To achieve this, a new EU framework should replace the existing one rather than devolve these choices to regulatory frameworks in the Member States. This is because investment firms authorised under MiFID today routinely provide their services to customers across EU borders. Separate and disjointed changes to the rules by Member States could introduce competitive distortions and discriminatory treatment, which would fragment the single market. This could increase cases of harmful regulatory arbitrage, with possible knock-on effects for financial stability and investor protection in other Member States in case of problems. It could also skew the range and type of investment services that are available in a given Member State, to the possible detriment of overall market efficiency and investor choice. The revised rules should avoid undue regulatory disparities and ensure a level playing field for all authorised firms across the single market.

### **• Proportionality**

As a REFIT exercise, the key objective is to render the new framework more suitable, relevant and proportionate compared to the existing framework for investment firms. Accordingly, this proposal strikes a balance between ensuring that the requirements are at once:

- comprehensive and robust enough to capture the risks of investment firms in a prudentially sound manner; and
- flexible enough to cater to the various types of business models without impeding their ability to operate in a commercially viable way.

The proposal is mindful of ensuring that the costs of the regime in terms of both capital requirements and associated compliance and administrative costs, which are generated by the need to manage the staff and systems in order to run the new requirements as well as

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<sup>16</sup> COM(2017) 592 final.

report on compliance to supervisors, are kept to the minimum to achieve this balance.

As outlined in the accompanying staff working document, these associated costs are expected to decrease on an ongoing basis, with some new one-off costs at the outset. In terms of capital, an overarching policy choice that has underpinned work on the review and impacts the above is the objective of ensuring that, on aggregate, EU-wide capital requirements on investment firms do not increase too much. This translates into different distribution effects for some types of firms. These are alleviated by the provisions of the proposal so that the biggest impacts are phased in and capped.

- **Choice of the instrument**

A Regulation is chosen since its provisions replace those in Regulation (EU) No 575/2013 relating to investment firms. This achieves the same direct legal effect as the current rulebook, ensuring that the objectives of the proposal are achieved consistently across the EU and helping create greater certainty and a level playing field for firms.

### **3. RESULTS OF EX-POST ASSESSMENTS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS**

- **Ex-post assessment of existing legislation**

The assessment of the existing CRR/CRD IV framework, which is based on the analysis carried out by the EBA and ESMA in their 2015 report<sup>17</sup> in particular and on the parallel work and analysis of the Commission services, is summarised in the accompanying staff working document.

It concludes that the existing rules, which are based on international regulatory standards for large banking groups and targeted at the risks of banks, only partially achieve their aims in terms of (i) ensuring sufficient capital for the risks of most investment firms; (ii) keeping compliance costs in check; (iii) securing a level playing field across the EU; and (iv) ensuring effective prudential oversight. Many of its provisions are considered ineffective and inefficient in this regard. The exception is large and systemic investment firms whose size, risk profile and interconnectedness with other participants in financial markets make them 'bank-like' in character.

For the rest, the status quo was assessed to create (i) excessive complexity and disproportionate compliance burdens especially for many small and medium-sized firms; (ii) poorly tailored and risk-insensitive prudential metrics and requirements for accurately capturing the risks of investment firms; and (iii) cases of diverging national implementation of the rules and a fragmented regulatory landscape across the EU.

- **Stakeholder consultations**

Stakeholders were consulted at several points during the review. In terms of the main milestones, following a first call for advice by the Commission in December 2014, EBA published a report on the current prudential framework for investment firms together with proposals for changes in December 2015. This constitutes a comprehensive and publicly

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<sup>17</sup> EBA report on investment firms, response to Commission's call for advice of December 2014 (EBA/Op/2015/20), <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-20+Report+on+investment+firms.pdf>



available analysis of the status quo, with data on numbers and types of investment firms in Member States. This analysis helped extend the review to stakeholders who may not be directly impacted by the rules and encouraged them to join in the subsequent discussion.

On 4 November 2016, EBA published a discussion paper for consultation focusing on a potential new prudential regime for investment firms. The paper was open for comments for 3 months. EBA published its draft recommendations on 3 July 2017, inviting comments from stakeholders. Its work was also supported by a detailed data-gathering exercise involving investment firms. This was carried out by national competent authorities on behalf of EBA in two stages in 2016 and 2017.

Given the detailed public consultation and data collection undertaken by EBA, the Commission considered it unnecessary to run a general public consultation in parallel. The Commission services instead consulted stakeholders in a targeted fashion to gather further views on the main elements of the review. This included:

- a roundtable with industry stakeholders (investment firms, investors, law firms, consultants) on 27 January 2017 on EBA draft proposals for a future regime;
- a workshop on the costs of the current regime on 30 May 2017; and
- a workshop on EBA's draft final recommendations on 17 July 2017.

The review was discussed with Member States in the Financial Services Committee in March and October 2017 and in the Experts Group on Banking, Payments and Insurance in June and September 2017. Stakeholder input received on the Commission's inception impact assessment published in March 2017 was also taken into account<sup>18</sup>. Finally, the Commission also considered input received previously in the wide-ranging call for evidence on the efficiency, consistency and coherence of the overall EU regulatory framework for financial services, in which several respondents pointed to various issues relevant for the review<sup>19</sup>.

Investment firms represent various business models, and their views tend to focus on aspects of the proposals specific to them. This complicates cross-cutting comparisons of the relative weight of stakeholder positions. However, in general the large majority of stakeholders welcome a tailored prudential framework more suited to their business models. They stress that their systemic relevance is limited and that capital requirements should focus on ensuring they can be wound down in an orderly way. In terms of specific requirements that apply to their particular business model, investment firms that conduct agency-only services and do not enter into transactions in financial instruments using their own balance sheet generally criticise proposals for linking capital requirements to the size of the client portfolios they manage in a linear way. While many firms that trade on own account agree that the existing framework for capturing market risk has some merit in light of the risks they incur and pose, other trading firms note that it exaggerates risks in the methods and products they trade in. These views have been taken into account in the calibration of the proposed new risk metrics (K-factors — see below) and the possibility to phase in and cap higher requirements.

- **Collection and use of expertise**

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<sup>18</sup> [https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-1546878\\_en](https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-1546878_en)

<sup>19</sup> See e.g. various replies submitted in the Commission's Call for Evidence of 2015 [http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index\\_en.htm](http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm)

The review was carried out based on comprehensive advice provided by EBA in consultation with ESMA, as required by the relevant Articles in Regulation (EU) No 575/2013, which constitute the legal basis for the review (notably Article 508(2) and (3)). The main public outputs of the EBA were as follows:

- the December 2015 report setting out a comprehensive assessment of the status quo and initial recommendations for changes;
- the November 2016 discussion paper published for consultation on the contours of a possible new regime; and
- the September 2017 final report with detailed recommendations.

The precise calibration of the recommendations for new capital requirements was supported by a detailed data-gathering exercise involving investment firms. This was carried out by national competent authorities on behalf of EBA in two stages in 2016 and 2017. The Commission was involved throughout and was able to benefit from the discussions assessing the advantages and disadvantages of the detailed policy recommendations as they unfolded.

- **Impact assessment**

According to the Better Regulation Toolbox (tool #9), no Commission impact assessment is necessary whenever an EU agency has been mandated to carry out policy design work and related analysis, to the extent that the Commission proposal does not deviate much from the agency's recommendations and the Commission services consider its assessment to be of sufficient quality.

While the Regulatory Scrutiny Board examined a draft impact assessment for this initiative, a staff working document was deemed more appropriate given that the specific mandate of the review is based on the advice of the ESAs and their stakeholder consultation and technical work. The objective of the staff working document accompanying the proposals is therefore to explain the advice given by the ESAs, including the results of their analysis and consultation, while providing the Commission services' views on its conclusions, with a view to guiding the Commission's decision-making.

On capital requirements, EBA assesses that its advice would increase these on aggregate for all non-systemic EU investment firms by 10 % compared to Pillar 1 requirements today, and decrease them by 16 % compared to total requirements applied as a result of Pillar 2 add-ons. The way in which these impacts would be distributed among investment firms depends on their size, which investment services they provide and how the new capital requirements will apply to them. As detailed in the Staff Working Document accompanying the proposals, including its Annex II, the 10% aggregate increase in Pillar 1 requirements is the sum of considerably lower requirements for some and increases in excess of 10% for others. On available own funds, EBA finds that only a few firms would fail to have sufficient capital to comfortably meet the new requirements – this involves just a small number of investment advisors, trading firms and multiservice firms. However, for firms in this group whose increases would be over twice their current requirements, a cap could be granted for a number of years.

The accompanying staff working document concludes that, overall, EBA's recommendations are considered to be an appropriate and proportionate means of achieving the review's objectives in an effective and efficient manner compared to the status quo. More generally, EBA's advice is a clear positive step towards a prudential framework for investment firms

that can both ensure that they operate on a sound financial basis while not hindering their commercial prospects. As such, it should support the review's aims in a balanced fashion. On the one hand, it should help ensure that the risks of investment firms for customers and markets are addressed in a more targeted way both in their ongoing operations and in case they need to be wound down. On the other, it should help ensure that they can fully perform their role in facilitating investment flows across the EU, which is consistent with the aims of the CMU to mobilise savings and investments in order to boost growth and jobs.

It only diverges with EBA's recommendations on the identification of systemic investment firms. Rather than postpone this so it is clarified via criteria to be developed in technical rules implementing the proposals as EBA recommends, it is considered more appropriate to set this out in the proposals themselves in order to ensure a regulatory level playing field between credit institutions and systemic investment firms. On this point, the proposals go beyond EBA's advice in its opinion on the review of investment firms. However, the proposals thereby deliver on EBA's opinion on issues related to the UK's decision to leave the EU<sup>20</sup>.

- **Regulatory fitness and simplification**

As outlined in the accompanying staff working document, simplification of the prudential rules for the vast majority of investment firms is expected to considerably reduce their administrative and compliance burdens. Various redundant regulatory and reporting requirements could be removed, allowing capital dedicated to regulatory purposes to switch to more productive uses. The proposals, by setting capital and other prudential requirements, including remuneration and governance, that are proportionate to investment firms alleviate for the first time the significant costs that firms incur as a result of the bank-centric requirements of the current regime. This would put an end to the complicated task of matching and reconciling business data to an ill-fitted regulatory framework and reporting regime.

Investment firms that are SMEs<sup>21</sup> are expected to be among the main beneficiaries. A more proportionate and appropriate prudential framework for them should help improve the conditions for conducting business, and barriers to entry should decrease. For example, streamlining the onerous reporting framework should reduce administrative burdens and compliance costs for SMEs, including innovative firms seeking to grow through digital means. Similarly, by exempting small and non-interconnected investment firms from the current governance and remuneration rules as laid down under the current CRD IV/CRR the proposals would reduce administrative and compliance costs for these enterprises. Some one-off costs of transitioning to the new regime are to be expected as firms need to overhaul risk management systems, update compliance departments and revise contracts with law firms and other service providers that are currently used to facilitate compliance. However, the compliance cost savings should support the CMU's aims in general by helping investment

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<sup>20</sup> Opinion of the European Banking Authority on issues related to the departure of the United Kingdom from the European Union (EBA/Op/2017/12) of 12 October 2017, <http://www.eba.europa.eu/documents/10180/1756362/EBA+Opinion+on+Brex+Issues+%28EBA-Op-2017-12+%29.pdf>

<sup>21</sup> As defined in the Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (OJ L 124, 20.5.2003, p. 36-41), i.e. enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million.

firms play their role in mobilising savings from investors towards productive uses.

In terms of compliance costs, firms are set to save tens of thousands to hundreds of thousands of euros depending on the type and size of firm. How these reductions in compliance costs relate and compare to changes in capital requirements for different types of firms is not known at this stage, but should feature in the future monitoring and evaluation of the framework.

- **Fundamental rights**

This proposal strengthens the exercise of the right of various investment firms to conduct their business unencumbered by rules designed primarily for other types of economic actors. The legislative measures in the proposals setting out rules for remuneration in investment firms observe the principles recognised by the Charter of Fundamental Rights of the European Union, notably the freedom to conduct a business and the right of collective bargaining and action.

#### **4. BUDGETARY IMPLICATIONS**

The proposal will not have implications for the EU budget.

#### **5. OTHER ELEMENTS**

- **Implementation plans and monitoring, evaluation and reporting arrangements**

The changes envisaged by the proposals should be evaluated in order to determine the degree to which the following objectives have been met:

- a simpler categorisation of investment firms in a manner that captures their different risk profiles;
- a set of prudential rules, notably on capital, liquidity, remuneration and governance requirements, that are appropriate, proportionate and sensitive to the specific risks that investment firms are exposed to and that ensure that capital is assigned to where it is needed;
- a framework that corresponds to the risks inherent in the nature and range of activities undertaken by investment firms in a direct and discernible way and thereby supports taking up the business; and
- a streamlined supervisory toolkit to enable the full and accurate oversight of business practices and the associated risks.

To this end, some of the following information could be gathered as part of a future review in order to serve as indicators in evaluating the impact of the proposed changes: (i) compliance costs in terms of staff, legal advice and regulatory reporting; (ii) levels of capital requirements; (iii) other new costs e.g. from liquidity rules; (iv) evolution in the numbers of firms between the different categories; (v) changes in recourse to Pillar 2 add-ons by competent authorities; (vi) cases and impact of failure of investment firms under the new regime; and (vii) evolution of the size of investment firms in terms of assets and client order volumes.

- **Detailed explanation of the specific provisions of the proposal**

## **Subject matter and scope**

The proposal sets out requirements in terms of own funds, levels of minimum capital, concentration risk, liquidity, reporting and public disclosure under this Regulation for all investment firms that are not systemic.

## **Level of application**

All investment firms within the scope of the Regulation are to apply its provisions on an individual basis. A derogation is provided for small and non-interconnected firms within banking groups subject to consolidated application and supervision under the CRR/CRD IV. A specific group capital requirement applies to groups containing only investment firms, with the parent company required to ensure sufficient capital to support its holdings in the investment firm subsidiaries.

## **Own funds**

The capital instruments which qualify as own funds for investment firms to meet their capital requirements under this Regulation consist of the same items as under CRR/CRD IV. For this purpose, Common Equity Tier 1 (CET1) capital should constitute at least 56 % of regulatory capital, with Additional Tier 1 (AT1) capital eligible for up to 44 % and Tier 2 capital eligible for up to 25 % of regulatory capital.

## **Capital requirements**

All investment firms shall maintain an amount equal to the initial capital required for their authorisation as permanent minimum capital at all times. Small and non-interconnected investment firms shall either apply this requirement or, if higher, one based on a quarter of their previous year's fixed overheads, calculated in accordance with Commission Delegated Regulation (EU) 2015/488<sup>22</sup>, as their capital requirement. These firms are defined as those not authorised to safeguard and administer client assets, hold client money or deal on own account in their own name, or which have assets under management under both discretionary portfolio management and non-discretionary (advisory) arrangements that are less than EUR 1.2 billion, handle daily client orders that are less than EUR 100 million for cash trades or EUR 1 billion for derivatives, and have a balance sheet of less than EUR 100 million and total gross revenues from their investment activities that are less than EUR 30 million. Investment firms which are above these thresholds shall apply the highest of their permanent minimum capital requirement, their fixed overheads requirement, or their requirement based on the sum of the K-factor requirement.

## **K-factors**

K-factors capture risks to customer (RtC), and for firms that deal on own account and execute client orders in their own name, risks to market (RtM) and risks to firm (RtF). RtC encompasses the following K-factors: assets under management (K-AUM), client money held (K-CMH), assets safeguarded and administered (K-ASA), and client orders handled (K-COH). RtM encompasses a K-factor for net position risk (K-NPR) based on the market risk

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<sup>22</sup> Commission Delegated Regulation (EU) 2015/488 of 4 September 2014 amending Delegated Regulation (EU) No 241/2014 as regards own funds requirements for firms based on fixed overheads (OJ L 78, 24.3.2015, p. 1-4).

requirements of the CRR (Title IV of Part Three), or alternatively if permitted by the competent authority, one based on margins posted with clearing members for trades guaranteed by the latter (K-CMG).

The threshold for an investment firm to be able to avail of the simplified standardised approach for market risk is amended to only refer to an absolute amount of total assets of EUR 300 million. RtF encompasses K-factors for trading counterparty default (K-TCD), for concentration risk in excess of defined thresholds (K-CON — see below) and for daily trading flow (K-DTF).

K-CMH, K-ASA, K-COH and K-DTF are calculated on the basis of a rolling average from the previous 3 months, while for K-AUM it is based on the previous year. These K-factors are multiplied by the corresponding coefficients set out in this Regulation in order to determine the capital requirement. Capital requirements for K-NPR are determined as per the CRR, and for K-CON and K-TCD using a simplified application of the corresponding requirements under CRR for, respectively, the treatment of large exposures in the trading book and counterparty credit risk.

### **Concentration risk**

Investment firms should monitor and control their concentration risk, including in respect of their customers. Only firms which are not considered small and non-interconnected should report to competent authorities on their concentration risks, for instance in the form of a default of their counterparties, where they hold client money, securities and their own cash, and concentration risk from their earnings. Those firms that deal on own account or execute client orders in their own name should not exceed an exposure to a single or to connected counterparties equal to 25 % of their regulatory capital, subject to specific derogations for exposures to credit institutions or other investment firms. These limits may only be exceeded if additional K-CON capital requirements are met. For investment firms specialised in commodity derivatives or emission allowances or derivatives thereof which can have large concentrated exposures to the non-financial groups they belong to, these limits may be exceeded without additional capital as long as they serve group-wide liquidity or risk management purposes.

### **Liquidity**

Investment firms should have internal procedures to monitor and manage their liquidity needs and be required to hold a minimum of one third of their fixed overheads requirements in liquid assets. These should consist of the list of high-quality liquid assets under the Commission Delegated Regulation on the Liquidity Coverage Ratio<sup>23</sup>, supplemented with the unencumbered own cash of the firm (which cannot include any client money) and for small and non-interconnected firms (those not subject to the K-factors), trade debtors and fees or commissions receivable within 30 days subject to specific conditions. In exceptional circumstances, investment firms may fall below the required threshold by monetising their liquid assets to cover liquidity needs, provided they notify their competent authority immediately.

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<sup>23</sup> Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for credit institutions (OJ L 11, 17.1.2015, p. 1-36).

## **Supervisory reporting and public disclosure**

Investment firms are required to report to their competent authorities on their compliance with the prudential framework in accordance with detailed requirements to be articulated in Level 2 implementing measures. Firms which are subject to the K-factors have more granular reporting requirements than those subject to the capital requirement either in terms of permanent minimum capital or fixed overheads. These firms shall publicly disclose their levels of capital, their capital requirements, remuneration policies and practices, and their governance arrangements whereas small and non-interconnected firms shall not be subject to public disclosure requirements.

## **Transitional provisions**

To facilitate a smooth transition for investment firms into the new regime, capital requirements would be subject to phase-in provisions as follows. For a period of five years from the date of application of this Regulation, investment firms for which capital requirement under the new regime would more than double compared to their existing capital requirement under the current framework should be allowed to limit their capital requirement to twice their relevant capital requirement under CRR/CRD IV. Further, for this period, new investment firms which were never subject to capital requirements under CRR/CRD IV could apply a limit at twice their fixed overheads requirement, while investment firms which were only subject to a requirement for initial capital under CRR/CRD IV could limit their capital requirement to twice this requirement to mitigate such increases. Finally, for a period of five years from the date of application of this Regulation, or until the date of application of the changes adopted to CRR/CRD IV as regards capital requirements for market risk pursuant to Article 1(84) of the Commission Proposal for a Regulation amending Regulation (EU) No 575/2013, whichever is earlier, investment firms subject to the corresponding provisions of this Regulation should continue to calculate their capital requirement for the trading book in accordance with the existing CRR.

## **Systemic investment firms**

This proposal amends the definition of credit institutions in article 4(1)(1) of CRR. This will grant the status of credit institutions to large investment firms which carry out the activities referred to in points (3) and (6) of Section A of Annex I of Mifid and have assets above EUR 30 billion. As a consequence, large investment firms of systemic importance will continue applying CRR/CRD IV and will be fully subject to the prudential and supervisory requirements applicable to credit institutions.. This includes the provisions on individual and consolidated supervision of the parent undertaking by the competent authorities. This will imply, among other things, that the operations of large investment firms established in Member States participating in the banking union are subject to direct supervision by the ECB in the framework of the Single Supervisory Mechanism. This approach would also be in line with regulatory development in other jurisdictions (e.g. United States, Switzerland, Japan) where, since the financial crisis, the regulatory and supervisory treatment of systemic investment firms have been increasingly aligned with that of credit institutions.

Proposal for a

**REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**on the prudential requirements of investment firms and amending Regulations (EU) No 575/2013, (EU) No 600/2014 and (EU) No 1093/2010**

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Central Bank,<sup>24</sup>

Having regard to the opinion of the European Economic and Social Committee,<sup>25</sup>

Acting in accordance with the ordinary legislative procedure,

Whereas:

- (1) Robust prudential requirements are an integral part of the regulatory conditions in which financial institutions may provide services within the Union. Investment firms are, together with credit institutions, subject to Directive 2013/36/EU<sup>26</sup> and to Regulation (EU) No 575/2013<sup>27</sup> as regards their prudential treatment and supervision, while their authorisation and other organisational and conduct requirements are set out in Directive 2004/39/EC<sup>28</sup>.
- (2) The existing prudential regimes under Regulation (EU) No 575/2013 and Directive 2013/36/EU are largely based on successive iterations of the international regulatory standards set for large banking groups by the Basel Committee on Banking Supervision and only partially address the specific risks inherent to the diverse

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<sup>24</sup> OJ C [...], [...], p. [...].

<sup>25</sup> OJ C [...], [...], p. [...].

<sup>26</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338–436)

<sup>27</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1–337)

<sup>28</sup> Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1–44)



activities of investment firms. The specific vulnerabilities and risks inherent to investment firms should therefore be specifically addressed by means of appropriate and proportionate prudential arrangements at Union level.

- (3) The risks which investment firms themselves incur and pose for their clients and the wider markets in which they operate depend on the nature and volume of their activities, including whether investment firms act as agents for their clients and are not party to the resulting transactions themselves, or whether they act as principals to the trades.
- (4) Sound prudential requirements should ensure that investment firms are managed in an orderly way and in the best interests of their clients. They should take into account the potential for investment firms and their clients to engage in excessive risk-taking and the different degrees of risk assumed and posed by investment firms. Equally, such prudential requirements should aim to avoid undue administrative burden on investment firms.
- (5) Many of the requirements that stem from Regulation (EU) No 575/2013 and Directive 2013/36/EU framework are designed to address common risks faced by credit institutions. Accordingly, the existing requirements are largely calibrated to preserve the lending capacity of credit institutions through economic cycles and to protect depositors and taxpayers from possible failure, and are not designed to address the different risk-profiles of investment firms. Investment firms do not have large portfolios of retail and corporate loans and do not take deposits. The likelihood that their failure can have detrimental impacts for overall financial stability is lower than in the case of credit institutions. The risks faced and posed by investment firms are thus substantially different to the risks faced and posed by credit institutions and such difference should be clearly reflected in the prudential framework of the Union.
- (6) The prudential requirements under Directive 2013/36/EU and the Regulation (EU) No 575/2013 which investment firms are subject to are based on those of credit institutions. Investment firms whose scope of authorisation is limited to specific investment services which are not targeted by the current prudential framework are subject to numerous exemptions from these requirements. This recognises that in this capacity these firms do not incur risks of the same nature as credit institutions. Investment firms which carry out activities which are targeted by the current framework involving trading in financial instruments but on a limited basis, are subject to the corresponding requirements of the framework in terms of capital, but can have exemptions in other areas such as liquidity, large exposures and leverage. Investment firms whose scope of authorisation is not subject to these limitations are subject to the full framework together with credit institutions.
- (7) Trading financial instruments, whether for the purposes of risk-management, hedging and liquidity-management or for taking directional positions on the value of the instruments over time, is an activity in which both credit institutions and investment firms authorised for dealing on own account may engage and which is already addressed by the Directive 2013/36/EU and Regulation (EU) No 575/2013 prudential framework. In order to avoid an unlevel playing field which could lead to regulatory arbitrage between credit institutions and investment firms in this area, the capital requirements resulting from these rules to cover this risk should therefore continue to apply to these investment firms. The exposures of these investment firms to their trading counterparties in specific transactions and corresponding capital requirements are also covered by the rules and should therefore also continue to apply in a

simplified way. Finally, the large exposures rules of the current framework are also relevant when the trading exposures of these investment firms to specific counterparties are particularly large and thereby generate an excessively concentrated source of risk for an investment firm from the default of the counterparty. These provisions should therefore also continue to apply to investment firms in a simplified way.

- (8) Differences in the application of the existing framework in different Member States threaten the level playing-field for investment firms within the Union. These differences stem from the overall complexity of the application of the framework to different investment firms based on the services they provide, where some national authorities adjust or streamline such application in national law or practice. Given that the existing prudential framework does not address all the risks faced and posed by some types of investment firms, large capital add-ons have been applied to certain investment firms in some Member States. Uniform provisions addressing those risks should be established in order to ensure harmonised prudential supervision of investment firms across the Union.
- (9) A specific prudential regime is therefore required for investment firms which are not systemic by virtue of their size and interconnectedness with other financial and economic actors. Systemic investment firms should, however, remain subject to the existing prudential framework under Directive 2013/36/EU and Regulation (EU) No 575/2013. Those investment firms are a subset of investment firms to which the Directive 2013/36/EU/Regulation (EU) No 575/2013 framework currently applies and do not benefit from dedicated exemptions from any of its principle requirements. The largest and most interconnected investment firms have business models and risk profiles that are similar to those of significant credit institutions – they provide “bank-like” services and underwrite risks on a significant scale. Therefore it is appropriate that those investment firms remain subject to the provisions set out in the Directive 2013/36/EU and Regulation (EU) No 575/2013. Furthermore, systemic investment firms are large enough, and have business models and risk-profiles which represent a threat for the stable and orderly functioning of financial markets on par with large credit institutions.
- (10) The specific prudential regime for investment firms which, by virtue of their size and interconnectedness with other financial and economic actors, are not considered systemic should address the specific business practices of different types of investment firms. Investment firms with the highest possibility of generating risks to clients, markets or the orderly functioning of the investment firms themselves should in particular be subject to clear and effective prudential requirements tailored to those specific risks. Those prudential requirements should be calibrated in a manner proportionate to the type of investment firm, the best interests of the clients of that type of investment firm and the promotion of the smooth and orderly functioning of the markets in which those types of investment firms operate. They should mitigate identified areas of risk and help ensure that, if an investment firm fails, it can be wound down in an orderly manner with minimal disruption to the stability of financial markets.
- (11) The prudential regime for investment firms which, by virtue of their size and interconnectedness with other financial and economic actors, are not considered systemic should apply to each investment firm on an individual basis. However, since the risks incurred by small and non-interconnected investment firms are limited for the most part, they should be allowed to avail themselves of an exemption from

the specific prudential requirements where they are part of a banking group headquartered and subject to consolidated supervision under Regulation (EU) No 575/2013/Directive 2013/36/EU in the same Member State, as in such cases the consolidated application of Regulation (EU) No 575/2013/ Directive 2013/36/EU to the group should adequately cover those risks. In order to mirror the possible existing treatment of groups of investment firms under the Regulation (EU) No 575/2013/ Directive 2013/36/EU, the parent undertaking in such groups should be required to have sufficient capital to support the book value of its holdings in the subsidiaries. Further, in order to account for cases where such investment firm groups carry a higher degree of risk or interconnectedness, they could be subject to capital requirements based on the consolidated situation of the group.

- (12) In order to allow investment firms to continue to rely on their existing own funds to meet their capital requirements under the prudential framework specific to investment firms, the definition and composition of own funds should be aligned with Regulation (EU) No 575/2013. This includes full deductions from balance-sheet items from own funds in accordance with Regulation (EU) No 575/2013, such as deferred tax assets and holdings of capital instruments of other financial sector entities. However, investment firms should be able to exempt non-significant holdings of capital instruments in financial sector entities from deductions if held for trading purposes in order to support market-making in these instruments. In order to align the composition of own funds with the Regulation (EU) No 575/2013, at least 56% of the capital requirement should be met by investment firms with Common Equity Tier 1 items, while Additional Tier 1 and Tier 2 items could be eligible up to 44% and 25% of regulatory capital, respectively.
- (13) In order to ensure that investment firms always operate on the basis of the level of capital required for their authorisation, all investment firms should, at all times, meet a permanent minimum capital requirement equal to the initial capital required for authorisation to conduct the relevant investment services set in accordance with Directive (EU) 2013/36/[IFD].
- (14) In order to ensure a simple application of the minimum capital requirement for small and non-interconnected investment firms, they should have capital equal to the higher of their permanent minimum capital requirement or a quarter of their fixed overheads measured on the basis of their activity of the preceding year in accordance with Commission Delegated Regulation (EU) 2015/488<sup>29</sup>.
- (15) To account for the higher risks of investment firms which are not small and non-interconnected, the minimum capital requirement for them should be the higher of their permanent minimum requirement, a quarter of their fixed overheads for the preceding year, or the sum of their requirement under the set of risk factors tailored to investment firms ('K-factors') which sets capital in relation to the risks in specific business areas of investment firms.
- (16) Investment firms should be considered small and non-interconnected for the purposes of the specific prudential requirements for investment firms where they do not conduct investment services which carry a high risk for clients, markets or themselves and whose size means they are less likely to cause widespread negative

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<sup>29</sup> Commission Delegated Regulation (EU) 2015/488 of 4 September 2014 amending Delegated Regulation (EU) No 241/2014 as regards own funds requirements for firms based on fixed overheads (OJ L 78, 24.3.2015, p. 1

impacts for clients and markets in case risks inherent in their business materialise or in case they fail. Accordingly, small and non-interconnected investment firms should be defined as those that do not deal on own account or incur risk from trading financial instruments, have no client assets or money under their control, have assets under both discretionary portfolio management and non-discretionary (advisory) arrangements of less than EUR 1.2 billion, handle fewer than EUR 100 million per day of client orders in cash trades or EUR 1 billion per day in derivatives, and have a balance sheet smaller than EUR 100 million and total gross annual revenues from the performance of their investment services of less than EUR 30 million.

- (17) In order to prevent regulatory arbitrage and reduce the incentive for investment firms to structure their operations in order to avoid exceeding the thresholds above which they do not qualify as small and non-interconnected firms, the thresholds for assets under management, client orders handled, balance sheet size and total gross revenues should be applied on a combined basis for all investment firms that are part of the same group. The other criteria, namely whether an investment firm holds client money, administers or safeguards client assets, or trades financial instruments and incurs market or counterparty risk, are binary and leave no scope for such restructuring and should therefore be assessed on an individual basis. In order to capture evolving business models and the risks they represent on an ongoing basis, these criteria and thresholds should be assessed on an end-of-day basis, with the exception of holding client money which should be assessed on an intra-day basis and balance sheet size and total gross revenues which should be assessed based on the situation of the investment firm at the end of the last financial year.
- (18) An investment firm that exceeds the regulatory thresholds or fails to meet the other criteria should not be considered small and non-interconnected and should be subject to the requirements for other investment firms, subject to the specific transitional provisions set out in this Regulation. This should incentivise investment firms to plan their business activities so as to clearly qualify as small and non-interconnected firms. For an investment firm which does not satisfy the requirements to be considered small and non-interconnected to qualify for such treatment, a monitoring phase should be provided where that firm meets the criteria and remains below the relevant thresholds for at least six consecutive months.
- (19) All investment firms should calculate their capital requirement with reference to a set of K-factors which capture Risk-To-Customer ('RtC'), Risk-to-Market ('RtM') and Risk-to-Firm ('RtF'). The K-factors under RtC capture client assets under management and ongoing advice (K-AUM), assets safeguarded and administered (K-ASA), client money held (K-CMH), and customer orders handled (K-COH).
- (20) The K-factor under RtM captures net position risk (K-NPR) in accordance with the market risk provisions of CRR or, where permitted by the competent authority for specific types of investment firms which deal on own account through clearing members, based on margins posted with an investment firm's clearing member (K-CMG).
- (21) The K-factors under RtF capture an investment firm's exposure to the default of their trading counterparties (K-TCD) in accordance with simplified provisions for counterparty credit risk based on CRR, concentration risk in an investment firm's large exposures to specific counterparties based on CRR-provisions for large exposures risk in the trading book (K-CON), and operational risks from an investment firm's daily trading flow (K-DTF).

- (22) The overall capital requirement under the K-factors is the sum of the requirements of the K-factors under RtC, RtM and RtF. K-AUM, K-ASA, K-CMH, K-COH and K-DTF relate to the volume of activity referred to by each K-factor. The volumes for K-CMH, K-ASA, K-COH, and K-DTF are calculated on the basis of a rolling average from the previous three months, while for K-AUM it is based on the previous year. The volumes are multiplied by the corresponding coefficients set out in this Regulation in order to determine the capital requirement. The capital requirements for K-NPR is derived from CRR, while the capital requirements for K-CON and K-TCD use a simplified application of the corresponding requirements under CRR for, respectively, the treatment of large exposures in the trading book and of counterparty credit risk. The amount of a K-factor is zero if a firm does not undertake the relevant activity.
- (23) The K-factors under RtC are proxies covering the business areas of investment firms from which harm to clients can conceivably be generated in case of problems. K-AUM captures the risk of harm to clients from an incorrect discretionary management of customer portfolios or poor execution and provides reassurance and customer benefits in terms of the continuity of service of ongoing portfolio management and advice. K-ASA captures the risk of safeguarding and administering customer assets, and ensures that investment firms hold capital in proportion to such balances, regardless of whether they are on its own balance sheet or segregated in other accounts. K-CMH captures the risk of potential for harm where an investment firm holds the money of its customers, regardless of whether they are on its own balance sheet or segregated in other accounts. K-COH captures the potential risk to clients of a firm which executes its orders (in the name of the client, and not in the name of the firm itself), for example as part of execution-only services to clients or when a firm is part of a chain for client orders.
- (24) The K-factor for RtM for investment firms which deal on own account is based on the rules for market risk for positions in financial instruments, in foreign exchange, and in commodities in accordance with Regulation (EU) No 575/2013 as amended<sup>30</sup>. This allows investment firms to choose to apply either the standardised approach under Regulation (EU) No 575/2013 (simplified standardised approach under Regulation (EU) No 575/2013 as amended) if their assets are below EUR 300 million or the revised standardised approach under Regulation (EU) No 575/2013 as amended as well as the option to use internal models. In the two last cases, the resulting capital requirement may be decreased to 65%, making permanent the possibility under Regulation (EU) No 575/2013 as amended to apply this on a temporary basis for three years, in order to take account of investment firms' overall lower prudential relevance. Alternatively, the capital requirement of trading firms whose business is centrally cleared should, subject to the approval of the competent authority, be equal to the margins posted with their clearing member.
- (25) For investment firms which deal on own account, the K-factors for K-TCD and K-CON under RtF constitute a simplified application of CRR rules on counterparty credit risk and large exposure risk, respectively. K-TCD captures the risk to an

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<sup>30</sup> 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.

investment firm of counterparties in over-the-counter (OTC) derivatives, repurchase transactions, securities and commodities lending or borrowing transactions, long-settlement transactions and margin lending transactions failing to fulfil their obligations by multiplying the value of the exposures, based on replacement cost and an add-on for potential future exposure, by risk factors based on Regulation (EU) No 575/2013, accounting for the mitigating effects of effective netting and the exchange of collateral. K-CON captures concentration risk in relation to individual or highly connected private sector counterparties with whom firms have exposures above 25% of their regulatory capital, or specific alternative thresholds in relation to credit institutions or other investment firms, by imposing a capital add-on in line with Regulation (EU) No 575/2013 for excess exposures above these limits. Finally, K-DTF captures the operational risks to an investment firm in large volumes of trades concluded for its own account or for clients in its own name in one day which could result from inadequate or failed internal processes, people and systems or from external events, based on the notional value of daily trades.

- (26) All investment firms should monitor and control their concentration risk, including in respect of their customers. However, only investment firms which are subject to a minimum capital requirement under the K-factors should report to competent authorities on their concentration risks. For investment firms specialised in commodity derivatives or emission allowances or derivatives thereof with large concentrated exposures to the non-financial groups to which they belong, the limits for concentration risk may be exceeded without additional capital under K-CON as long as they serve group-wide liquidity or risk management purposes.
- (27) All investment firms should have internal procedures to monitor and manage their liquidity requirements. These procedures should help ensure that they can function in an orderly way over time, without entailing a need to set aside liquidity specifically for times of stress. For this purpose, all investment firms should hold a minimum of one third of their fixed overheads requirement in liquid assets at all times. Those liquid assets should be of high quality and aligned with those listed in Commission Delegated Regulation (EU) 2015/61 on the Liquidity Coverage Ratio<sup>31</sup> together with the haircuts which apply to these assets under that Delegated Regulation. To account for the difference in liquidity-profiles of investment firms compared to credit institutions, the list of appropriate liquid assets should be supplemented by the unencumbered own cash of the firm (which should not include any client money). Small and non-interconnected firms could further include items related to trade debtors and fees or commissions receivable within 30 days as liquid assets, provided these do not exceed one-third of the minimum liquidity requirement, do not count towards any additional liquidity requirements imposed by the competent authority, and that they are subject to a haircut of 50%. In exceptional circumstances, investment firms should be permitted to fall below the required threshold by monetising their liquid assets to cover liquidity requirements, provided they notify their competent authority immediately. All financial guarantees provided to customers which can give rise to increased liquidity needs if triggered, should reduce the amount of available liquid assets by at least 1.6% of the total value of such guarantees.

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<sup>31</sup> Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions (OJ L 11, 17.1.2015, p. 1–36)

- (28) A proportionate corresponding regulatory reporting framework should be developed in conjunction with the new prudential regime and should be carefully tailored to the business of investment firms and the requirements of the prudential framework. Reporting requirements for investment firms should concern the level and composition of their own funds, their capital requirements, the basis for the calculation of their capital requirements, their activity profile and size in relation to the parameters for considering investment firms as small and non-interconnected, their liquidity requirements and their adherence to the provisions on concentration risk. EBA should be charged with developing draft implementing technical standards to further specify the detailed templates and arrangements for that regulatory reporting and those standards should be proportionate to the scale and complexity of different investment firms and should notably take account of whether investment firms are considered to be small and non-interconnected.
- (29) In order to provide transparency to their investors and the wider markets, investment firms which are not considered to be small and non-interconnected should publicly disclose their levels of capital, their capital requirements, their governance arrangements and remuneration policies and practices. The transparency regarding the remuneration of high earners serves the general interest of contributing to sound and stable financial markets, given the important role high earners play in directing the business and long term performance of the investment firms. For reasons of confidentiality, disclosure of the remuneration of high earners should be required on an aggregated basis. Small and non-interconnected firms should not be subject to public disclosure requirements, except where they issue Additional Tier 1 instruments in order to provide transparency to the investors in these instruments.
- (30) In order to facilitate a smooth transition for investment firms from the requirements of Regulation (EU) No 575/2013 and Directive 2013/36/EU to the requirements under this Regulation and Directive (EU) ----/--[IFD], it is appropriate to provide for appropriate transitional measures. Notably, for a period of five years from the date of application of this Regulation, investment firms for which capital requirements under this Regulation would more than double compared to their capital requirement under Regulation (EU) No 575/2013/Directive 2013/36/EU should be able to mitigate the effects of potential increases by limiting the capital requirement to twice their relevant capital requirement under Regulation (EU) No 575/2013/Directive 2013/36/EU.

In order not to disadvantage new investment firms with similar profiles to existing firms, investment firms which were never subject to capital requirements under Regulation (EU) No 575/2013/Directive 2013/36/EU should be able to limit their capital requirements under this Regulation to twice their fixed overheads requirement for a period of five years from the date of application of this Regulation.

Equally, investment firms which were only subject to a requirement for initial capital under Regulation (EU) No 575/2013/Directive 2013/36/EU and for which capital requirements under this Regulation would more than double compared to their situation under Regulation (EU) No 575/2013/Directive 2013/36/EU should be able to limit their capital requirement under this Regulation to twice their initial capital requirement under Regulation (EU) No 575/2013/Directive 2013/36/EU for a period of five years from the date of application of this Regulation.

These transitional measures should, where applicable, be available also to investment firms referred to in Article 498 of Regulation (EU) No 575/2013 which exempts

these firms from own funds requirements under that Regulation, whereas the requirements for initial capital with respect to those investment firms depend on the investment services or activities they provide. For a period of five years from the date of application of this Regulation, their capital requirements under the transitional provisions of this Regulation should be calculated in view of these applicable levels.

For a period of five years from the date of application of this Regulation, or until the date of application of the changes adopted to Regulation (EU) No 575/2013/Directive 2013/36/EU as regards capital requirements for market risk pursuant to Article 1(84) of the Commission Proposal for a Regulation amending Regulation (EU) No 575/2013, whichever is earlier, investment firms subject to the corresponding provisions of this Regulation should continue to calculate their capital requirement for the trading book in accordance with Regulation (EU) No 575/2013.

- (31) The largest investment firms providing key wholesale market and investment banking services (dealing on own account in financial instruments or underwriting financial instruments or placing financial instruments on a firm commitment basis) have business models and risk profiles that are similar to those of significant credit institutions. Their activities expose the firms to credit risk, mainly in the form of counterparty credit risk, as well as market risk for positions they take on own account, client related or not. As such, they present a risk to financial stability, given their size and systemic importance.
- (32) Those large firms present an additional challenge for their effective prudential supervision by national competent authorities. Even though the largest investment firms provide cross-border investment banking services on a significant scale, as investment firms they are subject to prudential supervision by authorities designated under Directive 2004/39/EU, which are not necessarily the same competent authorities as those designated under Directive 2013/36/EU, which may result in an un-level playing field in the application of Regulation (EU) No 575/2013/Directive 2013/36/EU provisions within the Union. This prevents supervisors from obtaining an overall prudential perspective which is essential for effectively addressing the risks associated with large cross-border firms. As a consequence, prudential supervision may become less effective and may also distort competition within the Union. The largest investment firms should therefore be given the status of credit institutions so as to create synergies from supervising cross-border wholesale market activities in a peer group, promoting a level playing field, and allowing for consistent supervision across groups.
- (33) Those firms, by virtue of becoming credit institutions, should therefore continue applying Regulation (EU) No 575/2013 and Directive 2013/36/EU be subject to supervision by competent authorities, including the ECB in the framework of the Single Supervisory Mechanism, in charge of credit institutions. This would ensure that the prudential supervision of credit institutions is implemented in a coherent and effective manner, that the single rulebook for financial services is applied in the same manner to all credit institutions in light of their systemic importance. In order to prevent regulatory arbitrage and reduce the risks of circumvention, competent authorities should endeavour to avoid situations where potentially systemic groups would structure their operations in such a way as to not exceed the thresholds set out in Article 4(1)(1)(b) and circumvent the obligation to seek authorization as credit institutions pursuant to Article 8a of Directive 2013/36/EU.



- (34) In addition, supervision of credit institutions on a consolidated basis aims to ensure, inter alia, the stability of the financial system and, in order to be effective, should be applied to all groups, including those the parent undertakings of which are not credit institutions or investment firms.. Therefore, all credit institutions, including those that previously had the status of investment firms, should be subject to the rules on individual and consolidated supervision of the parent undertaking by the competent authorities pursuant to Section I of Chapter 3 of Title VII of Directive 2013/36/EU.
- (35) Regulation (EU) No 600/2014 introduced a Union harmonised regime for granting access for third country firms providing investment services or activities to eligible counterparties and professional clients that are established in the Union. Access to the internal market is conditional on the Commission adopting an equivalence decision and ESMA registering the third country firm. It is important that the assessment of equivalence is done on the basis of the relevant applicable Union law and that effective tools to monitor that the conditions under which equivalence is granted are in place. For those reasons, third-country registered firms should be required to report annually to ESMA information concerning the scale and scope of services provided and activities carried out in the Union. Supervisory cooperation in relation to monitoring, enforcement and the fulfilment of the equivalence conditions should also be improved.
- (36) To ensure investor protection as well as the integrity and the stability of financial markets in the Union, the Commission, when adopting an equivalence decision, should take into account the potential risks posed by the services and the activities that firms from that third-country could carry out in the Union following that decision. Their systemic importance should be considered based on criteria such as the likely scale and scope of service provision and performance of activities by firms from the third country concerned. For the same purpose, the Commission may consider appropriate to take into account whether the third country is identified as a non-cooperative jurisdiction for tax purposes under the relevant Union policy or as a high-risk third country pursuant to Article 9(2) of Directive (EU) 2015/849<sup>32</sup>.
- (37) Since the objectives of this Regulation, namely to set up an effective and proportionate prudential framework to ensure that investment firms, which are authorised to operate within the Union operate on a sound financial basis and are managed in an orderly way including, where relevant, in the best interests of their clients, cannot be sufficiently achieved by the Member States but by reason of their scale and effects would be better achieved at Union level, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality, as set out in that Article, this Regulation does not go beyond what is necessary in order to achieve those objectives.
- (38) The European Banking Authority (EBA), with the participation of the European Securities and Markets Authority (ESMA), has issued a report based on thorough background analysis, data collection and consultation for a bespoke prudential

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<sup>32</sup> Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (OJ L 141, 5.6.2015, p. 73).

regime for all non-systemic investment firms which serves as the basis for the revised prudential framework for investment firms.

- (39) In order to ensure the harmonised application of this Regulation, EBA should be charged with drafting technical standards to specify the calculation of fixed overheads, the calculation for setting capital requirements equal to the initial margin posted with clearing members, and the templates for the public disclosures and regulatory reporting required under this Regulation.
- (40) In order to ensure the uniform application of this Regulation and to take account of developments in financial markets, the power to adopt acts in accordance with Article 290 of the Treaty on the Functioning of the European Union should be delegated to the Commission in respect of the further specification of the definitions in this Regulation and of technical adjustment to the non-essential elements of the capital requirements in this Regulation. It is of particular importance that the Commission carry out appropriate consultations during its preparatory work, including at expert level, and that those consultations be conducted in accordance with the principles laid down in the Interinstitutional Agreement on Better Law-Making of 13 April 2016. In particular, to ensure equal participation in the preparation of delegated acts, the European Parliament and the Council receive all documents at the same time as Member States' experts, and their experts systematically have access to meetings of Commission expert groups dealing with the preparation of delegated acts.
- (41) To ensure uniform conditions for the implementation of this Regulation, and in particular with regard to the adoption the draft implementing technical standards of EBA regarding disclosure and reporting templates, implementing powers should be conferred on the Commission.
- (42) In order to ensure legal certainty and avoid overlaps between the current prudential framework applicable to both credit institutions and investment firms and this Regulation, Regulation (EU) No 575/2013 and Directive 2013/36/EU are amended in order to remove investment firms from their scope. However, investment firms which are part of a banking group should remain subject to those provisions in Regulation (EU) No 575/2013 and Directive 2013/36/EU which are relevant for the banking group, such as the provisions on the intermediate EU parent undertaking referred to in [Article 21b] of Directive 2013/36/EU and to the rules on prudential consolidation set out in Chapter 2 of Title 2 of Part One of Regulation (EU) No 575/2013.

HAVE ADOPTED THIS REGULATION:

# PART ONE GENERAL PROVISIONS

## TITLE I

### SUBJECT MATTER, SCOPE AND DEFINITIONS

#### *Article 1*

##### *Subject matter and scope*

This Regulation lays down uniform prudential requirements which apply to investment firms authorised and supervised under Directive 2014/65/EU and supervised for compliance with prudential requirements under Directive (EU) ----/--[IFD] in relation to the following:

- (a) capital requirements relating to quantifiable, uniform and standardised elements of risk-to-firm, risk-to-customers and risk-to-market;
- (b) requirements limiting concentration risk;
- (c) liquidity requirements relating to quantifiable, uniform and standardised elements of liquidity risk;
- (d) reporting requirements related to points (a), (b) and (c);
- (e) public disclosure requirements.

#### *Article 2*

##### *Supervisory powers*

For the purposes of ensuring compliance with this Regulation, competent authorities shall have the powers and shall follow the procedures set out in Directive (EU) ----/--[IFD].

#### *Article 3*

##### *Application of stricter requirements by investment firms*

This Regulation shall not prevent investment firms from holding own funds and their components in excess of, or applying measures that are stricter than, those required by this Regulation.

#### *Article 4*

##### *Definitions*

1. For the purpose of this Regulation, the following definitions shall apply:
  - (1) ‘ancillary services undertaking’ means ancillary services undertaking as defined in Article 4(1)(18) of Regulation (EU) No 575/2013;

- (2) 'client' means client as defined in Article 4(1)(9) of Directive 2014/65/EU;
- (3) 'commodity dealers' means commodity dealers as defined in Article 4(1)(145) of Regulation (EU) No 575/2013;
- (4) 'commodity derivatives' means commodity derivatives as defined in Article 2(1)(30) of Regulation (EU) No 600/2014;
- (5) 'competent authority' means competent authority as defined in Article 3(5) of Directive (EU) ----/[IFD] ;
- (6) 'credit institution' means credit institution as defined in Article 4(1)(1) of Regulation (EU) No 575/2013;
- (7) 'daily trading flow' means the value of transactions in the trading book where the firm is dealing on own account, whether for itself or on behalf of a client;
- (8) 'dealing on own account' means dealing on own account as defined in Article 4(1)(6) of Directive 2014/65/EU;
- (9) 'derivatives' means derivatives as defined in Article 2(1)(29) of Regulation (EU) No 600/2014;
- (10) 'K-factor consolidated situation' means the situation that results from applying the requirements of this Regulation in accordance with K-factors to an investment firm as if that investment firm formed, together with one or more other entities in the same group, a single investment firm;
- (11) 'execution of orders on behalf of clients' means execution of orders on behalf of clients as defined in Article 4(1)(5) of Directive 2014/65/EU;
- (12) 'exposure' means the following:
  - (a) for the purposes of concentration risk limits, any asset or off-balance sheet item held in the trading book and not explicitly exempt under Article 40;
  - (b) for the purposes of reporting concentration risk, any asset or off-balance sheet item;
- (13) 'financial institution' means an undertaking other than a credit institution or investment firm, the principal activity of which is to acquire holdings or to pursue one or more of the activities listed in points (2) to (12) and point (15) of Annex I to Directive 2013/36/EU, including a financial holding company, a mixed financial holding company, an investment holding company, a payment institution within the meaning of Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market, and an asset management company, but excluding insurance holding companies and mixed-activity insurance holding companies as defined in point (g) of Article 212(1) of Directive 2009/138/EU;
- (14) 'financial instrument' means financial instrument as defined in Article 4(1)(50) of Regulation (EU) No 575/2013;
- (15) 'financial holding company' means financial holding company as defined in point of Article 4(1)(20) of Regulation (EU) No 575/2013;
- (16) 'financial sector entity' means financial sector entity as defined in Article 4(1)(27) of Regulation (EU) No 575/2013;

- (17) ‘initial capital’ means initial capital as defined in Article 3(17) of Directive (EU) 2014/65/EU [IFD];
- (18) ‘group of connected clients’ means group of connected clients as defined in Article 4(1)(39) of Regulation (EU) No 575/2013;
- (19) ‘investment advice’ means investment advice as defined in Article 4(1)(4) of 2014/65/EU;
- (20) ‘investment firm’ means investment firm as defined in Article 4(1)(1) of Directive 2014/65/EU;
- (21) ‘investment holding company’ means a financial institution, the subsidiaries of which are exclusively or mainly investment firms or financial institutions, at least one of such subsidiaries being an investment firm, and which is not a financial holding company as defined in Article 4(1)(20) of Regulation (EU) No 575/2013;
- (22) ‘investment services and activities’ means investment services and activities as defined in Article 4(1)(2) of 2014/65/EU;
- (23) ‘investment firm group’ means a group of undertakings which does not include a credit institution, where the parent undertaking is either an investment firm, an investment holding company or a mixed financial holding company and which may include other financial institutions and tied agents owned by the investment firm. The investment firm group may consist either of a parent undertaking and its subsidiaries, or of undertakings which meet the conditions set out in Article 22 of Directive 2013/34/EU;
- (24) ‘K-factors’ means capital requirements set out in Title II of Part Three for risks that an investment firm poses to customers, markets and to itself;
- (25) ‘K-AUM’ or ‘K-factor in relation to assets under management (AUM)’ means the capital requirement relative to the value of assets that an investment firm manages for its clients under both discretionary portfolio management and non-discretionary arrangements constituting investment advice, including assets delegated to another undertaking and excluding assets that another undertaking has delegated to the investment firm;
- (26) ‘K-CMH’ or ‘K-factor in relation to client money held (CMH)’ means the capital requirement relative to the amount of client money that an investment firm holds or controls, regardless of any legal arrangements in relation to asset segregation and irrespective of the national accounting regime applicable to client money held by the investment firm;
- (27) ‘K-ASA’ or ‘K-factor in relation to assets safeguarded and administered (ASA)’ means the capital requirement relative to the value of assets that an investment firm safeguards and administers for clients, including assets delegated to another undertaking and assets that another undertaking has delegated to the investment firm, irrespective of whether assets appear on the investment firm’s own balance sheet or are segregated in other accounts;
- (28) ‘K-COH’ or ‘K-factor in relation to client orders handled (COH)’ means the capital requirement relative to the value of orders that an investment firm handles for clients, through the reception and transmission of client orders and through the execution of orders on behalf of clients;

- (29) ‘K-CON’ or ‘K-factor in relation to concentration risk (CON)’ means the capital requirement relative to the exposures in the trading book of an investment firm to a client or a group of connected clients the value of which exceeds the limits in Article 36(1);
- (30) ‘K-CMG’ or ‘K-factor in relation to clearing member guarantee (CMG)’ means the capital requirement equal to the amount of initial margins posted with a clearing member, where the execution and settlement of transactions of an investment firm dealing on own account take place under the responsibility of a general clearing member;
- (31) ‘K-DTF’ or ‘K-factor in relation to daily trading flow (DTF)’ means the capital requirement relative to the daily value of transactions that an investment firm enters through dealing on own account or the execution of orders on behalf of clients in its own name;
- (32) ‘K-NPR’ or ‘K-factor in relation to net position risk (NPR)’ means the capital requirement relative to the value of transactions recorded in the trading book of an investment firm;
- (33) ‘K-TCD’ or ‘K-factor in relation to trading counterparty default risk (TCD)’ means the capital requirement relative to the exposures in the trading book of an investment firm in instruments and transactions referred to in Article 25 giving rise to the risk of trading counterparty default;
- (34) ‘long settlement transactions’ means long settlement transactions as defined in Article 272(2) of Regulation (EU) No 575/2013;
- (35) ‘margin lending transaction’ means margin lending transactions as defined in Article 272(3) of Regulation (EU) No 575/2013;
- (36) ‘management body’ means management body as defined in Article 4(1)(36) of Directive 2014/65/EU;
- (37) ‘parent undertaking’ means parent undertaking within the meaning of Articles 2(9) and 22 of Directive 2013/34/EU;
- (38) ‘participation’ means participation as defined in Article 4(1)(35) of Regulation (EU) No 575/2013;
- (39) ‘profit’ means profit as defined in Article 4(1)(121) of Regulation (EU) No 575/2013;
- (40) ‘qualifying central counterparty’ or ‘QCCP’ means qualifying central counterparty as defined in Article 4(1)(88) of Regulation (EU) No 575/2013;
- (41) ‘portfolio management’ means portfolio management as defined in Article 4(1)(8) of Directive 2014/65/EU;
- (42) ‘regulatory capital’ means the capital requirement specified in Article 11;
- (43) ‘repurchase transaction’ means repurchase transaction as defined in Article 4(1)(83) of Regulation (EU) No 575/2013;
- (44) ‘subsidiary’ means subsidiary within the meaning of Article 2(10) and 22 of Directive 2013/34/EU, including any subsidiary of a subsidiary undertaking of an ultimate parent undertaking;
- (45) ‘tied agent’ means tied agent as defined in Article 4(1)(29) of Directive 2014/65/EU;

- (46) ‘total gross revenue’ means the annual operating income of an investment firm, in connection with the firm's investment services and activities it is authorised to perform, including income stemming from interest receivable, from shares and other securities whether fixed yield or variable, from commission and fees, any gain and losses that the investment firms incurs on its trading assets, assets held at fair value, or from hedging activities, but excluding any income which is not linked to the investment services and activities performed;
- (47) ‘trade exposure’ means trade exposure as defined in point (91) of Article 4(1) of Regulation (EU) No 575/2013;
- (48) ‘trading book’ means trading book as defined in point (86) of Article 4(1) of Regulation (EU) No 575/2013;
- (49) ‘Union parent investment firm’ means an investment firm in a Member State which is not itself a subsidiary of another investment firm authorised in any Member State, or of an investment holding company or mixed financial holding company set up in any Member State;
- (50) ‘Union parent investment holding company’ means an investment holding company in a Member State which is not itself a subsidiary of an investment firm authorised in any Member State or of another investment holding company in any Member State;
- (51) ‘Union parent mixed financial holding company’ means a parent undertaking of an investment firm group which is a mixed financial holding company as defined in Article 2(15) of Directive 2002/87/EC.
2. The Commission shall be empowered to adopt delegated acts in accordance with Article 54 in order to clarify:
- (a) the definitions set out in paragraph 1 to ensure uniform application of this Regulation;
- (b) the definitions set out in paragraph 1 to take account, in the application of this Regulation, of developments on financial markets.

## TITLE II

### LEVEL OF APPLICATION OF REQUIREMENTS

#### CHAPTER 1

#### **Application of requirements on an individual basis**

*Article 5*  
*General principle*

An investment firm shall comply with the requirements laid down in Parts Two to Seven on an individual basis.

*Article 6*  
*Exemptions*

1. Competent authorities may exempt an investment firm from the application of Article 5 in respect of Parts Two to Four, Six and Seven, where all of the following apply:
  - (a) the investment firm is a subsidiary and is included in the supervision on a consolidated basis of a credit institution, a financial holding company or a mixed financial holding company, in accordance with the provisions of Chapter 2, Title II, Part One of Regulation (EU) No 575/2013;
  - (b) both the investment firm and its parent undertaking are subject to authorisation and supervision by the same Member State;
  - (c) the authorities competent for the supervision on consolidated basis in accordance with Regulation (EU) No 575/2013 agree to such an exemption;
  - (d) own funds are distributed adequately between the parent undertaking and the investment firm and all of the following conditions are satisfied:
    - (i) the investment firm meets the conditions set out in Article 12(1);
    - (ii) there is no current or foreseen material practical or legal impediment to the prompt transfer of capital or repayment of liabilities by the parent undertaking;
    - (iii) upon prior approval by the competent authority, the parent undertaking declares that it guarantees the commitments entered into by the investment firm or that the risks in the investment firm are of negligible interest;
    - (iv) the risk evaluation, measurement and control procedures of the parent undertaking include the investment firm; and
    - (v) the parent undertaking holds more than 50% of the voting rights attached to shares in the capital of the investment firm or has the right to appoint or remove a majority of the members of the investment firm's management body.
2. Competent authorities may exempt investment firms from the application of Article 5 in respect of Part Five where all of the following conditions are satisfied:
  - (a) the investment firm is included in the supervision on a consolidated basis in accordance with Chapter 2, Title II of Part One of Regulation (EU) No 575/2013;
  - (b) the group has established centralised liquidity management functions; and
  - (c) the authorities competent for the supervision on consolidated basis in accordance with Regulation (EU) No 575/2013 agree to such an exemption.



## CHAPTER 2

### Application of requirements for compliance with the group capital test and exemptions

#### *Article 7*

#### *The group capital test*

1. A Union parent investment firm, a Union parent investment holding company, a Union parent mixed financial holding company shall hold at least enough own funds to cover the sum of the following:
  - (a) the sum of the full book value of any holdings, subordinated claims and instruments referred to in points (h) and (i) of Article 36(1), points (c) and (d) of Article 56, and points (c) and (d) of Article 66 of Regulation (EU) No 575/2013 in investment firms, financial institutions, ancillary services undertakings and tied agents in the investment firm group; and
  - (b) the total amount of any contingent liability in favour of investment firms, financial institutions, ancillary services undertakings and tied agents.
2. Competent authorities may allow a Union parent investment holding company or a Union parent mixed financial holding company to hold a lower amount of own funds than the amount calculated under paragraph 1, provided that this amount is no lower than the sum of the own funds requirements imposed on an individual basis on investment firms, financial institutions, ancillary services undertakings and tied agents in the group, and the total amount of any contingent liabilities in favour of these entities.

For the purposes of paragraph 1, where no Union or national prudential legislation applies for any of the entities referred to in paragraph 1, a notional own funds requirement shall apply.
3. A Union parent investment firm, a Union parent investment holding company, a Union parent mixed financial holding company shall have systems in place to monitor and control the sources of capital and funding of all investment firms, investment holding companies, mixed financial holding companies, financial institutions, ancillary services undertakings and tied agents within the investment firm group.

#### *Article 8*

#### *K-factor consolidation*

The competent authorities of a Union parent investment firm or the competent authorities determined in accordance with Article 42(2) of Directive (EU)---/--[IFD] may require a Union parent investment firm, a Union parent investment holding company or a Union parent mixed financial holding company to comply with the requirements set out in Article 15 on the basis of the K-factor consolidated situation where either of the following conditions applies:

- (a) there are significant material risks to customers or to market, stemming from the group as a whole which are not fully captured by the capital requirements applicable to the investment firms in the group on an individual basis; or
- (b) for investment firm groups with a high degree of inter-connectedness in terms of risk management, the application of requirements to the investment firm on an individual basis may lead to a duplication of the requirements for those firms.

## **PART TWO OWN FUNDS**

### *Article 9 Own funds requirements*

1. An investment firm shall have own funds consisting of the sum of its Tier 1 capital and Tier 2 capital where:
  - (a) at least 56 % of the sum shall consist of Common Equity Tier 1 capital in accordance with Chapter 2 of Title 1 of Part Two of Regulation (EU) No 575/2013;
  - (b) up to 44 % of the sum may consist of additional Tier 1 capital in accordance with Chapter 3 of Title 1 of Part Two of Regulation (EU) No 575/2013;
  - (c) up to 25% of the sum may consist of Tier 2 capital in accordance with Chapter 4 of Title 1 of Part Two of Regulation (EU) No 575/2013;
2. By way of derogation from paragraph 1, the following shall not apply to the determination of own funds:
  - (a) the threshold exemptions referred to in Article 48 of Regulation (EU) No 575/2013;
  - (b) the deductions referred to in Articles 46, 60 and 70 of Regulation (EU) No 575/2013;
  - (c) the trigger event referred to in Article 54(1)(a) of Regulation (EU) No 575/2013. The trigger event shall instead be specified by the investment firm in the terms of the additional Tier 1 instrument referred to in paragraph 1;
  - (d) the aggregate amount referred to in Article 54(4)(a) of Regulation (EU) No 575/2013. The amount to be written down or converted shall be the full principal amount of the additional Tier 1 instrument referred to in paragraph 1.
3. An investment firms shall apply the provisions set out in Chapter 6 of Title 1 in Part Two of Regulation (EU) No 575/2013 where determining the own funds requirements pursuant to this Regulation.

### *Article 10 Holdings outside the financial sector*

1. For the purposes of this Part, an investment firm shall deduct amounts in excess of the limits specified in points (a) and (b) from the determination of Common Equity Tier 1 items referred to in Article 26 of Regulation (EU) No 575/2013:
  - (a) a holding, the amount of which exceeds 15 % of the regulatory capital of the investment firm, in an undertaking which is not a financial sector entity;

- (b) the total amount of the holdings of an investment firm in undertakings other than financial sector entities that exceeds 60 % of its regulatory capital.
- 2. Competent authorities may prohibit an investment firm from having holdings referred to in paragraph 1 the amount of which exceeds the percentages of regulatory capital laid down in that paragraph. Competent authorities shall make public their decision exercising this power without delay.
- 3. Shares in undertakings other than financial sector entities shall not be included in the calculation specified in paragraph 1 where any of the following conditions is met:
  - (a) those shares are held temporarily during a financial assistance operation as referred to in Article 79 of Regulation (EU) No 575/2013;
  - (b) the holding of those shares is an underwriting position held for five working days or fewer;
  - (c) those shares are held in the own name of the investment firm and on behalf of others.
- 4. Shares which are not financial fixed assets as referred to in Article 35(2) of Directive 86/635/EEC shall not be included in the calculation specified in paragraph 1.

# PART THREE

## CAPITAL REQUIREMENTS

### TITLE I

#### GENERAL REQUIREMENTS

##### *Article 11*

##### *Capital requirement*

1. An investment firm shall at all times have capital which amounts to the highest of the following:
  - (a) its fixed overheads requirement calculated according to Article 13.
  - (b) its permanent minimum requirement according to Article 14.
  - (c) its K-factor requirement calculated according to Article 15.
2. An investment firm that meets the conditions set out in Article 12(1) shall at all times only have capital which amounts to the highest of the amounts specified in points (a) and (b) of paragraph 1.
3. Where competent authorities consider that there has been a material change in the business activities of an investment firm, they may require the investment firm to be subject to a different capital requirement referred to in this Article, in accordance with Title IV, Chapter 2, section IV of Directive (EU) ----/--[IFD].

##### *Article 12*

##### *Small and non-interconnected investment firms*

1. An investment firm shall be deemed a small and non-interconnected investment firm for the purposes of this Regulation where it meets all of the following conditions:
  - (a) AUM (or assets under management) calculated in accordance with Article 17 is less than EUR 1.2 billion;
  - (b) COH (or client orders handled) calculated in accordance with Article 20 is less than either:
    - i) EUR 100 million/day for cash trades or
    - ii) EUR 1 billion/day for derivatives.
  - (c) ASA (or assets safeguarded and administered) calculated in accordance with Article 19 is zero;
  - (d) CMH (or client money held) calculated in accordance with Article 18 is zero;
  - (e) DTF (daily trading flow) calculated in accordance with Article 32 is zero;
  - (f) NPR (net position risk) or CMG (clearing member guarantee) calculated in accordance with Articles 22 and 23 is zero;

- (g) TCD (trading counterparty default) calculated in accordance with Article 26 is zero;
- (h) the balance sheet total of the investment firm is less than EUR 100 million;
- (i) the total annual gross revenue from investment services and activities of by the investment firm is less than EUR 30 million.

For the purposes of points (a), (b), (c), (e), (f), and (g), end-of day levels shall apply.

For the purposes of point (d), intra-day levels shall apply.

For the purposes of points (h) and (i), the levels applicable at the end of the last financial year shall apply.

2. The conditions set out in points (a), (b), (h) and (i) of paragraph 1 shall apply on a combined basis for all investment firms that are part of a group.

The conditions set out in points (c), (d), (e), (f) and (g) shall apply to each investment firm on an individual basis.

Where an investment firm no longer meets all the conditions set out in paragraph 1, it shall not be considered a small and non-interconnected investment firm with immediate effect.

3. Where an investment firm no longer meets the conditions set out in points (a) or (b) of paragraph 1 but continues to meet the conditions set out in points (c) to (i) of paragraph 1, it shall not be considered a small and non-interconnected investment firm after a period of 3 months, calculated from the date when the threshold has been exceeded.
4. Where an investment firm which has not met all of the conditions set out in paragraph 1 subsequently meets those conditions, it shall be considered, subject to approval by the competent authority, a small and non-interconnected investment firm after a period of 6 months from the date when those conditions are met.
5. In order to take account of developments in financial markets, the Commission shall be empowered to adopt delegated acts in accordance with Article 54 in order to adjust the conditions for investment firms to qualify as small and non-interconnected firms in accordance with this Article.

### *Article 13*

#### *Fixed overheads requirement*

1. For the purposes of Article 11(1)(a), the fixed overheads requirement shall amount to at least one quarter of the fixed overheads of the preceding year.
2. Where the competent authority considers that there has been a material change in the activity of an investment firm, the competent authority may adjust the amount of capital referred to in paragraph 1.
3. Subject to approval by the competent authorities, where an investment firm has no fixed overheads from the previous year, it shall have capital amounting to at least one quarter of the fixed overheads which have been projected in its business plan for the year following the year of commencement of its activities.

4. EBA, in consultation with ESMA, and taking into account Commission Delegated Regulation (EU) 2015/488 shall develop draft regulatory technical standards to further specify the calculation of the requirement referred to in paragraph 1.

EBA shall submit those draft regulatory technical standards to the Commission by [*nine month from the date of entry into force of this Regulation*].

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

*Article 14*

*Permanent minimum requirement*

For the purposes of Article 11(1)(b), the permanent minimum requirement shall amount to at least the levels of initial capital specified in Article 8 of Directive (EU) -- --[IFD].

**TITLE II**  
**K-FACTOR CAPITAL REQUIREMENT**

**CHAPTER 1**  
**General principles**

*Article 15*

*K-factor requirement and applicable coefficients*

1. For the purposes of Article 11(1)(c), the K-factor requirement shall amount to at least the sum of the following:
  - (a) Risk-to-Customer (RtC) K-factors calculated in accordance with Chapter 2;
  - (b) Risk-to-Market (RtM) K-factors calculated in accordance with Chapter 3;
  - (c) Risk-to-Firm (RtF) K-factors calculated in accordance with Chapter 4.
  
2. The following coefficients shall apply to the corresponding K-Factors:

*Table 1*

| <b>K-FACTORS</b>  |       | <b>COEFFICIENT</b> |
|---|-------|--------------------|
| Assets under management under both discretionary portfolio management and non-discretionary (advisory) arrangements | K-AUM | 0.02%              |
| Client money held   | K-CMH | 0.45%              |
| Assets under safekeeping and administration   | K-ASA | 0.04%              |

|                       |                   |       |
|-----------------------|-------------------|-------|
| Client orders handled | K-COH cash trades | 0.1%  |
|                       | K-COH derivatives | 0.01% |
| Daily trading flow    | K-DTF cash trades | 0.1%  |
|                       | K-DTF derivatives | 0.01% |

3. An investment firm shall monitor the value of its K-factors for any trends that could leave it with a materially different capital requirement for the next reporting period and shall notify its competent authority of that materially different capital requirement.
4. Where competent authorities consider that there has been a material change in the business activities of an investment firm that impacts the amount of a relevant K-factor, they may adjust the corresponding amount in accordance with Article 36(2)(a) of Directive (EU) 2017/1031 [IFD].
5. In order to ensure the uniform application of this Regulation and to take account of developments in financial markets, the Commission shall be empowered to adopt delegated acts in accordance with Article 54 in order to:
  - (a) specify the methods for measuring the K-factors in Title II of Part Three;
  - (b) adjust the coefficients specified in paragraph 2 of this Article.

## CHAPTER 2

### RtC K-factors

#### *Article 16* *RtC K-factor requirement*

The RtC K-factor requirement is determined by the following formula:

$$\mathbf{K-AUM + K-CMH + K-ASA + K-COH}$$

where

- (a) K-AUM is equal to AUM measured in accordance with Article 17, multiplied by the corresponding coefficient in Article 15(2);
- (b) K-CMH is equal to CMH measured in accordance with Article 18, multiplied by the corresponding coefficient in Article 15(2);
- (c) K-ASA is equal to ASA measured in accordance with Article 19, multiplied by the corresponding coefficient in Article 15(2);
- (d) K-COH is equal to COH measured in accordance with Article 20, multiplied by the corresponding coefficient in Article 15(2);



*Article 17*  
*Measuring AUM for the purposes of calculating K-AUM*

1. For the purposes of calculating K-AUM, AUM shall be the rolling average of the value of the total monthly assets under management, measured on the last business day of each of the previous 15 calendar months, excluding the 3 most recent monthly values.

AUM shall be the average or simple arithmetic mean of the remaining 12 monthly measurements.

K-AUM shall be calculated within the first 14 days of each calendar month.

2. Where the investment firm has formally delegated the assets under management to another financial entity, those delegated assets shall be included in the total amount of AUM measured in accordance with paragraph 1.

Where another financial entity has formally delegated the assets under management to the investment firm, those delegated assets shall not be included in the total amount of assets under management measured in accordance with paragraph 1.

3. Where an investment firm has been managing assets for less than 15 months, it may use business projections of AUM to calculate K-AUM, subject to the following cumulative requirements:

- (a) historical data is used as soon as it becomes available;
- (b) the business projections of the investment firm submitted in accordance with Article 7 of Directive 2014/65/EU have been positively assessed by the competent authority.

*Article 18*  
*Measuring CMH for the purposes of calculating K-CMH*

1. For the purposes of calculating K-CMH, CMH shall be the rolling average of the value of total daily client money held, measured at the end of each business day for the previous 3 calendar months.

CMH shall be the average or simple arithmetic mean of the daily measurements in the 3 calendar months.

K-CMH shall be calculated by the end of business day following the measurement referred to in the first subparagraph.

2. Where an investment firm has been holding client money for less than 3 months, it may use business projections to calculate K-CMH, subject to the following cumulative requirements:

- (a) historical data is used as soon as it becomes available;
- (b) the business projections of the investment firm submitted in accordance with Article 7 of Directive 2014/65/EU have been positively assessed by the competent authority.

*Article 19*  
*Measuring ASA for the purposes of calculating K-ASA*

1. For the purposes of calculating K-ASA, ASA shall be the rolling average of the value of the total daily assets safeguarded and administered, measured at the end of each business day for the previous 6 calendar months, excluding the 3 most recent calendar months.

ASA shall be the average or simple arithmetic mean of the daily measurements from the remaining 3 calendar months.

K-ASA shall be calculated within the first 14 days of each calendar month.

2. Where an investment firm has been in operation for less than 3 months, it may use business projections to calculate K-ASA, subject to the following cumulative requirements:
  - (a) historical data is used as soon as it becomes available;
  - (b) the business projections of the investment firm submitted in accordance with Article 7 of Directive 2014/65/EU have been positively assessed by the competent authority.

*Article 20*  
*Measuring COH for the purposes of calculating K-COH*

1. For the purposes of calculating K-COH, COH shall be the rolling average of the value of the total daily client orders handled, measured at the end of each business day over the previous 6 calendar months, excluding the 3 most recent calendar months.

COH shall be the average or simple arithmetic mean of the daily measurements for the remaining 3 calendar months.

K-COH shall be calculated within the first 14 days of each quarter.

2. COH shall be measured as the sum of the absolute value of buys and the absolute value of sells for both cash trades and derivatives in accordance with the following:
  - (a) for cash trades, the value is the amount paid or received on each trade.
  - (b) for derivatives, the value of the trade is the notional amount of the contract.

COH shall include transactions executed by investment firms providing portfolio management services on behalf of investment funds.

COH shall exclude transactions executed by the investment firm in its own name either for itself or on behalf of a client.

3. Where an investment firm has been in operation for less than 3 months, it may use business projections to calculate K-COH, subject to the following cumulative requirements:
  - (a) historical data is used as soon as it becomes available;

- (b) the business projections of the investment firm submitted in accordance with Article 7 of Directive 2014/65/EU have been positively assessed by the competent authority.

## **CHAPTER 3**

### **RtM K-Factors**

#### *Article 21* *RtM K-factor requirement*

The RtM K-factor requirement for the trading book positions of an investment firm dealing on own account, whether for itself or on behalf of a client shall be the higher of K-NPR calculated in accordance with Article 22 or K-CMG calculated in accordance with Article 23.

#### *Article 22* *Calculating K-NPR*

1. For the purposes of K-NPR, the capital requirement for the trading book positions of an investment firm dealing on own account, whether for itself or on behalf of a client shall be calculated using one of the following approaches:
  - (a) the [simplified standardised] approach set out in Chapters 2 to 4 of Title IV of Part Three of Regulation (EU) No 575/2013 where the investment firm's trading book business is equal to or less than EUR 300 million;
  - (b) the standardised approach set out in [*Chapter 1(a) of Title IV of Part Three of the Regulation No (EU) No 575/2013, in accordance with Article 1(84) of the 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*];
  - (c) the internal model approach set out in [*Chapter 1(b) of Title IV of Part Three of the Regulation No (EU) No 575/2013 in accordance with Article 1(84) of the 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*].

K-NPR calculated under the approaches specified under points (b) and (c) shall be multiplied by a factor of 65%.

2. For the purposes of the second sentence of point (a) of paragraph 1, an investment firm shall calculate the size of on- and off- balance sheet business in accordance with [paragraphs 2 to 7 of Article 325a of Regulation No (EU) No 575/2013].

*Article 23*  
*Calculating K-CMG*

1. By way of derogation from Article 22, the competent authority may allow an investment firm to calculate K-CMG for positions that are centrally cleared subject to the following conditions:
  - (a) the investment firm is not part of a group containing a credit institution;
  - (b) the execution and settlement of the transactions of the investment firm that are centrally cleared take place under the responsibility of a clearing member and are either guaranteed by that clearing member or otherwise settled on a delivery-versus-payment basis;
  - (c) the calculation of the initial margin posted by the investment firm to the clearing member is based on an internal model of the clearing member that complies with the requirements set out in Article 41 of Regulation (EU) No 648/2012;
  - (d) the clearing member is a credit institution.

K-CMG shall be the highest total amount of initial margin posted to the clearing member by the investment firm over the preceding 3 months.

2. EBA, in consultation with ESMA, shall develop draft regulatory technical standards to specify the calculation of the amount of the initial margin referred to in paragraph 1(c).

The EBA shall submit those draft regulatory technical standards to the Commission by [nine months from the date of entry into force of this Regulation].

Power is delegated to the Commission to adopt the revised regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

## **CHAPTER 4**

### **Rtf K-Factors**

#### *Article 24* *RtF K-factor requirement*

1. The RtF K-factor requirement is determined by the following formula:

$$\mathbf{K-TCD + K-DTF + K-CON}$$

where

K-TCD is equal to the amount calculated in accordance with Article 26;

K-DTF is equal to DTF measured in accordance with Article 32, multiplied by the corresponding coefficient established in Article 15(2) and

K-CON is equal to the amount calculated in accordance with Article 38.

K-TCD and K-CON shall be based on the transactions recorded in the trading book of an investment firm dealing on own account, whether for itself or on behalf of a client.

K-DTF shall be based on the transactions recorded in the trading book of an investment firm dealing on own account, whether for itself or on behalf of a client, and the transactions that an investment firm enters into through the execution of orders on behalf of clients in its own name.

## **SECTION I**

### **TRADING COUNTER PARTY DEFAULT**

#### *Article 25* *Scope*

1. The following transactions shall be subject to this Section:
- (a) derivative instruments listed in Annex II of Regulation (EU) No 575/2013, with the exception of the following:
    - (i) OTC derivatives traded with central governments and central banks of Member States;
    - (ii) OTC derivatives cleared through a qualifying central counterparty (QCCP);
    - (iii) OTC derivatives cleared through a clearing member, where transactions are subject to a clearing obligation pursuant to Article 4 of Regulation (EU) No 648/2012 or to an equivalent requirement to clear that contract in a third country, or where all of the following conditions are met:

aa. the positions and assets of the investment firm related to those transactions are distinguished and segregated, at the level of both the clearing member and the QCCP, from the positions and assets of both the clearing member and the other clients of that clearing member and, as a result of that distinction and segregation, those positions and assets are bankruptcy remote under national law in the event of the default or insolvency of the clearing member or one or more of its other clients;

bb. laws, regulations and contractual arrangements applicable to or binding the clearing member facilitate the transfer of the client's positions relating to those contracts and transactions and of the corresponding collateral to another clearing member within the applicable margin period of risk in the event of default or insolvency of the original clearing member;

cc. the investment firm has obtained an independent, written and reasoned legal opinion which concludes that, in the event of legal challenge, the investment firm would bear no losses on account of the insolvency of its clearing member or of any of its clearing member's clients.

- (iv) exchange-traded derivatives;
- (v) derivatives held for hedging a position of the firm resulting from a non-trading book activity;
- (b) long settlement transactions;
- (c) repurchase transactions;
- (d) securities or commodities lending or borrowing transactions;
- (e) margin lending transactions.

2. By way of derogation from this Section, an investment firm may calculate its capital requirement for the transactions referred to in paragraph 1 by applying one of the methods set out in [Sections 3, 4 or 5, Title II, Part 3 of Regulation (EU) No 575/2013] and shall immediately inform the competent authority thereof.

*Article 26*  
*Calculating K-TCD*

For the purposes of K-TCD, the capital requirement shall be determined by the following formula:

$$\text{Capital requirement} = \text{Exposure value} * \text{RF}$$

where RF is the risk factor defined per counterparty type according to Table 2.

Table 2

| Counterparty type                        | Risk factor |
|--|-------------|
| Credit institutions and investment firms | 1.6%        |
| Other counterparties                     | 8%          |

*Article 27*  
*Calculation of exposure value*

The calculation of the exposure value shall be determined in accordance with the following formula:

$$\text{Exposure value} = \text{Max (0; RC + PFE - C)}$$

where:

RC = replacement cost as determined in Article 28.

PFE = potential future exposure as determined in Article 29; and

C = collateral as determined in Article 30.

The replacement cost (RC) and collateral (C) shall apply to all transactions referred to in Article 25.

The potential future exposure (PFE) applies only to derivative contracts and long settlement transactions.

*Article 28*  
*Replacement cost (RC)*

The replacement cost referred to in Article 27 shall be determined as follows:

- (a) for derivative contracts, RC is determined as the current market value (CMV);
- (b) for long settlement transactions, RC is determined as the settlement amount;
- (c) for repurchase transactions and securities or commodities lending or borrowing transactions, RC is determined as the net amount of cash borrowed and received.

*Article 29*  
*Potential future exposure*

1. The potential future exposure (PFE) referred to in Article 28 shall be calculated for each derivative and long-settlement transaction as the product of:

- (a) the effective notional (EN) amount of the transaction set in accordance with paragraphs 2 to 6 of this Article;
  - (b) the supervisory factor (SF) set according to paragraph 7 of this Article; and
  - (c) a maturity factor (MF) set according to paragraph 8 of this Article.
2. The effective notional (EN) amount shall be the product of the notional amount calculated in accordance with paragraph 3 of this Article, its duration for interest rate and credit derivative contracts calculated in accordance with paragraph 4 of this Article, and its delta for option contracts calculated in accordance with paragraph 6 of this Article.
3. The notional amount, unless clearly stated and fixed until maturity, shall be determined as follows:
- (a) for foreign exchange derivatives, the notional amount is defined as the notional of the foreign currency leg of the contract, converted to the domestic currency. If both legs of a foreign exchange derivative are denominated in currencies other than the domestic currency, the notional amount of each leg is converted to the domestic currency and the leg with the larger domestic currency value is the notional amount;
  - (b) for equity and commodity derivatives and emission allowances and derivatives thereof, the notional amount is defined as the product of the current (future) price of one unit of the stock or and the number of units referenced by the trade;
  - (c) for transactions with multiple payoffs that are state contingent including digital options or target redemption forwards, an investment firm shall calculate the notional amount for each state and use the largest resulting calculation;
  - (d) where the notional is a formula of market values, the investment firm shall enter the current market values to determine the trade notional amount;
  - (e) for variable notional swaps such as amortising and accreting swaps, investment firms shall use the average notional over the remaining life of the swap as the trade notional amount;
  - (f) leveraged swaps shall be converted to the notional amount of the equivalent unleveraged swap so that where all rates in a swap are multiplied by a factor, the stated notional amount is multiplied by the factor on the interest rates to determine the notional amount;
  - (g) for a derivative contract with multiple exchanges of principal, the notional amount shall be multiplied by the number of exchanges of principal in the derivative contract to determine the notional amount.
4. The notional amount of interest rate and credit derivatives for the time to maturity (in years) of these contracts shall be adjusted according to the duration set out in the following formula:

$$\text{Duration} = (1 - \exp(-0.05 * \text{time to maturity})) / 0.05;$$



5. The maturity of a contract shall be the latest date when the contract may still be executed.

If the derivative references the value of another interest rate or credit instrument, the time period shall be determined on the basis of the underlying instrument.

For options, the maturity shall be the latest contractual exercise date as specified by the contract.

For a derivative contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the fair value of the contract is zero, the remaining maturity shall equal the time until the next reset date.

6. The delta of options and swaptions may be calculated by the investment firm itself, using an appropriate model. The model shall estimate the rate of change of the option's value with respect to small changes in the market value of the underlying. For transactions other than options and swaptions, the delta shall be 1 for long positions and -1 for short positions.
7. The supervisory factor (SF) for each asset class shall be set according to the following table:

*Table 3*

| <b>Asset class</b>               | <b>Supervisory factor</b> |
|----------------------------------|---------------------------|
| Interest rate                    | 0.5%                      |
| Foreign exchange                 | 4%                        |
| Credit                           | 1%                        |
| Equity single name               | 32%                       |
| Equity index                     | 20%                       |
| Commodity and emission allowance | 18%                       |

8. The maturity factor (MF) for each transaction shall be determined by the following formula:

$$MF = (\min (M; 1 \text{ year}) / 1 \text{ year})^{0.5}$$

For unmargined trades, maturity (M) shall be the shorter of one year and remaining maturity of the derivative contract, as determined in the second subparagraph of paragraph 5, but no less than ten business days.

For margined trades, maturity (M) shall be the margin period of risk. The minimum margin period of risk shall be at least ten business days for non-centrally cleared derivative transactions subject to daily margin agreements and five business days for centrally cleared derivative transactions subject to daily margin agreements.

*Article 30  
Collateral*

1. All non-cash collateral posted and received by an investment firm, both in bilateral and cleared transactions referred to in Article 23, shall be subject to haircuts in accordance with the following table:

*Table 4*

| Asset class  |                    | Haircut repurchase transactions | Haircut other transactions |
|--|--------------------|---------------------------------|----------------------------|
| Debt securities issued by central governments or central banks | ≤ 1 year           | 0.707%                          | 1%                         |
|  | > 1 year ≤ 5 years | 2.121%                          | 3%                         |
|  | > 5 years          | 4.243%                          | 6%                         |
| Debt securities issued by other entities                       | ≤ 1 year           | 1.414%                          | 2%                         |
|  | > 1 year ≤ 5 years | 4.243%                          | 6%                         |
|  | > 5 years          | 8.485%                          | 12%                        |
| Securitisation positions                                       | ≤ 1 year           | 2.828%                          | 4%                         |
|  | > 1 year ≤ 5 years | 8.485%                          | 12%                        |
|  | > 5 years          | 16.970%                         | 24%                        |
| Listed equities and convertibles                               |                    | 14.143%                         | 20%                        |
| Gold   |                    | 10.607%                         | 15%                        |
| Cash   |                    | 0%                              | 0%                         |

For the purposes of Table 4, securitisation positions shall not include re-securitisation positions.

2. The value of non-cash collateral posted by the investment firm to its counterparty shall be increased and the value of the non-cash collateral received by the investment firm from its counterparty shall be decreased according to Table 4.
3. Where there is a currency mismatch between the transaction and the collateral received or posted, an additional currency mismatch haircut of 8% shall apply.

### *Article 31* *Netting*

For the purposes of this Section, an investment firm may treat perfectly matching contracts included in a netting agreement as if they were a single contract with a notional principal equivalent to the net receipts, may net other transactions subject to novation under which all obligations between the investment firm and its counterparty are automatically amalgamated in such a way that the novation legally substitutes one single net amount for the previous gross obligations, and other transactions where the investment firm ensures to the satisfaction of the competent authority that the following conditions have been met:

- (a) a netting contract with the counterparty or other agreement which creates a single legal obligation, covering all included transactions, such that the investment firm would have either a claim to receive or obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions in the event a counterparty fails to perform due to any of the following:
  - (i) default;
  - (ii) bankruptcy;

- (iii) liquidation;
  - (iv) similar circumstances.
- (b) the netting contract does not contain any clause which, in the event of default of a counterparty, permits a non-defaulting counterparty to make limited payments only, or no payments at all, to the estate of the defaulting party, even if the defaulting party is a net creditor;
- (c) the investment firm has obtained an independent, written and reasoned legal opinion that, in the event of a legal challenge of the netting agreement, the investment firm's claims and obligations would be equivalent to those referred to in point (a) under the following legal regime:
- the law of the jurisdiction in which the counterparty is incorporated;
  - if a foreign branch of a counterparty is involved, the law of jurisdiction in which the branch is located;
  - the law that governs the individual transactions in the netting agreement; or
  - the law that governs any contract or agreement necessary to effect the netting.

## SECTION II

### DAILY TRADING FLOW

#### *Article 32*

#### *Measuring DTF for the purposes of calculating K-DTF*

1. For the purposes of calculating K-DTF, DTF shall be the rolling average of the value of the total daily trading flow, measured at the end of each business day over the previous 6 calendar months, excluding the 3 most recent calendar months.  
DTF shall be the average or simple arithmetic mean of the daily measurements for the remaining 3 calendar months  
K-DTF shall be calculated within the first 14 days of each quarter.
2. DTF shall be measured as the sum of the absolute value of buys and the absolute value sells for both cash trades and derivatives in accordance with the following:
  - (a) for cash trades, the value is the amount paid or received on each trade.
  - (b) for derivatives, the value of the trade is the notional amount of the contract.
3. DTF shall exclude transactions executed by an investment firm providing portfolio management services on behalf of investment funds.  
DTF shall include transactions executed by an investment firm in its own name either for itself or on behalf of a client.

4. Where an investment firm has been in operation for less than 3 months, it may use business projections to calculate K-DTF subject to the following cumulative requirements:
- (a) historical data is used as soon as it becomes available;
  - (b) the business projections of the investment firm submitted in accordance with Article 7 of Directive 2014/65/EU have been positively assessed by the competent authority.

## **PART FOUR**

### **CONCENTRATION RISK**

#### *Article 33* *Monitoring obligation*

1. An investment firm shall monitor and control its concentration risk in accordance with this Part, by means of sound administrative and accounting procedures and robust internal control mechanisms.
2. For the purposes of this Part, the terms credit institution and investment firm shall include private or public undertakings, including their branches, which, were they established in the Union, would be a credit institution or an investment firm as defined in this Regulation and have been authorised in a third country that applies prudential supervisory and regulatory requirements at least equivalent to those applied in the Union.

#### *Article 34* *Reporting requirements*

An investment firm that does not meet the conditions set out in Article 12(1) shall report the following levels of risk to the competent authorities on at least an annual basis:

- (a) level of concentration risk associated with the default of counterparties for trading book exposures, both on an individual counterparty and aggregate basis;
- (b) level of concentration risk towards the credit institutions, investment firms and other entities where client money is held;
- (c) level of concentration risk towards the credit institutions, investment firms and other entities where client securities are deposited;
- (d) level of concentration risk towards the credit institutions where the firm's own cash is deposited; and
- (e) level of concentration risk from earnings.

*Article 35*  
*Calculation of the exposure value*

1. An investment firm that does not meet the conditions set out in Article 12(1) shall calculate the following exposures for the purposes of this Part:

- (a) exposures to individual clients which arise on the trading book, by adding those exposures to the net exposures in all financial instruments issued by that individual client.

The net exposure shall be calculated by deducting those underwriting positions which are subscribed or sub-underwritten by third parties based on a formal agreement, reduced by the following factors:

*Table 5*

|                      |       |
|----------------------|-------|
| working day 0:       | 100 % |
| working day 1:       | 90 %  |
| working days 2 to 3: | 75 %  |
| working day 4:       | 50 %  |
| working day 5:       | 25 %  |
| after working day 5: | 0 %.  |

An investment firm shall set up systems to monitor and control its underwriting exposures between the time of the initial commitment and the next business day, in the light of the nature of the risks incurred in the markets in question.

- (b) exposures to groups of connected clients, by adding all the exposures to the individual clients within the group, which shall be treated as a single exposure.

2. In calculating the exposure to a client or a group of connected clients, an investment firm shall take all reasonable steps to identify underlying assets in relevant transactions and the counterparty of the underlying exposures.

*Article 36*  
*Limits to concentration risks*

1. An investment firm dealing on own account, whether for itself or on behalf of a client, shall not incur an exposure to an individual client or group of connected clients the value of which exceeds 25% of its regulatory capital, unless it meets the obligation to notify set out in Article 37 and the K-CON capital requirement set out in Article 38.

Where that individual client is a credit institution or an investment firm, or where a group of connected clients includes one or more credit institutions or investment firms, that value shall not exceed 25% of the investment firm's regulatory capital

calculated in accordance with Article 11 or EUR 150 million, whichever is higher, provided that the sum of exposure values, to all connected clients that are not credit institutions or investment firms does not exceed 25 % of the investment firms' regulatory capital.

Where the amount of EUR 150 million is higher than 25% of the investment firm's regulatory capital, the value of the exposure shall not exceed 100% of the investment firm's regulatory capital.

2. The limits referred to in paragraph 1 may be exceeded where the following conditions are met:
  - (a) the investment firm meets the K-CON capital requirement on the excess in respect of the limit laid down in paragraph 1, calculated in accordance with Article 38;
  - (b) where 10 days or less have elapsed since the excess occurred, the trading-book exposure to the individual client or group of connected clients in question shall not exceed 500% of the investment firm's regulatory capital;
  - (c) any excesses that have persisted for more than 10 days do not, in aggregate, exceed 600 % of the investment firm's regulatory capital.

*Article 37*  
*Obligation to notify*

1. Where the limits referred to in Article 36(1) are exceeded, an investment firm shall notify the amount of the excess, the name of the individual client concerned and, where applicable, the name of the group of connected clients concerned, without delay to the competent authorities.
2. Competent authorities may grant the investment firm a limited period to comply with the limit referred to in Article 36(1).

Where the amount of EUR 150 million referred to in Article 36(1) is applicable, the competent authorities may allow the 100% limit of the investment firm's regulatory capital to be exceeded.

*Article 38*  
*Calculating K-CON*

1. For the purposes of calculating K-CON, the excess referred to in Article 36(2) shall be the exposure to the individual client or group of connected clients in question that arises in the trading book.
2. Where the excess has not persisted for more than 10 days, the K-CON capital requirement shall be 200% of the requirements referred to in paragraph 1.
3. After the period of 10 days calculated from the date on which the excess has occurred, the excess shall be allocated to the appropriate line in Column 1 of Table 6.
4. The K-CON capital requirement shall be the product of the excess multiplied by the corresponding factor in Column 2 of Table 6.

Table 6

| Column 1:<br>Excess over the limits<br>(based on a percentage of regulatory capital) | Column 2:<br>Factors |
|--|----------------------|
| Up to 40 %   | 200 %                |
| From 40 % to 60 %  | 300 %                |
| From 60 % to 80 %  | 400 %                |
| From 80 % to 100 %   | 500 %                |
| From 100 % to 250 %  | 600 %                |
| Over 250 %   | 900 %                |

5. In order to ensure the uniform application of this Regulation and to take account of developments in financial markets, the Commission shall be empowered to adopt delegated acts in accordance with Article 54 in order to specify the method for measuring the K-factor in this Article.

#### *Article 39*

##### *Procedures to prevent investment firms from avoiding the K-CON capital requirement*

1. Investment firms shall not temporarily transfer the exposures exceeding the limit laid down in Article 36(1) to another company, whether within the same group or not, or by undertaking artificial transactions to close out the exposure during the 10-day period referred to in Article 38 and creating a new exposure.
2. Investment firms shall maintain systems which ensure that any transfer referred to in the paragraph 1 is immediately reported to the competent authorities.

#### *Article 40*

##### *Exclusions*

1. The following exposures shall be excluded from the requirements set out in Article 38(1):
  - (a) exposures not arising in the trading book;
  - (b) exposures which are entirely deducted from an investment firm's own funds;
  - (c) certain exposures incurred in the ordinary course of settlement of payment services, foreign currency transactions, securities transactions and provision of money transmission;
  - (d) asset items constituting claims on central governments:

- (i) exposures to central governments, central banks, public sector entities, international organisations or multilateral development banks (MDBs) and exposures guaranteed by or attributable to such persons;
  - (ii) exposures to central governments or central banks (other than those referred to under point (i) which are denominated and, where applicable, funded in the national currency of the borrower;
  - (iii) exposures to, or guaranteed by European Economic Area (EEA) states' regional governments and local authorities.
- (e) exposures and default fund contributions to central counterparties.
2. Competent authorities may fully or partially exempt the following exposures from the application of Article 38(1):
- (a) covered bonds;
  - (b) exposures to, or guaranteed by EEA states' regional governments and local authorities;
  - (c) liquidity requirements held in government securities, provided that, at the discretion of the competent authority they are assessed as investment grade;
  - (d) exposures to recognised exchanges as defined in Article 4(1)(72) of Regulation (EU) 575/2013.

#### *Article 41*

#### *Exemption for commodity and emission allowance dealers*

1. The provisions of this Part shall not apply to commodity and emission allowance dealers when all the following conditions are met for intra-group transactions:
- (a) the other counterparty is a non-financial counterparty;
  - (b) both counterparties are included in the same consolidation;
  - (c) both counterparties are subject to appropriate centralised risk evaluation, measurement and control procedures;
  - (d) the transaction can be assessed as reducing risks directly relating to the commercial activity or treasury financing activity of the non-financial counterparty or of that group.
2. For the purposes of this Article, counterparties shall be considered to be included in the same consolidation under one of the following conditions:
- (a) the counterparties are included in a consolidation in accordance with Article 22 of Directive 2013/34/EU;
  - (b) the counterparties are included in a consolidation in accordance with Article 4 of Regulation (EC) No 1606/2002;
  - (c) in relation to a group the parent undertaking of which has its head office in a third country, the counterparties are included in consolidation in accordance with generally accepted accounting principles of a third country determined to be equivalent to IFRS in accordance with Article 3



of Regulation (EC) No 1569/2007 or to accounting standards of a third country the use of which is permitted in accordance with Article 4 of that Regulation.

3. An investment firm shall notify the competent authority before using the exemption referred to in paragraph 1.

The competent authority shall permit the application of the exemption only if all the conditions set out in paragraph 1 are met.

## **PART FIVE**

### **LIQUIDITY**

#### *Article 42*

##### *Liquidity requirement*

1. An investment firm shall hold an amount of liquid assets equivalent to at least one third of the fixed overhead requirements calculated in accordance with Article 13(1).  
For the purposes of the first subparagraph, liquid assets shall be any of the following:
  - (a) the assets referred to in Articles 10 to 13 of Commission Delegated Regulation (EU) 2015/61;
  - (b) unencumbered cash.
2. For the purposes of paragraph 1, an investment firm that meets the conditions set out in Article 12(1) may also include receivables from trade debtors and fees or commissions receivable within 30 days in their liquid assets, where those receivables comply with the following conditions:
  - (a) they account for up to one third of the minimum liquidity requirements as referred to in paragraph 1;
  - (b) they are not to be counted towards any additional liquidity requirements required by the competent authority for firm-specific risks in accordance with Article 36(2)(k) of Directive (EU) ----/--[IFD];
  - (c) they are subject to a haircut of 50%.

#### *Article 43*

##### *Temporary reduction of the liquidity requirement*

1. An investment firm may, in exceptional circumstances, reduce the amount of liquid assets held. Where such reduction occurs, the investment firm shall notify the competent authority without delay.
2. Compliance with the liquidity requirement set out in Article 42(1) shall be restored within 30 days of the original reduction.

#### *Article 44*

##### *Customer guarantees*

An investment firm shall increase their liquid assets by 1.6% of the total amount of guarantees provided to customers.

## **PART SIX**

### **DISCLOSURE BY INVESTMENT FIRMS**

#### *Article 45* *Scope*

1. An investment firm that does not meet the conditions set out in Article 12(1) shall publicly disclose the information specified in this Part on the same day it publishes its annual financial statements.
2. An investment firm that meets the conditions set out in Article 12(1) which issues Additional Tier 1 instruments shall publicly disclose the information set out in Articles 46, 48, 49 and 50 on the same day it publishes its annual financial statements.
3. An investment firm shall publicly disclose the information set out in Articles 47 and 51 where it meets the requirements set out in Article 23 of Directive (EU) ----/-- [IFD].  
The investment firm that meets the requirements set out in Art 23 of Directive (EU) - ---/--[IFD] shall disclose the information as of the financial year following the financial year in which the assessment referred to in Article 23(1) of Directive (EU) - ---/--[IFD] took place.
4. An investment firm may determine the appropriate medium and location to comply effectively with the disclosure requirements referred to in paragraphs 1 and 2. All disclosures shall be provided in one medium or location where possible. If the same or similar information is disclosed in two or more media, a reference to the synonymous information in the other media shall be included within each medium.

#### *Article 46* *Risk management objectives and policies*

An investment firm shall disclose its risk management objectives and policies for each separate category of risk in Parts Three to Five in accordance with Article 45, including the strategies and processes to manage those risks and a risk statement approved by the management body succinctly describing the investment firm's overall risk profile associated with the business strategy.

#### *Article 47* *Governance*

An investment firm shall disclose the following information regarding internal governance arrangements, in accordance with Article 45:

- (a) the number of directorships held by members of the management body;

- (b) the policy on diversity with regard to the selection of members of the management body, its objectives and any relevant targets set out in that policy, and the extent to which those objectives and targets have been achieved;
- (c) whether or not the investment firm has set up a separate risk committee and the number of times the risk committee has met annually.

*Article 48*  
*Own funds*

1. An investment firm shall disclose the following information regarding its own funds, in accordance with Article 45:
  - (a) a full reconciliation of Common Equity Tier 1 items, Additional Tier 1 items, Tier 2 items and applicable filters and deductions applied to own funds of the investment firm and the balance sheet in the audited financial statements of the investment firm;
  - (b) a description of the main features of the Common Equity Tier 1 and Additional Tier 1 instruments and Tier 2 instruments issued by the investment firm;
  - (c) the full terms and conditions of all Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments;
  - (d) separate disclosure of the nature and amounts of the prudential filters and deductions applied as well as of items not deducted in relation to own funds;
  - (e) a description of all restrictions applied to the calculation of own funds in accordance with this Regulation and the instruments, prudential filters and deductions to which those restrictions apply;
2. EBA, in consultation with ESMA, shall develop draft implementing technical standards to specify templates for disclosure under points (a), (b), (d) and (e) of paragraph 1.

EBA shall submit those draft implementing technical standards to the Commission by *[nine months from the date of entry into force of this Regulation]*.

Power is conferred on the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with Article 15 of Regulation (EU) No 1093/2010.

*Article 49*  
*Capital requirements*

An investment firm shall disclose the following information regarding its compliance with the requirements laid down in Article 11(1) and in Article 22 of Directive (EU) ----/--[IFD], in accordance with Article 45:

- (a) a summary of the investment firm's approach to assessing the adequacy of its internal capital to support current and future activities;

- (b) upon demand from the competent authority, the result of the investment firm's internal capital adequacy assessment process, including the composition of the additional own funds based on the supervisory review process as referred to in Article 36(2)(a) of Directive (EU) ----/--[IFD] ;
- (c) the capital requirements calculated separately, in accordance with each K-factor applicable to the investment firm as set out in Article 15, and in aggregate form, based on the sum of the applicable K-factors;
- (d) the fixed overheads requirement determined in accordance with Article 13.

*Article 50*  
*Disclosure of return on assets*

An investment firm shall disclose its return on assets calculated as its net profit divided by its total balance sheet in its annual report as referred to in Article 45.

*Article 51*  
*Remuneration policy and practices*

Investment firms shall disclose the following information regarding their remuneration policy and practices for those categories of staff whose professional activities have a material impact on investment firm's risk profile, in accordance with Article 45;

- (a) the most important design characteristics of the remuneration system, including the level of variable remuneration and criteria for its award, pay out in instruments policy, deferral policy and vesting criteria;
- (b) the ratios between fixed and variable remuneration set in accordance with Article 28(2) of Directive (EU) ----/--[IFD];
- (c) aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the investment firm, indicating the following:
  - i) the amounts of remuneration awarded in the financial year, split into fixed remuneration including a description of the fixed components, and variable remuneration, and the number of beneficiaries;
  - ii) the amounts and forms of awarded variable remuneration, split into cash, shares, share-linked instruments and other types separately for the part paid upfront and the deferred part;
  - iii) the amounts of deferred remuneration awarded for previous performance periods, split into the amount due to vest in the financial year and the amount due to vest in subsequent years;
  - iv) the amount of deferred remuneration due to vest in the financial year, and that is reduced through performance adjustments;
  - v) the guaranteed variable remuneration awards during the financial year, and the number of beneficiaries of those awards;

- vi) the severance payments awarded in previous periods, that have been paid out during the financial year;
  - vii) the amounts of severance payments awarded during the financial year, split into paid upfront and deferred, the number of beneficiaries of those payments and highest payment that has been awarded to a single person;
- (d) the number of individuals that have been remunerated EUR 1 million or more per financial year, with the remuneration between EUR 1 million and EUR 5 million broken down into pay bands of EUR 500 000 and with the remuneration of EUR 5 million and above broken down into pay bands of EUR 1 million;
  - (e) upon demand from the competent authority, the total remuneration for each member of the management body or senior management;
  - (f) information on whether the investment firm benefits from a derogation laid down in Article 30(4) of Directive (EU) 2016/2251 [IFD].

For the purposes of point (f), investment firms that benefit from such a derogation shall indicate whether that derogation has been granted on the basis of point (a) or point (b) of Article 30(4) of Directive (EU) 2016/2251 [IFD], or both. They shall also indicate for which of the remuneration principles they apply the derogation(s), the number of staff members that benefit from the derogation(s) and their total remuneration, split into fixed and variable remuneration.

This Article shall be without prejudice to the provisions set out in Regulation (EU) 2016/679.

## **PART SEVEN**

### **REPORTING BY INVESTMENT FIRMS**

#### *Article 52*

##### *Reporting requirements*

1. An investment firm shall submit an annual report to the competent authorities including all of the following information:
  - (a) level and composition of own funds;
  - (b) capital requirements;
  - (c) capital requirement calculations;
  - (d) the level of activity in respect of the conditions set out in Article 12(1), including the balance sheet and revenue breakdown by investment service and applicable K-factor;
  - (e) concentration risk;
  - (f) liquidity requirements.
2. By way of derogation from paragraph 1, an investment firm that meets the conditions in Article 12(1) shall not be required to report the information specified in points (e) and (f).
3. EBA, in consultation with ESMA, shall develop draft implementing technical standards to specify the formats, reporting dates, definitions and the IT solutions to be applied for the reporting referred to in paragraph 1, which take into account the difference in granularity of information submitted by an investment firm that meets the conditions in Article 12(1).

EBA shall develop the implementing technical standards referred to in the first subparagraph by [nine months from the date of entry into force of this Regulation].

Power is conferred on the Commission to adopt the implementing technical standards referred to in this paragraph in accordance with Article 15 of Regulation (EU) No 1093/2010.

#### *Article 53*

##### *Reporting requirements for investment firms carrying out activities referred to in Article 4(1)(1)(b) of Regulation (EU) No 575/2013*

1. Investment firms which do not meet the conditions of Article 12(1) and which carry out any of the activities referred to in Article 4(1)(1)(b) of Regulation (EU) No 575/2013, shall verify the size of their total assets on a monthly basis and report quarterly that information to the competent authority and to the EBA.
2. Where an investment firm referred to in paragraph 1 is part of a group in which one or more other undertakings is an investment firm which carries out any of the activities referred to in Article 4(1)(1)(b) of Regulation (EU) No 575/2013, such investment firms shall verify the size of their total assets on a monthly basis and

inform each other. Those investment firms shall then report quarterly their combined total assets to the relevant competent authorities and to the EBA.

3. Where the average of monthly total assets of the investment firms referred to in paragraphs 1 and 2 reaches any of the thresholds set out in Article 4(1)(1)(b) of Regulation (EU) No 575/2013 calculated over a period of twelve consecutive months, EBA shall notify those investment firms and the authorities competent for granting authorisation in accordance with Article [8a] of Directive 2013/36/EU thereof.
4. EBA, in consultation with ESMA, shall develop draft regulatory technical standards to specify further the obligation to provide information to the relevant competent authorities referred to in paragraphs 1 and 2 in order to allow effective monitoring of the thresholds set out in paragraphs 1 (a) and (b) of Article [8a] of Directive 2013/36/EU.

EBA shall submit those draft technical standards to the Commission by [*1<sup>st</sup> January 2019*].

Power is conferred on the Commission to adopt the regulatory technical standards referred to in this paragraph, in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.



## PART EIGHT DELEGATED AND IMPLEMENTING ACTS

### *Article 54 Exercise of the delegation*

1. The power to adopt delegated acts is conferred on the Commission subject to the conditions laid down in this Article.
2. The power to adopt delegated acts referred to in Articles 4(2), 12(5), 15(5) and 38(5) shall be conferred on the Commission for an indeterminate period of time from [*date of entry into force of this Regulation*].
3. The delegation of power referred to in Articles 4(2) and 15(5) may be revoked at any time by the European Parliament or by the Council. A decision to revoke shall put an end to the delegation of the power specified in that decision. It shall take effect the day following the publication of the decision in the *Official Journal of the European Union* or at a later date specified therein. It shall not affect the validity of any delegated acts already in force.
4. Before adopting a delegated act, the Commission shall consult experts designated by each Member State in accordance with the principles laid down in the Interinstitutional Agreement of 13 April 2016 on Better Law-Making.
5. As soon as it adopts a delegated act, the Commission shall notify it simultaneously to the European Parliament and to the Council.
6. A delegated act adopted pursuant to Articles 4(2) and 15(5) shall enter into force only if no objection has been expressed either by the European Parliament or the Council within a period of [*two months*] of notification of that act to the European Parliament and the Council or if, before the expiry of that period, the European Parliament and the Council have both informed the Commission that they will not object. That period shall be extended by [*two months*] at the initiative of the European Parliament or of the Council.

### *Article 55 Implementing Acts*

The specification of templates for disclosure prescribed in Article 48(2) and of formats, reporting dates, definitions and IT solutions to be applied to reporting as prescribed in Article 52(2) shall be adopted as implementing acts in accordance with the examination procedure referred to in Article 56(2).

*Article 56*  
*Committee procedure*

1. The Commission shall be assisted by the European Banking Committee established by Commission Decision 2004/10/EC<sup>33</sup>. That committee shall be a committee within the meaning of Regulation (EU) No 182/2011 of the European Parliament and of the Council<sup>34</sup>.
2. Where reference is made to this paragraph, Article 5 of Regulation (EU) No 182/2011 shall apply.

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<sup>33</sup> Commission Decision 2004/10/EC of 5 November 2003 establishing the European Banking Committee (OJ L 3, 7.1.2004, p. 36).

<sup>34</sup> Regulation (EU) No 182/2011 of the European Parliament and of the Council of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers (OJ L 55, 28.2.2011, p. 13).

# PART NINE TRANSITIONAL PROVISIONS, REPORTS, REVIEWS AND AMENDMENTS

## TITLE I TRANSITIONAL PROVISIONS

### *Article 57*

#### *Transitional provisions*

1. Articles 42 to 44 and 45 to 51 shall apply to commodity and emission allowance dealers from [*five years from the date of application of this Regulation*].
2. Until five years from the date of application of this *Regulation* or the date of application of the provisions referred to in Article 22(1)(b) and (c) pursuant to [*Chapters 1(a) and 1(b) of Title IV of Part Three of the Regulation No (EU) No 575/2013, in accordance with Article 1(84) of the 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*], whichever is the earlier, an investment firm shall apply the requirements set out in Title IV of Part Three of Regulation (EU) No 575/2013.
3. By way of derogation from Article 11, investment firms may limit their capital requirements for a period of five years from [*the date of application of this Regulation*] as follows:
  - (a) twice the relevant capital requirement pursuant to Chapter 1 of Title 1 of Part Three of Regulation (EU) No 575/2013 had it continued to be subject to that Regulation;
  - (b) twice the applicable fixed overhead requirement set out in Article 13 of this Regulation where an investment firm was not in existence on or before [*date of application of this Regulation*];
  - (c) twice the applicable initial capital requirement set out in Title IV of Directive 2013/36/EU on [*date of application of this Regulation*] where an undertaking was subject only to an initial capital requirement until that point in time.

### *Article 58*

#### *Derogation for undertakings referred to in Article 4(1)(1)(b) of Regulation (EU) 575/2013*

Investment firms which on the date of entry into force of this Regulation meet the conditions of Article 4(1)(1)(b) of Regulation (EU) 575/2013 and have not yet obtained authorisation as credit institutions in accordance with Article 8 of Directive 2013/36/EU shall continue to be subject to Regulation (EU) 575/2013 and to Directive 2013/36/EU.

## TITLE II

# REPORTS AND REVIEWS

### *Article 59* *Review clause*

1. By [3 years from the date of entry into force of this Regulation], the Commission shall carry out a review the application of the following:
  - (a) the conditions for investment firms to qualify as small and non-interconnected firms in accordance with Article 12;
  - (b) the methods for measuring the K-factors in Title II of Part Three and in Article 38;
  - (c) the coefficients in Article 15(2);
  - (d) the provisions set out in Articles 42 to 44;
  - (e) the provisions set out in Section 1 of Chapter 4 of Title II of Part Three;
  - (f) the application of Part Three to commodity and emission allowance dealers.
2. By [3 years from the date of entry into force of this Regulation], the Commission shall submit the report referred to in paragraph 1 to the European Parliament and the Council, together with legislative proposals where appropriate.

## TITLE III

# AMENDMENTS

### *Article 60* *Amendments of Regulation (EU) No 575/2013*

Regulation (EU) No 575/2013 is amended as follows:

1. In the title, the words ‘and investment firms’ are deleted.
2. Article 4(1) is amended as follows:
  - (a) point (1) is replaced by the following:

“(1) ‘credit institution’ means an undertaking the business of which consists of any of the following:

    - (a) to take deposits or other repayable funds from the public and to grant credits for its own account;
    - (b) to carry out any of the activities referred to in points (3) and (6) of Section A of Annex I of Directive 2014/65/EU, where

one of the following applies, but the undertaking is not a commodity and emission allowance dealer, a collective investment undertaking or an insurance undertaking:

i) the total value of the assets of the undertaking exceeds EUR 30 billion, or

ii) the total value of the assets of the undertaking is below EUR 30 billion, and the undertaking is part of a group in which the combined total value of the assets of all undertakings in the group that carry out any of the activities referred to in points (3) and (6) of Section A of Annex I of Directive 2014/65/EU and have total assets below EUR 30 billion exceeds EUR 30 billion, or

iii) the total value of the assets of the undertaking is below EUR 30 billion, and the undertaking is part of a group in which the combined total value of the assets of all undertakings in the group that carry out any of the activities referred to in points (3) and (6) of Section A of Annex I of Directive 2014/65/EU exceed EUR 30 billion, where the consolidating supervisor in consultation with the supervisory college so decides in order to address potential risks of circumvention and potential risks for the financial stability of the Union.

(b) point (2) is replaced by the following:

“(2) ‘investment firm’ means a person as defined in Article 4(1)(1) of Directive 2014/65/EU, which is authorised under that Directive, excluding a credit institution;”.

(c) point (3) is replaced by the following:

(3) ‘institution’ means a credit institution authorised under Article 8 of Directive 2013/36/EU or an undertaking referred to in Article 8a(3) of Directive 2013/36/EU;”.

(d) point (4) is deleted;

(e) point (26) is replaced by the following:

“(26) ‘financial institution’ means an undertaking other than an institution, the principal activity of which is to acquire holdings or to pursue one or more of the activities listed in points 2 to 12 and point 15 of Annex I to Directive 2013/36/EU, including an investment firm, a financial holding company, a mixed financial holding company, an investment holding company, a payment institution within the meaning of Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market, and an asset management company, but excluding insurance holding companies and mixed-activity insurance holding companies as defined in point (g) of Article 212(1) of Directive 2009/138/EU;”.

(f) point (51) is replaced by the following:

“(51) ‘initial capital’ means the amount and types of own funds specified in Article 12 of Directive 2013/36/EU;”;

(g) point (145) is added:

“(145) ‘commodity and emission allowance dealers’ mean undertakings the main business of which consists exclusively of the provision of investment services or activities in relation to commodity derivatives or commodity derivatives contracts referred to in points 5, 6, 7, 9 and 10, derivatives of emission allowances referred to in point 4, or emission allowances referred to in point 11 of Section C of Annex I to Directive 2014/65/EU;”.

3. Article 6 is amended as follows:

(a) paragraph 4 is replaced by the following:

“(4) Credit institutions shall comply with the requirements laid down in Parts Six and Seven on an individual basis.”.

(b) paragraph 5 is deleted.

4. In Part I, Title II, Chapter 2 on Prudential consolidation, a new Article 10a is inserted:

“For the purposes of application of this Chapter, parent financial holding companies in a Member State and Union parent financial holding companies shall include investment firms where such investment firms are parent undertakings of an institution.”.

5. In Article 11, paragraph 3 is replaced by the following:

“3. EU parent institutions, institutions controlled by an EU parent financial holding company and institutions controlled by an EU parent mixed financial holding company shall comply with the obligations laid down in Part Six on the basis of the consolidated situation of that parent institution, financial holding company or mixed financial holding company, if the group comprises one or more credit institutions or investment firms that are authorised to provide the investment services and activities listed in points (3) and (6) of Section A of Annex I to Directive 2004/39/EC”.

6. Article 15 is deleted.

7. Article 16 is deleted.

8. Article 17 is deleted.

9. In Article 81, point (a) of paragraph 1 is replaced by the following:

“(a) the subsidiary is one of the following:

(i) an institution;

(ii) an undertaking that is subject by virtue of applicable national law to the requirements of this Regulation and Directive 2013/36/EU;

(iii) an investment firm;”.

10. In Article 82, point (a) of paragraph 1 is replaced by the following:

“(a) the subsidiary is one of the following:

(i) an institution;

- (ii) an undertaking that is subject by virtue of applicable national law to the requirements of this Regulation and Directive 2013/36/EU;
  - (iii) an investment firm;”.
11. Article 93 is amended as follows:
- (a) paragraph 3 is deleted.
  - (b) paragraphs 4, 5 and 6 are replaced by the following:
    - “4. Where control of an institution falling within the category referred to in paragraph 2 is taken by a natural or legal person other than the person who controlled the institution previously, the amount of own funds of that institution shall attain the amount of initial capital required.
    - 5. Where there is a merger of two or more institutions falling within the category referred to in paragraph 2, the amount of own funds of the institution resulting from the merger shall not fall below the total own funds of the merged institutions at the time of the merger, as long as the amount of initial capital required has not been attained.
    - 6. Where competent authorities consider it necessary to ensure the solvency of an institution that the requirement laid down in paragraph 1 is met, the provisions laid down in paragraphs 2 to 4 shall not apply.”.
12. Section 2 of Chapter I, Title I, Part Three is deleted on [5 years from the date of application of Regulation (EU) \_\_\_\_/\_\_\_\_IFR].
13. In Article 197, point (c) of paragraph 1 replaced by the following:
- “(c) debt securities issued by institutions and investment firms, which securities have a credit assessment by an ECAI which has been determined by EBA to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to institutions under Chapter 2;”.
14. In Article 202, the introductory phrase is replaced by the following:
- “An institution may use institutions, investment firms, insurance and reinsurance undertakings and export credit agencies as eligible providers of unfunded credit protection which qualify for the treatment set out in Article 153(3) where they meet all the following conditions:”.
15. Article 388 is deleted.
16. In Article 456(1), points (f) and (g) are deleted.
17. In Article 493, paragraph 2 is deleted.
18. Article 498 is deleted.
19. In Article 508, paragraphs 2 and 3 are deleted.

#### *Article 61*

#### *Amendment to Regulation (EU) No 600/2014*

Regulation (EU) No 600/2014 is amended as follows:

- (1) Article 46 is amended as follows:
- (a) in paragraph 2, the following point (d) is added:  
“(d) the firm has established the necessary arrangements and procedures to report the information set out in paragraph 6a.”;
  - (b) the following paragraph 6a is added:  
“6a. Third-country firms providing services or performing activities in accordance with this Article shall, on an annual basis, inform ESMA about the following:
    - (a) the scale and scope of the services and activities carried out by the firms in the Union;
    - (b) the turnover and the aggregated value of the assets corresponding to the services and activities referred to in point (a);
    - (c) whether investor protection arrangements have been taken, and a detailed description thereof;
    - (d) the risk management policy and arrangements applied by the firm to the carrying out of the services and activities referred to in point (a).”;
  - (c) paragraph 7 is replaced by the following:  
“7. ESMA, in consultation with EBA, shall develop draft regulatory technical standards to specify the information that the applicant third-country firm is to provide in the application for registration referred to in paragraph 4 and the information to be reported in accordance with paragraph 6a.  
  
ESMA shall submit those draft regulatory technical standards to the Commission by *[date to be inserted]*.  
  
Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.”;
  - (d) the following paragraph 8 is added:  
“8. ESMA shall develop draft implementing technical standards to specify the format in which the application for registration referred to in paragraph 4 is to be submitted and the information referred to in paragraph 6a is to be reported.  
  
ESMA shall submit those draft implementing technical standards to the Commission by *[date to be inserted]*.  
  
Power is delegated to the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with Article 15 of Regulation (EU) No 1095/2010.”.
- (2) Article 47 is amended as follows:
- (a) the first subparagraph of paragraph 1 is replaced by the following:  
“The Commission may adopt a decision in accordance with the examination procedure referred to in Article 51(2) in relation to a third country stating that the legal and supervisory arrangements of that third country ensure all of the following:



- (a) that firms authorised in that third country comply with legally binding prudential and business conduct requirements which have equivalent effect to the requirements set out in this Regulation, in Directive 2013/36/EU, in Regulation (EU) No 575/2013, in Directive (EU) ----/--[IFD] and in Regulation (EU)----/---[IFR] and in Directive 2014/65/EU and in the implementing measures adopted under those Regulations and Directives;
- (b) that firms authorised in that third country are subject to effective supervision and enforcement ensuring compliance with the applicable legally binding prudential and business conduct requirements; and
- (c) that the legal framework of that third country provides for an effective equivalent system for the recognition of investment firms authorised under third-country legal regimes;

Where the services provided and the activities performed by third-country firms in the Union following the adoption of the decision referred to in the first subparagraph are likely to be of systemic importance for the Union, the legally binding prudential and business conduct requirements referred to in the first subparagraph may only be considered to have equivalent effect to the requirements set out in the acts referred to in that subparagraph after a detailed and granular assessment. For these purposes, the Commission shall also assess and take into account the supervisory convergence between the third country concerned and the Union.

When adopting the decision referred to in the first subparagraph, the Commission shall take into account whether the third country is identified as a non-cooperative jurisdiction for tax purposes under the relevant Union policy or as a high-risk third country pursuant to Article 9(2) of Directive (EU) 2015/849.”;

- (b) in paragraph 2, point (c) is replaced by the following:  
“(c) the procedures concerning the coordination of supervisory activities including investigations and on-site inspections.”;
- (c) the following paragraph 5 is added:  
“5. ESMA shall monitor the regulatory and supervisory developments, the enforcement practices and other relevant market developments in third countries for which equivalence decisions have been adopted by the Commission pursuant to paragraph 1 in order to verify whether the conditions on the basis of which those decisions have been taken are still fulfilled. The Authority shall submit a confidential report on its findings to the Commission on an annual basis.”.

*Article 62*  
*Amendment to Regulation (EU) No 1093/2010*

Regulation (EU) No 1093/2010 is amended as follows:

- (1) In Article 4(2), the following point (v) is added:

“(v) with regard to Regulation (EU) ----/---- [IFR] and Directive (EU)----/--[IFD], competent authorities as defined in Article 3(5) of Directive (EU)----/--[IFD].”.

# **PART TEN**

## **FINAL PROVISIONS**

### *Article 63*

#### *Entry into force and date of application*

1. This Regulation shall enter into force on the [...] day following that of its publication in the Official Journal of the European Union.
2. This Regulation shall apply from [18 months after the date of entry into force].
3. For the purposes of prudential requirements of investment firms, references to Regulation (EU) No 575/2013 in other Union acts shall be construed as references to this Regulation.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the European Parliament*  
*The President*

*For the Council*  
*The President*