



EUROPEAN COMMISSION

Directorate-General for Financial Stability, Financial Services and Capital Markets Union

Call for advice to the EBA and ESMA for the purposes of the reports on the prudential requirements applicable to investment firms

Context

Regulation (EU) 2019/2033¹ (henceforth ‘the Investment Firms Regulation’ or ‘IFR’) and Directive (EU) 2019/2034² (henceforth ‘the Investment Firms Directive’ or ‘IFD’) set a new prudential framework for investment firms in the EU. This framework, which entered into force on 25 December 2019, is fully applicable since 26 June 2021.

While investment firms in the EU were subject to prudential requirements set out in the Capital Requirements Directive³ (CRD) and the Capital Requirements Regulation⁴ (CRR) before, alongside with credit institutions, the entry into application of the IFR/IFD framework has carved out most investment firms from the CRR/CRD framework and subjected them to a new bespoke prudential regime that is aimed to be more proportionate to the nature, size, and complexity of their activities.

In accordance with Article 60 of IFR and with Article 66 of IFD, the Commission is required to submit, by 26 June 2024, two reports to the European Parliament and the Council. In preparing these reports, the Commission is required to consult with the EBA and ESMA.

¹ Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014 (Text with EEA relevance).

² Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU (Text with EEA relevance).

³ 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 (Text with EEA relevance).

⁴ 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 (Text with EEA relevance).

The Commission recognises that the prudential framework for investment firms has entered into force only relatively recently. This may impact the ability of the EBA and ESMA to collect the necessary evidence on the topics in this Call for Advice. The EBA and ESMA are therefore invited to evaluate these topics to the extent currently possible and identify those topics which are better suited for a future review when the prudential framework has been in place longer. The advice on which topics are better suited for a future review should also indicate the timeframe under which such review would be feasible.

The EBA and ESMA may pursue a flexible approach when deciding on the nature (i.e. qualitative vs. quantitative), depth and detail of their review and make this dependant on, for example, the data available. The EBA and ESMA are also encouraged to make use of, and build on, analyses yet conducted, for example with respect to ESG risks, digitalisation and crypto's. While providing for this flexibility, the assessment should at least analyse the topics set out under [A, B1, B2a-c, B2e and B5].

This Call for Advice is, in accordance with the review clauses in the IFR and IFD, addressed to the EBA and ESMA. Both are asked to allocate the topics of this Call for Advice among each other, based on their respective areas of competence and expertise and decide about the suitable working arrangements to finalise their assessment.

Scope and need for technical advice

A. General considerations

The Commission services would like to invite the EBA and ESMA to provide an evaluation of the new prudential framework for investment firms that became applicable in June 2021. This evaluation should provide information about the structure of the market, distinguishing between investment firms' categories and business models, in a way that would allow the Commission to judge whether the objective of proportionality, which underpins the new prudential framework, has been met without creating any undue risk to financial stability and regulatory arbitrage opportunities.

When reporting on their evaluation, the EBA and ESMA should provide all information considered relevant to inform the Commission's decision on the need to revise certain areas of the current legislation and on the content of any subsequent legislative proposals. In this context, the EBA and ESMA are invited to review and assess the items identified under Article 60 of the IFR and under Article 66 of the IFD exhaustively.

The assessment should be substantiated by quantitative and/or qualitative analyses. In particular, the impact on the capital requirements of investment firms resulting from any change proposed to the current legislation should be assessed considering each proposed modification individually as well as in combination. Those impacts should be assessed in comparison to the situation under the current prudential framework (IFR/IFD and CRR/CRD), being the general "baseline" for such comparison.

The assessment should ideally estimate the impact of any recommendation both in terms of changes to the own funds' requirements (and of any identified shortfalls) and in terms of operational and administrative costs incurred by investment firms, also reflecting on the potential need to amend reporting or disclosure requirements. Such assessment should consider Pillar 1, Pillar 2 and Pillar 3 requirements, distinguishing between the three where possible.

The analysis should preferably be clustered with respect to the categories (i.e. class 1, class 1 minus, class 2 and class 3), size, levels of consolidation, geographical location and activities (as per MiFID Annex A) of investment firms, where relevant.

B. Specific considerations

1. Categorisation of investment firms

The assessment should reflect on the appropriateness of categorising investment firms and determine whether the implemented categorisation of investment firms is adequate and effective to differentiate prudential requirements according to the nature, size and complexity of the considered business models.

The assessment should assess the consistency of the thresholds used to determine such categorisation and identify any issue encountered by national competent authorities through the implementation of the categorisation. Recommendations should be provided on how these identified issues could be addressed. In particular, the report should provide clarity on potential incentives for regulatory arbitrage and on possible economic constraints that may have been created for EU investment firms through a categorisation approach based exclusively on fixed numerical thresholds. In this context, the report should also provide an overview of the distribution of investment firms in terms of consolidated assets, considering both EU and global assets. This overview should notably allow to analyse the distribution of firms around any of the thresholds set by the current legislation.

In this context, the report should provide an analysis of the impact of the chosen scope for the determination of the consolidated assets on the considered categorisation, comparing EU assets (i.e. consolidated assets of investment firms and groups of investment firms established in the Union, including their branches and subsidiaries in third countries) on the one hand, and global assets (i.e. consolidated assets of investment firms and groups of investment firms established in the Union and in third countries that have one or more entities authorised in the Union) on the other hand.

Furthermore, the report should strive to provide a more detailed focus of the following elements:

a) Adequacy of prudential requirements

While there are currently no indications that the current calibration of the prudential requirements is an area of concern, the report should assess whether the design and calibration of all relevant aspects of the current prudential regime, including the liquidity requirements, are indeed appropriate to achieve the intended proportionality while at the same time guaranteeing the safety and soundness of the activities performed by investment firms. In particular, the assessment should consider whether risks that their operations and business models present are adequately captured and reflected in their own funds requirements.

In this context, the impact on the calculation of fixed overhead requirements of different business models of investment firms should be assessed specifically.

b) Conditions to qualify as small and non-interconnected investment firms

The report should provide, where applicable, per Member State, an overview of investment firms currently qualifying as “small and non-interconnected” together

with an estimation of their corresponding own funds requirements per risk category, should they be subject to K-factors.

The report should include an assessment of the appropriateness of the prudential treatment of investment firms qualifying as “small and non-interconnected” as well as of the conditions for such qualification.

c) Conditions to qualify as credit institutions

The report should provide an overview of investment firms that have been authorised as credit institutions in accordance with point (b) of Article 4(1) of the CRR and in application of Article 8a of the CRD.

Similarly, the report should analyse the use of the following legislative provisions:

- The discretion of competent authorities to subject investment firms to the CRR requirements under point (b)(iii) of Article 4(1) of the CRR in the light of potential risks of circumvention and potential risks for the financial stability of the Union;
- Article 1(2) of the IFR mandating CRR requirements for investment firms dealing on own accounts or underwriting financial instruments under certain conditions; and,
- The discretion of competent authorities to subject investment firms to the CRR requirements under Article 5 of the IFD.

In each case, the report should indicate, in absolute and relative terms, the number of investment firms per Member State that have been authorised as credit institutions or subject to the CRR requirements as well as the corresponding own funds requirements per risk category that have been applied to the concerned undertakings, where possible comparing these figures with the equivalent requirements under the IFR.

2. Interactions with the CRR/CRD

a) Prudential consolidation

The report should analyse the structure and organisation of investment firm groups that are currently in place in the Union as well as the methodologies that are used by competent authorities to determine their prudential situation on a consolidated basis. The report should assess to what extent the IFR’s consolidation requirements rightly capture the entities that should be subject to the scope of consolidation.

In particular, the assessment should include qualitative and quantitative information on the use of exemptions and supervisory discretions as allowed under Article 6 of the IFR regarding the application of the prudential requirements on an individual or on a consolidated basis. The report should also provide detailed information on the application of the group capital test under Article 8 of the IFR.

The analysis should determine whether a distinction is justified between the methods for prudential consolidation allowed under the CRR framework and those provided for under the IFR, including their respective technical standards, based on the specificities of investment firm groups.

b) Liquidity requirements

Considering the various activities of investment firms, the report should determine whether the liquidity requirements, including the scope of assets considered liquid, set out in the IFR are appropriate or could benefit from further granularity.

In particular, the analysis should consider the structure of liquidity requirements under the CRR framework and determine whether further alignment or some adjustments would be required to ensure that investment firms and their competent authorities are adequately equipped to address liquidity risks, including under stressed market situations.

The assessment should establish whether differences in liquidity requirements between the IFR and the CRR frameworks are duly justified by the specificities of investment firms. In this context, particular attention should be paid to activities of EU investment firms in third countries or their dependence on third countries service providers, for instance as regards the treatment of short-term deposits held at third country credit institutions.

c) Scope of K-factors

The report should assess whether all relevant risk categories pertaining to the activities and operations of an investment firm are adequately captured by the K-factors methodology, in a sufficiently risk-sensitive manner.

In particular, the assessment should consider whether the range of operational risks that are faced by investment firms are adequately reflected in their own funds requirements. This analysis should be made in a going concern perspective and independently of the fixed overheads requirements imposed to ensure an orderly exit of the market.

d) Implications of the adoption of the Banking Package (CRR3/CRD6)

The report should generally identify any implications for the prudential framework of investment firms resulting from the adoption of the new Banking Package, making reasonable assumptions to reflect the fact that the latter is still under negotiation by the co-legislators.

In particular, some elements pertaining to the calculation of the own funds requirements for investment firms refer explicitly to the methods and approaches set out under the CRR. This is the case, for instance, for the calculation of the K-NPR under Article 22 of the IFR. Such requirement, that determines the own funds requirement for the trading book positions of an investment firm dealing on own account, whether for itself or on behalf of a client, is referring directly to the approaches set out in Title IV of Part Three of the CRR. In other instances, the IFR implements a more proportionate and simpler approach than the one existing under the CRR. This is notably the case for Article 32 of the IFR that provides for a simpler consideration of the CVA risk in the determination of the own funds requirements for trading counterparty default.

In the context of the finalisation of the transposition of the Basel III standards in EU legislation and of the revision of the CRR/CRD framework, the analysis should determine whether the requirements set out in the IFR need to be adjusted in order to either better reflect some of the provisions introduced in the new CRR/CRD framework or on the contrary, simplify certain elements of this new framework in

light of the specificities of investment firms. The report should notably provide an estimate of the impact of introducing the final FRTB for investment firms and the need for possible adjustments of the corresponding K-factors. In this context, the report should also allow the comparison between an estimate of the accounting value of the institutions' assets and liabilities subject to own funds requirements for market risk and the corresponding own funds requirements for market risk currently applicable under the IFR.

e) Remuneration

The IFD offers the possibility for class 2 firms not to apply certain remuneration rules if certain conditions are met, in particular a threshold⁵. In addition, Member States have the discretion to modify the threshold within a certain range. At the same time, some investment firms may be subject to the CRD, which also has a similar exemption mechanism to the IFD. The different frameworks, IFD/CRD, were calibrated to take into account investment firms' and credit institutions' characteristics. The report should analyse the situation of the investment firms through a level-playing field and regulatory arbitrage perspectives. The report should particularly take into account possible threshold effects taking into account Member States' transposition of IFD and CRD.

f) Investment policy disclosure

The assessment should pay specific attention to the obligation for the largest class 2 firms to disclose their investment policy. The report should assess the benefits and cost associated with this new requirement as well as its scope.

3. Considerations on ESG Risks

The impact of ESG risks, in particular climate-related risks, on financial institutions has gained further traction in recent years. These risks may have a financial impact on investment firms thereby impacting their resilience. The assessment should therefore consider the extent to which these risks can be sufficiently addressed by the current prudential framework for investment firms or would require dedicated requirements. The analysis should also consider the potential duplication or conflicts with ESG-related requirements in other pieces of sectoral legislation, such as MiFID, AIFMD and UCITS.

Article 66(3) of the IFD requires an analysis of whether any ESG risks are to be considered for an investment firm's internal governance and remuneration policy, the treatment of risk or the SREP. In addition, the analysis should provide further evidence on whether there is a need to consider ESG risks further under Pillar 1, Pillar 2 and Pillar 3. Here, the EBA can build on or where possible refer to their existing work, including the analysis that was performed under Article 34 of the IFR and Article 35 of the IFD.

4. Future proofing IFR/IFD regime

The analysis should consider whether the IFR/IFD currently applies to all relevant market participants and whether changes to the IFR/IFD are warranted as a result of the emergence

⁵ Point (a) of Article 32(4) of the IFD provides an exemption where the value of an investment firm' on and off-balance sheet assets is on average equal to or less than EUR 100 million over the four-year period immediately preceding the financial year considered.

of new market players or transformations of businesses as a result of digitalisation, and the impact of crypto's on investment firms.

Where possible, the report should also provide information on the role and impact investment firms may have, if any, on the development and distribution of crypto-assets, or refer to existing work on this topic.

Finally, the assessment should consider the interactions between investment firms and other financial activities (and their specific regulatory frameworks, such as UCITS and AIFM), and determine whether changes would be required in the IFR/IFD to better reflect risks resulting from these interactions.

5. Specific considerations on commodity and emission allowance dealers and on energy firms

In its letter to the Commission of 22 September 2022⁶, ESMA suggested to regulate and supervise large commodity traders acting like investment firms. According to ESMA this would ensure that significant entities active in commodity derivatives markets conducting essentially the same business as investment firms would be subject to requirements established in financial regulation. ESMA noted however that some specific requirements would need to be adjusted. In this context, the report could provide a first overview on how the current prudential regime, in particular in the fields of liquidity risk and concentration risk, could be extended to energy firms trading actively on commodity markets.

While recognising that certain information on these energy firms may be difficult to obtain as many of them benefit from the current “ancillary activity exemption” set out in MiFID and are therefore currently unregulated, the report should primarily seek to provide insights on the market structure and the profile of energy firms operating in these markets. These insights may be based on existing reporting and disclosure information available which can be used on a best-efforts basis.

Where feasible, the report should assess the extent to which the current prudential regime, or certain elements of it, could address the specificities of these commodity trading firms, could be extended or should be adapted.

Data collection

The EBA and ESMA are requested to collect all data and information that they deem necessary to answer this Call for Advice and substantiate their recommendations with sufficient evidence. The information should be collected from a sample of investment firms of different size, location, and business model and to the extent possible using the periodic supervisory reporting. While all relevant information for the purpose of ensuring a comprehensive response to this Call for Advice should be collected, attention should be paid to the feasibility and burden related to such data request.

Final considerations

The Commission services would appreciate it if the report could also contain information on any other issues or inconsistencies that competent authorities in the EU may have

⁶https://www.esma.europa.eu/sites/default/files/library/esma24-436-1414_-_response_to_ec_commodity_markets.pdf

identified during the implementation of the IFR/IFD framework. Suggestions on how to rectify the identified issues and inconsistencies or how to clarify the terminology used would be particularly welcome, taking into consideration the competitive landscape within and outside the Union as well as any possibilities for regulatory arbitrage.

The Commission is aware that time and resource constraints may restrict the range of methodologies that may be used to analyse certain aspects of the Call for Advice. Where it is the case, such limitations should be highlighted in the report.

It is recalled that the analysis provided will not prejudice the Commission's final decision on whether to submit a legislative proposal. Moreover, in accordance with the established practices of the Commission Expert Group on Banking, Payments and Insurance, the Commission will continue, where appropriate, to consult the experts appointed by the Member States in the preparation of any proposal.

The EBA and ESMA should deliver their joint report on this Call for Advice to the Commission services by 31 May 2024.