

EBA/CP/2021/42

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Consultation Paper

Draft Guidelines on liquidity requirements exemption for investment firms under Article 43(4) of Regulation (EU) 2019/2033

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1. Responding to this consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 10 March 2022. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EU) 2018/1725 of the European Parliament and of the Council of 23 October 2018. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

Regulation (EU) 2019/2033 (IFR) introduces mandatory liquidity requirements for all investment firms. However, under Article 43(1) of IFR small and non-interconnected investment firms that meet the conditions set out in Article 12(1) of IFR may be exempted from liquidity requirements by their competent authority.

These guidelines, developed in accordance with the mandate set out in Article 43(4) of IFR, specify the criteria under which competent authorities may exempt small and non-interconnected investment firms from liquidity requirements.

The guidelines contain three main elements addressing the following:

- a set of investment services and activities provided by investment firms which are eligible for the exemption;
- criteria for the exemption;
- a guidance on a process for competent authorities when granting the exemption.

These guidelines provide a set of investment services and activities that are provided by an investment firm to be eligible for the exemption from liquidity requirements. The guidelines also specify that, together with investment services and activities, the competent authorities shall take due consideration into ancillary services provided by an investment firm and on and off-balance sheet positions of an investment firm, whereas such services or positions may give rise to liquidity risk. Services usually are related to credit risk, such as granting credit or loans, engaging into securities lending transactions, and on and off-balance sheet positions are related with hedging positions. Investment firms providing such services or holding such positions at a significant scale should not be exempted from liquidity requirements.

Small and non-interconnected investment firms do not hold clients' assets, thus liquidity requirements for such firms do not intend to cover risks of potential losses of clients' assets. Liquidity requirements for investment firms intend to ensure that investment firms maintain a sufficient level of liquid assets for its orderly wind down. On the basis of this, the guidelines specify that the exemption should be based on the assessment of financial resource needs for orderly wind-down of an investment firm.

Finally, in order to apply the exemption in a uniform way across the Union, the guidelines provide a general guidance for the competent authorities on a process of granting an exemption, such as requirements for the information submitted by the firm, withdrawal of the exemption and a process for compliance with liquidity requirements after the exemption is ceased to be applied.

Next steps

Following the consultation, the aim is to publish the final guidelines by mid-2022. The authorities and investment firms in scope of these guidelines should comply in full two months after date of their issuance. The analysis of the responses to this Consultation Paper will be communicated in due time in the form of the final report.

3. Background and rationale

3.1 Background

1. For the investment firms (IF) authorised under Directive 2014/65/EU ('MiFID 1'), Directive (EU) 2019/2034 (IFD) and Regulation (EU) 2019/2033 (IFR) introduced liquidity requirements that are harmonised for investment firms across the Union for the first time.
2. Liquidity requirements under the IFR specify the amount of liquid assets, which investment firms shall hold and their composition. Under Article 43(1) of the IFR investment firms shall hold an amount of liquid assets equivalent to at least one third of the fixed overhead requirement. The rationale behind such liquidity requirements is to ensure that an investment firm would be able to wind-down or restructure its activities in an orderly manner in a given period (henceforth: 'wind-down period'). For an orderly wind-down, investment firms should hold sufficient financial resources to withstand operational expenses over an appropriate period of time during which an investment firm still needs to continue its business and needs to be able to absorb losses which are not matched by a sufficient volume of revenues in order to protect its clients.
3. An investment firm may not be able to convert its own funds into liquid funds at all or to convert them quickly enough in order to settle its claims during the winding-down phase and thus orderly and progressively reduce its operations. This creates the potential risk that the investment firm may still have sufficient own funds in the wind-down phase, but cannot convert them into liquid funds, and therefore is not able to settle its liabilities in a timely manner. This may ultimately lead to a collapse in a disorderly manner which is then likely to cause damage to its clients.
4. Liquidity requirements set out in the IFD and IFR take into account the proportionality principle ensuring that certain investment firms, which because of their size or nature of activities are not exposed to liquidity risk can be exempted from the liquidity requirements set out in Article 43 of the IFR, subject to their competent authorities' permission.
5. Article 43(4) of the IFR requires that the EBA, in consultation with ESMA, issues guidelines specifying further the criteria which the competent authorities may take into account when exempting investment firms that meet the conditions for qualifying as small and non-interconnected investment firms set out in Article 12(1) from the liquidity requirement.
6. In order to ensure that this exemption is applied in a uniform way across the Union, it is important to achieve a common understanding of the criteria to be used in granting the

¹ [EBA/Op/2015/20 Report on investment firms](#)

exemption. Therefore, these guidelines set common criteria which competent authorities should take into account when considering granting such exemptions.

3.2 Regulatory approach of the draft Guidelines

7. Investment firms which meet the conditions set out in Article 12(1) of the IFR are not allowed to hold clients assets or money, which cannot create situations of an investment firm being unable to return them to clients. Therefore, the liquidity requirements for these investment firms do not cover risks of potential losses of clients' money or assets.
8. Investment firms which meet the conditions for qualifying as a small and non-interconnected investment firm can provide a variety of investment services, including ancillary investment services as referred to in section B of Annex I of Directive 2014/65/EU. Some services may give rise to liquidity risk, for example, if investment firms engage significantly into granting credits or loans to their clients. Liquidity risk is related with credit risk especially with regards to borrowers default. Loan default increases the liquidity risk because of the lowered cash inflow and depreciation it triggers. Therefore, investment firms which engage in the ancillary service of granting credits or loans to an investor should not be exempted from liquidity requirements. More broadly, these guidelines should specify which investment services may give rise to liquidity risk and firms providing such services should not be exempted from liquidity requirements.
9. For example, one service which can be provided without precluding the exemption is 'placing of financial instruments without firm commitment basis' as referred to in point 7 of Section A of Annex I of Directive 2014/65/EU. However, in order to be exempted, investment firms shall not use its account for the transaction of financial instrument for which it is providing this service. For the investment firm to be exempted, this service should be provided only as an offering or listing of financial instruments to the clients.
10. Another situation where investment firm's clients do not need to be protected by liquid assets occurs when portfolio management or investment advice was outsourced to the investment firm by another institution (e.g. another investment firm or an asset management company) so that the other institution can take over their activity back at any time.
11. To demonstrate long term view, the assessment should take into account cash inflows and outflows and settlement of payments under ordinary conditions as well as financial resources needs under stressed conditions. Since certain conditions may increase an investment firm's financial resources needs, competent authorities should assess an investment firm's exposure to liquidity risk under normal as well as under stressed conditions.
12. The exemption may be granted by the approval of competent authorities and only after it assessed that the investment firm is not exposed to liquidity risks. Competent authorities should use all accessible information for the assessment, including, where available, historical data, such as supervisory reporting data and information from previous on-site and

off-site inspections. Competent authorities should consider the investment firm's liquidity risk management framework and take due consideration if it mitigated liquidity risks.

4. Draft Guidelines on liquidity requirements exemption for investment firms under Regulation (EU) 2019/2033

In between the text of the draft guidelines that follows, further explanations on specific aspects of the proposed text are occasionally provided, which either offer examples or provide the rationale behind a provision, or set out specific questions for the consultation process. Where this is the case, this explanatory text appears in a framed text box.

1. Compliance and reporting obligations

Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010². In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must make every effort to comply with the guidelines.
2. Guidelines set the EBA view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities as defined in Article 4(2) of Regulation (EU) No 1093/2010 to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by **[[dd.mm.yyyy]]**. In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website with the reference **'EBA/GL/2022/xx'**. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to EBA.
4. Notifications will be published on the EBA website, in line with Article 16(3).

² Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, (OJ L 331, 15.12.2010, p.12).

2. Subject matter, scope and definitions

Subject matter

5. These guidelines specify further the criteria which competent authorities may take into account when exempting investment firms referred to in Article 12(1) of Regulation (EU) 2019/2033 from liquidity requirements in accordance with Article 43 of Regulation (EU) 2019/2033.

Scope of application

6. These guidelines apply to investment firms on an individual basis within the scope set out in Article 43 of Regulation (EU) 2019/2033.

Addressees

7. These guidelines are addressed to competent authorities as defined in Article 4, points (2)(i) and (2)(viii) of Regulation (EU) No 1093/2010, and to financial institutions as referred to in Article 4, point (1) of Regulation (EU) No 1093/2010 that are investment firms that meet the conditions for qualifying as small and non-interconnected investment firms set out in Article 12(1) of Regulation (EU) 2019/2033.

Definitions

8. Unless otherwise specified, terms used and defined in Directive (EU) 2019/2034 or Regulation (EU) 2019/2033 have the same meaning in the guidelines.

3. Implementation

Date of application

9. These guidelines apply from [two months after issuance date].

4. Guidelines

4.1 General considerations

10. Competent authorities may exempt an investment firm, which meets the conditions for qualifying as small and non-interconnected investment firms as set out in Article 12(1) of Regulation (EU) 2019/2033, from the liquidity requirements set out in Article 43(1) of Regulation (EU) 2019/2033 where an investment firm fulfils the criteria for the exemption set out in these guidelines.
11. Where a competent authority imposed specific liquidity requirements under Article 42 of Directive (EU) 2019/2034 to an investment firm, such investment firm can be exempted from liquidity requirement only when it ceases to be subject to such specific liquidity requirements in accordance with Article 42 of Directive (EU) 2019/2034.
12. Competent authorities should exempt an investment firm from the liquidity requirement under Article 43(1) of Regulation (EU) 2019/2033 only based on an investment firm's request to be exempted. Together with such request, the investment firm should provide all information necessary for the competent authority to assess if the requirements of these guidelines are met. That information should include a description of the investment firm's activity and how the investment firm fulfils the requirements for the exemption.

4.2 Investment firm eligible for the exemption

13. For the exemption from the liquidity requirement under Article 43(1) of Regulation (EU) 2019/2033, competent authorities should only consider investment firms that provide the following limited set of investment services:
 - i) reception and transmission of orders in relation to one or more financial instruments as referred to in Annex I, Section A, point (1) of Directive 2014/65/EU;
 - ii) execution of orders on behalf of clients as referred to in Annex I, Section A, point (2) of the Directive 2014/65/EU;
 - iii) portfolio management as referred to in Annex I, Section A, point (4) of Directive 2014/65/EU;
 - iv) investment advice as referred to in Annex I, Section A, point (5) of Directive 2014/65/EU;
 - v) placing of financial instruments without a firm commitment basis as referred to in Annex I, Section A, point (7) of Directive 2014/65/EU;
14. Competent authorities should consider if ancillary services provided by an investment firm give raise to liquidity risk. An investment firm that engages into activities such as granting credits or loans to an investor is exposed to higher liquidity risk and therefore such investment firm should not be exempted from liquidity requirements.

15. Competent authorities should consider if other services provided by an investment firm give rise to liquidity risk in providing guarantees to clients or third parties, as they are also subject to higher liquidity requirement in accordance with Article 45 of Regulation (EU) 2019/2033. The same assessment should be performed for an investment firm which engages into securities lending, as an investment firm would be exposed to liquidity risk because the borrower may not be able to return security in time or on demand of the investment firm.
16. Competent authorities should consider on and off-balance sheet positions, including non-trading book derivative positions held for hedging purposes, when exempting an investment firm from liquidity requirements, as an investment firm holding significant amounts of such off-balance sheet items could be exposed to material liquidity risk.
17. Competent authorities should not grant an exemption where an investment firm engages at significant scale in transactions in foreign currencies and the investment firm's ability to swap currencies and its access to the relevant foreign exchange markets may be impaired during stress times.

Question for public consultation

Question 1. With regards to the investment services and activities eligible for the exemption listed in paragraph 13, do you consider that other services and activities should be included? If yes, please provide an explanation.

4.3 Criteria for the exemption

18. Competent authorities, after receiving a request from an investment firm, should assess if that investment firm may be exempted from liquidity requirements based on the investment firm's financial resources needs for an orderly wind-down or restructuring.
19. For the purpose of the assessment referred to in paragraph 18, competent authorities should take into account investment firm's risks to its clients and the firm itself, nature, scope and complexity of its activities and types of activities performed by the firm and, if available, any outcome of the supervisory review and evaluation carried out in accordance with Article 36 of Directive (EU) 2019/2034.
20. Competent authorities may exempt investment firm which is providing portfolio management or investment advice on an ongoing basis when an investment firm manages assets which are delegated for it by other financial institutions.
21. The assessment of the needs for liquid financial resources should be performed both under normal and under stressed conditions lead to increased risk of mismatch between outflows and inflows, in particular with regard to payments related with off-balance sheet positions or legal costs.

Question for public consultation

Question 2. Do you consider that the exemption based on investment firms financial resources needs for its orderly wind down is sufficient?

4.4 Information to be provided

22. For the purpose of the assessment for the exemption, competent authorities should use all relevant information, such as, where available: (i) regulatory reporting, (ii) accounting and financial reporting, (iii) internal investment firm's accounts, (iv) ILAAP and ICAAP conclusions, (v) the investment firm's wind-down plans.
23. Competent authorities should request any additional information or evidence to ensure that the investment firm seeking for exemption is not exposed to liquidity risk.
24. In case of a material change in the information submitted with the request for exemption, an investment firm should without delay re-submit the amended information.

4.5 Amendment and withdrawal of the exemption

25. Competent authorities should not grant an exemption to an investment firm if they consider that an investment firm does not comply with the criteria for an exemption at the time of the request or will likely not comply with the criteria subsequently.
26. Competent authorities should ensure that the investment firm informs the competent authority if there have been changes in the circumstances of the investment firm's activities which would concern the compliance with the exemption criteria.
27. Competent authorities should withdraw the exemption if they consider that the investment firm does not comply anymore with the criteria for the exemption set out in these guidelines or if, at any stage, the competent authority considers it necessary for the investment firm that has already obtained an exemption to comply with the liquidity requirements due to potential future liquidity needs. Competent authorities should notify immediately the investment firm about the decision to withdraw the exemption.
28. Competent authorities should ensure that the investment firm complies with liquidity requirements set out in Article 43(1) at the latest 90 days after the date of the notification of the competent authority's decision to revoke the exemption.

5. Accompanying documents

5.1 Draft cost-benefit analysis / impact assessment

29. Article 43(4) of Regulation (EU) 2019/2033 (IFR) mandates EBA, in consultation with ESMA, to issue guidelines specifying further the criteria which the competent authorities may take into account when exempting investment firms that meet the conditions for qualifying as small and non-interconnected investment firms set out in Article 12(1) from the liquidity requirement.
30. As per Article 16(2) of Regulation (EU) No 1093/2010 (EBA Regulation), any Guidelines (GL) and recommendations developed by the EBA shall be accompanied by an Impact Assessment (IA), which analyses 'the potential related costs and benefits'.
31. This section presents the cost-benefit analysis of the provisions of the draft GL as described in this consultation paper. The analysis provides an overview of problem identified, the proposed options to address this problem and the potential impact of these options. Given the nature and the scope of the draft GL, the analysis is high-level and qualitative in nature.

A. Problem identification and Baseline scenario

32. Until 26 June 2021, the prudential rules for investment firms were part of the wider EU prudential framework which applies to credit institutions, as set out in Regulation (EU) No 575/2013 and Directive 2013/36/EU, also known as the Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD), respectively.
33. The CRR/CRD did not impose harmonised EU level liquidity requirements for all types of investment firms. Pursuant to paragraph 4 of Article 6 of CRR, only 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 had to comply with the liquidity requirements on an individual basis if competent authority does not exempt such investment firms from liquidity requirements on an individual basis taking into account the nature, scale and complexity of its activities. Investment firms with limited authorisation to provide investment services were not subject to liquidity requirements on an individual basis. Moreover, Article 11(3) of CRR extended the exemption to liquidity requirements on a consolidated basis where the group comprises only investment firms. The justification behind these exemptions were due to the fact that the liquidity ratios were originally developed by The Basel Committee on Banking Supervision (BCBS) with a view to applying to credit institutions and not to investment firms and without taking account of the specificities of the activities and services provided by investment firms. Finally, Article 105 of the CRD gave the power to competent authorities, following the supervisory review and

evaluation process, to impose specific liquidity requirements to capture liquidity risks to which an investment firm is or might be exposed.

34. On 26 June 2021, investment firms, authorized under Directive 2014/65/EU became subject to a new prudential framework, composed of Regulation (EU) 2019/2033 and Directive (EU) 2019/2034, also known as the Investment Firms Regulation (IFR) and the Investment Firms Directive (IFD), respectively. With the application of the IFD/IFR, liquidity requirements became mandatory for investment firms unless the competent authority grants an exemption for the smallest investment firms.
35. Under Article 43 of the IFR, all investment firms are subject to requirement to hold liquid assets, where an amount of liquid assets equivalent to at least one third of the fixed overhead requirement.

B. Policy objectives

36. Investment firms throughout the EU are an important element of a well-functioning capital markets, due to their key role in efficient capital allocation. Adequate liquidity requirements are therefore necessary to meet any immediate or additional liquidity needs an investment firm may have (e. g. due to operational expenses, etc.), contributing to sound financial stability.
37. The specific objective of these draft guidelines is to establish common criteria which competent authorities should take into account when exempting investment firms from liquidity requirements. Generally, the draft guidelines aim to create a level playing field across the EU, as well as promote consistency of market practices and convergence of supervisory practices across competent authorities.

C. Options considered, assessment of the options and the preferred option

38. This section presents the main policy options discussed during the development of the guidelines, the costs and benefits of these options, as well as the retained preferred options.

Scope of the exemption

39. The EBA considered 2 policy options regarding the scope of the exemption criteria:

Option 1a: the guidelines should provide a narrow list of the exemption

Option 1b: the guidelines should provide a broad list of the exemption

40. Option 1a has been retained, because liquidity requirements under Article 43 of the IFR are not burdensome for investment firms to implement and the exemption should be granted only to a limited number of investment firms.

Provide procedure for the exemption of an investment firm

41. The EBA considered 2 policy options regarding setting out detailed procedure for competent authorities to grant the exemption:

Option 2a: retain neutral approach regarding the procedure for granting the exemption.

Option 2b: to set detailed procedure for granting the exemption.

42. Option 2a has been retained. Since those guidelines seeking to harmonize exemption across the Union, some guidance on the process is also provided under those guidelines. However, this process is not detailed, concrete measures are left for each competent authority to decide. Besides, most competent authorities have their internal procedures for supervisory measures and detailed process under those guidelines could conflict with their internal procedures.

5.2 Overview of questions for consultation

Questions for public consultation

Question 1. With regards to the investment services and activities eligible for the exemption listed in paragraph 13, do you consider that other services and activities should be included? If yes, please provide an explanation

Question 2. Do you consider that the exemption based on investment firms financial resources needs for its orderly wind down is sufficient?