

EBA/RTS/2022/07

21/07/2022

Final Report

Draft Regulatory Technical Standards on Pillar 2 add-ons for investment firms under Article 40(6) of Directive (EU) 2019/2034

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1. Executive Summary

The EBA has developed these draft regulatory technical standards (RTS) on determination of additional own funds requirements (i.e. Pillar 2 add-ons) for investment firms in consultation with the European Securities and Markets Authority (ESMA), in accordance with the mandate under Article 40(6) of Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms¹. These draft RTS clarify how competent authorities should measure risks or elements of risks that investment firms face or pose to others, that are not covered or not sufficiently covered by the own funds requirements set out in Part Three and Four of Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms².

These draft RTS are relevant for class 2 and class 3 investment firms, class 3 investment firms gathering all investment firms complying with Article 12(1) of Regulation (EU) 2019/2033, and aim to ensure a consistent and proportionate application of supervisory practices across the Union, providing granular guidance embedding different sizes, business models, and risk profiles of the investment firms, while maintaining risk sensitivity of the calculation of capital requirements under Pillar 2. Given that the application of additional own funds requirement results from a comprehensive supervisory review and evaluation process (SREP), these draft RTS should be read together with the SREP guidelines under Article 45(2) of Directive (EU) 2019/2034.

The approach specified in these RTS builds on the structure of own funds requirements set out in Article 11 of Regulation (EU) 2019/2033, differentiating between class 2 and class 3 investment firms, and reflecting various objectives of the own funds requirements. On the one hand, competent authorities are expected to determine for class 2 and class 3 investment firms, additional own funds requirement to cover the risk of an unorderly wind-down, which could pose threats to their clients, counterparties, and the wider markets in which they operate in case of their failure. On the other hand, for class 2 investment firms only, competent authorities should determine additional own funds requirement to decrease the likelihood of a failure of the investment firm, by covering material risks related to their ongoing activities, including risks to clients, to markets, to the investment firms itself, and risks that are not addressed by any own funds requirements.

These draft RTS propose a number of indicative qualitative metrics to support competent authorities in the identification, assessment, and quantification of material risks and elements of risks not covered or not sufficiently covered by own funds requirements set out in Article 11 of

¹ OJ L 314 5.12.2019, p. 64

² OJ L 314 5.12.2019, p. 1

Regulation (EU) 2019/2033. The proposed metrics reflect the size, complexity of activities and business models of the various investment firms across the European Union.

Next steps

The draft RTS will be submitted to the Commission for endorsement before being published in the Official Journal of the European Union. The technical standards should be in force when the SREP Guidelines for Investment Firms under Directive (EU) 2019/2034 become applicable.

2. Background and rationale

Introduction

1. Until the adoption of the Regulation (EU) 2019/2033 and Directive (EU) 2019/2034, the prudential and supervisory requirements regarding own funds and additional own funds were set out in the 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 institutions³ and 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 firms⁴, with however, some investment firms exempted from full Directive 2013/36/EU / Regulation (EU) No 575/2013 requirements, depending on which services they provide, and their combination or size.
2. The Directive (EU) 2019/2034 and the Regulation (EU) 2019/2033, which were published in the Official Journal of the European Union on 5 December 2019 and entered into force on 26 December 2019, replaced the existing prudential and supervisory framework for investment firms, with the definition of investment firms now aligned with the definition set out in Article 4(1) of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments⁵.
3. Investment firms authorised under Directive 2014/65/EU vary greatly in terms of size, business model, risk profile, complexity, and interconnectedness, ranging from one-person companies to large internationally active groups, requiring proportionality with regard to the regulatory and supervisory framework. The new regime for investment firms distinguishes between investment firms deemed similar in terms of business models and risk profiles to credit institutions that will remain subject to the prudential and supervisory requirements of the Regulation (EU) No 575/2013 and Directive 2013/36/EU (Class 1 investment firms), and firms that became subject to the new requirements of the Regulation (EU) 2019/2033 and Directive (EU) 2019/2034, according to their systemic importance, and other criteria including size and types of activities under Directive 2014/65/EU (Class 2 and Class 3 investment firms, the latter class encompassing only small and non-interconnected investment firms in line with the criteria of Article 12(1) of Regulation (EU) 2019/2033).
4. The new regime for investment firms under Regulation (EU) 2019/2033 and Directive (EU) 2019/2034 will be complemented by further harmonisation of the regulatory requirements and supervisory practices through level 2 regulations, in order to foster a European level playing field across investment firms. One of the areas requiring further clarifications to ensure common supervisory practices is the application of Pillar 2 requirements. Given that the application of addi-

³ OJ L 176 27.6.2013, p. 338

⁴ OJ L 176 27.6.2013, p. 1

⁵ OJ L 173 12.6.2014, p. 349

tional own funds requirement (i.e. Pillar 2 add-ons) results from a comprehensive supervisory review and evaluation process (SREP), a fully integrated approach is required for the development of these proposed draft RTS on Pillar 2 add-ons and the SREP guidelines under Article 45(2) of the Directive (EU) 2019/2034.

5. In this context the EBA, in consultation with ESMA, has developed these draft RTS in accordance with the mandate contained in Article 40(6) of Directive (EU) 2019/2034. In developing the proposed draft RTS as well as the SREP guidelines, the EBA's key objective was to provide for a consistent application of methodologies across the Union and sufficient granularity of assessment, while ensuring proportionate approach reflecting different sizes, business models, and risk profiles of investment firms. The proposed RTS aim at maintaining risk sensitivity and proportionality in determining own funds requirements under Pillar 2.
6. Competent authorities shall impose additional own funds requirement on various grounds set out in Article 40(1) of Directive (EU) 2019/2034. In accordance with the mandate, these draft RTS focus only on one of these situations, detailed in point (a) of that Article, namely where the investment firm is exposed to risks or elements of risks, or poses risks to others that are material and are not covered or not sufficiently covered by minimum own funds requirements. Other aspects of setting additional own funds requirement, in particular based on points (b) to (e) of Article 40(1) of Directive (EU) 2019/2034, are further clarified in the SREP guidelines.

Policy proposals

7. The proposed draft RTS elaborate on the methodology for competent authorities to assess, determine, and where necessary, update the amount of additional own funds the investment firms should hold to cover relevant risks. On the one hand, the additional own funds requirement should decrease the likelihood of a failure of investment firms by covering risks related to their ongoing activities, including in particular their risks-to-clients, risks-to-firms, and risks-to-markets. On the other hand, competent authorities should also assess the risk of an unorderly wind-down of investment firms' businesses, which could pose threats to their clients, counterparties, and the wider markets in which they operate, in case of their failure. This dual objective of additional own funds requirement justifies a dichotomous approach separating the assessment of the risks related to the on-going activities of the investment firm, and the risk of an unorderly wind-down. It is also consistent with the structure of minimum own funds requirements as set out in Article 11 of Regulation (EU) 2019/2033.
8. The investment firm's total capital requirements should, at all times, be at least equal to the own funds requirements set out in Part Three and Four of Regulation (EU) 2019/2034. To that aim, the capital considered adequate to cover the risk of unorderly wind-down of an investment firm and the capital considered adequate to cover risks from ongoing activities shall at least be respectively equal to the fixed overhead requirements and K-factor requirements determined in accordance with Article 11 of Regulation (EU) 2019/2033.
9. In addition, investment firms may be exposed to other risks arising from ongoing activities that cannot reasonably be attributed to any own funds requirements set out in Article 11 of Regulation (EU) 2019/2033. These include in particular risks such as ICT risk, interest rate risk in the banking

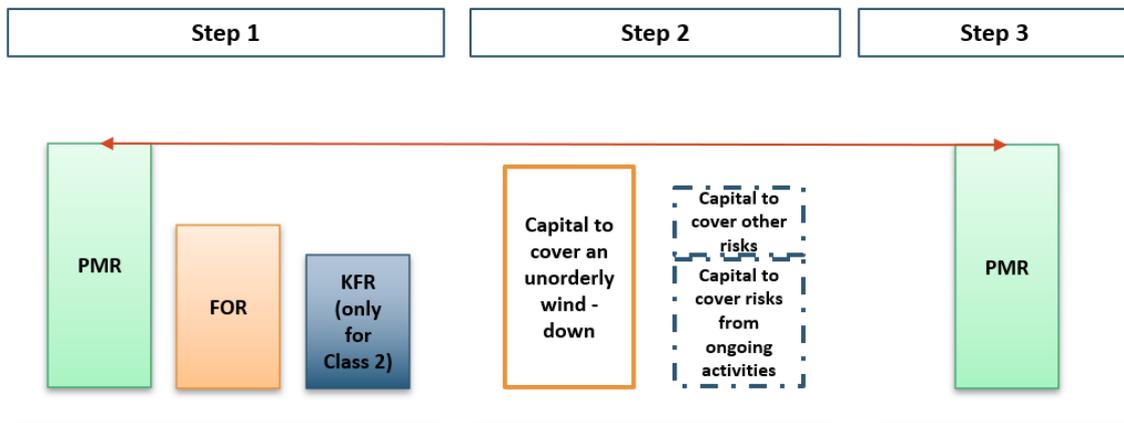
book or credit risk that are not addressed by the minimum own funds requirements. Where those risks are material in nature, competent authorities will need to assess their impact separately and consider such impact within the capital considered adequate to cover risks related to the investment firms' ongoing activities.

10. The RTS specify a number of indicative metrics to support competent authorities in the identification, assessment, and quantification of material risks and elements of risks not covered or not sufficiently covered by own funds requirements set out in Article 11 of Regulation (EU) 2019/2033. The proposed metrics reflect the size, complexity of activities, and business model of the various investment firms within the European Union.

Examples

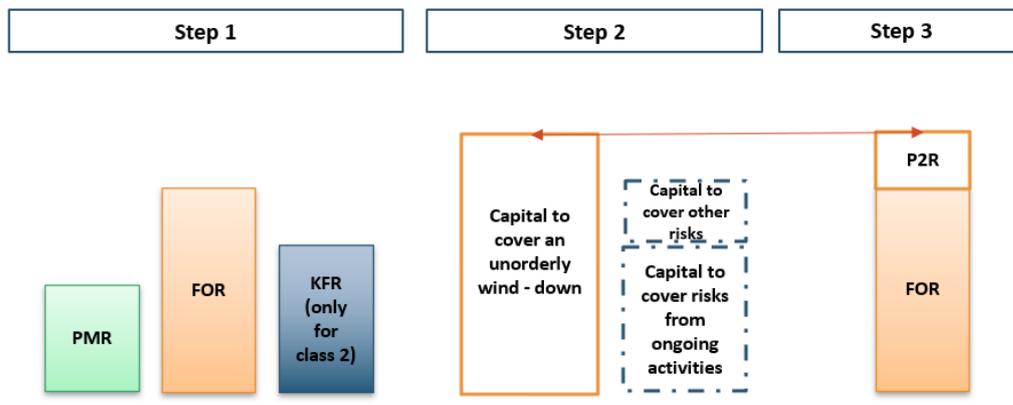
11. The calculation of additional own funds requirement would typically follow the following steps:
 - 1) An investment firm with a known permanent minimum capital requirement (PMCR) calculates its fixed overheads requirement (FOR) and, if belonging to Class 2, its K-factor requirement (K-FR). In line with Article 11 of Regulation (EU) 2019/2033, it determines the minimum own funds requirements as the highest of PCMR, FOR, and KFR.
 - 2) The competent authority then calculates the capital considered adequate to cover the risk of an unorderly wind-down of the investment firm's business, and if the investment firm belongs to Class 2, also the capital considered adequate to cover the risks-to-clients, risks-to-firm, and risks-to-markets from its on-going activities.
 - 3) The competent authority also calculates the capital considered adequate to cover any other risks arising from ongoing activities that are not covered by any own funds requirements. Such capital shall be added to the capital considered adequate to cover the risks-to-clients, risks-to-firm, and risks-to-markets computed in step 2.
 - 4) In line with the provision of Article 40(3) of Directive (EU) 2019/2034, the competent authority shall determine the level of the additional own funds as the difference between the highest computed capital considered adequate to cover aspects set out in point 2 and the minimum own funds requirements set out in point 1. The result of this deduction is floored at the level of minimum own funds requirements.
 - 5) .The Pillar 2 add-on may be further adjusted by determining additional own funds requirements to address points (b) to (e) of Article 40(1) of Directive (EU) 2019/2034, as further explained in the SREP guidelines.
12. Several illustrative examples are presented below for the practical application of the proposed framework. Please note that all these examples present only the part of the process of setting own funds requirements that is addressed in these RTS. They therefore assume that there are no further adjustments to the Pillar 2 add-on which could be performed in step 5 as explained in the previous paragraph. Moreover, the scale used in these examples is not meaningful and therefore the relations between the levels of minimum and additional own funds requirements should not be read from these examples.

Figure 1: Example 1 of P2R determination



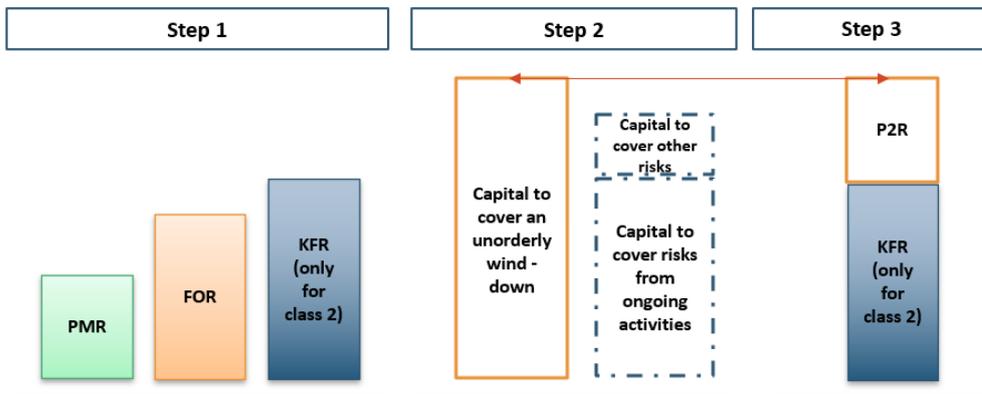
13. Figure 1 presents an example where FOR and KFR are lower than PMCR, which is higher than the the capital considered adequate to cover the risk of an unorderedly wind-down or to cover risks from ongoing activities. In this case the Pillar 2 add-on is nil.

Figure 2: Example 2 of P2R determination



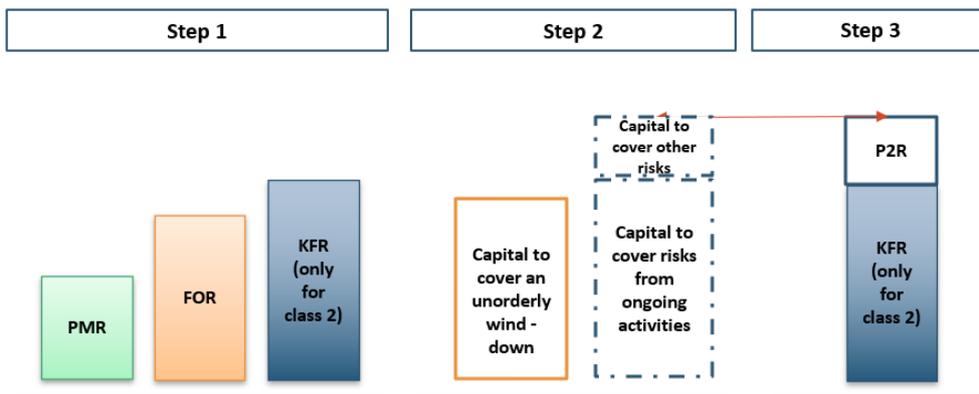
14. Figure 2 presents an example where FOR is lower than the capital considered adequate to cover the risk of an unorderedly wind-down. In this case, the Pillar 2 add-ons reflects the capital necessary to cover the risk of an unorderedly wind-down.

Figure 3: Example 3 of P2R determination



15. Figure 3 presents an example where KFR is lower than the capital considered adequate to cover the risk of an unorderly wind-down. In this case, the Pillar 2 add-ons reflects only the capital necessary to cover the risk of an unorderly wind-down.

Figure 4: Example 4 of P2R determination



16. Figure 4 presents an example where the capital considered adequate to cover risks from ongoing activities is equal to KFR. In this case, the Pillar 2 add-ons reflects the capital necessary to cover other risks from the investment firm’s ongoing activities.

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3. Draft regulatory technical standards on Pillar 2 add-ons for investment firms under Article 40(6) of Regulation (EU) 2019/2034

COMMISSION DELEGATED REGULATION (EU) .../...

of **XXX**

supplementing Directive (EU) 2019/2034 of the European Parliament and of the Council with regard to regulatory technical standards specifying the calculation of additional own funds requirements to cover risks or elements of risks not covered or not sufficiently covered by own funds requirements set out in Part Three and Four of Regulation (EU) 2019/2033

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,
Having regard to Directive (EU) 2019/2034 of the Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2014/59/EU and 2014/65/EU⁶, and in particular the sixth paragraph of Article 40 thereof,

Whereas:

- (1) To ensure harmonised application of additional own funds requirement across the Union, a uniform approach on the measurement of this requirement should be set out in this Regulation by determining the level of capital adequate to address all material risks to which the investment firms may be exposed.
- (2) A detailed and comprehensive methodology, proportionate to the nature, scope and complexity of activities of the investment firm is necessary for competent authorities to appropriately monitor the risk profile of investment firms and to identify, assess and quantify material risks, using all relevant sources of information. Based on this methodology, competent authorities will be able to ensure that investment firms hold adequate additional own funds to cover each risk category (risk-to-client, risk-to-firm, risk-to-market) as well as any other material risks.
- (3) The level of additional own funds requirement should be seen as adequate, when it both reduces the likelihood of a failure of the investment firm and limits the risk of its unorderly wind-down that would pose threats to the firm's clients and to the wider market, including other financial institutions, market infrastructures, or the market as a whole. Due to this dual objective of additional own funds requirement, and consistently with the structure of minimum own funds requirements as set out in Part Three and Four of 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

⁶

OJ L 314 5.12.2019, p. 64

and (EU) No 806/2014⁷, it is appropriate that competent authorities consider separately the risks related to on-going activities of the investment firm, and the risk of unordered wind-down of the investment firm's business.

- (4) To ensure that an orderly wind-down of an investment firm's business is attainable, an investment firm should hold sufficient own funds to withstand additional operational expenses occurring and risks arising upon winding-down period. In particular, business continuity, investor protection and market integrity should not be jeopardised during the winding-down period and, to that end, the firm should be capable, also during this period, to absorb costs and losses not matched by a sufficient volume of profits. Considering that the length of the winding-down period may significantly differ depending on specific circumstances, it is appropriate that competent authorities take it into account when setting additional own funds requirement. Moreover, considering the potentially diverse legal forms that investment firms can have, had to be taken into account the applicable national insolvency, corporate and trade laws, which may affect the length of wind-down processes, as well as associated costs and risks.
- (5) To ensure proportionality in determining additional own funds requirement, this Regulation should set out that risks and elements of risk not covered or not sufficiently covered by the K-factor requirement as specified in Article 15 of Regulation (EU) 2019/2033 should be measured only for those investment firms that are subject to the K-factor requirement in accordance with that Article 15 and not for the small and non-interconnected firms that meet the criteria specified in Article 12 and are not subject to K-factor requirement in accordance with Article 11(2) of Regulation (EU) 2019/2033.
- (6) In addition to the risks not fully or sufficiently covered by the own funds requirements set out in Part Three and Four of Regulation (EU) 2019/2033 that should be taken into account by competent authorities when determining the additional own funds requirement in accordance with this Regulation, other risks not covered at all by the own funds requirements set out in Part Three and Four of Regulation (EU) 2019/2033 including risks explicitly excluded therefrom exist for investment firms. To ensure appropriateness and proportionality, this Regulation should, therefore, specify that risks not covered at all by the own funds requirements set out in Part Three and Four of Regulation (EU) 2019/2033 including risks explicitly excluded therefrom should be assessed and measured by competent authorities on the basis of the size and business model of the investment firm as well as on the basis of the scope, nature and complexity of its activities.
- (7) To ensure the correct measurement of risks, the risks referred to in Part Three and Four of Regulation (EU) 2019/2033 but not fully or adequately covered therefrom should, in principle, be measured separately for each risk category (risk-to-clients, risk-to-markets, risk-to-firm). For the same reason, the risks not covered in Part Three and Four of that Regulation included those explicitly excluded therefrom, should, in principle, be measured on a risk-by-risk basis. Nevertheless, when the measurement per risk category or on a risk-by-risk basis is not feasible or overly burdensome, this Regulation lays down, taking into account the principle of proportionality, that the measurement of risks should in those cases be performed on an aggregate level.

⁷ OJ L 314 5.12.2019, p. 1

- (8) To strike the right balance between prudential considerations and proportional application, this Regulation lays down that the measurement of risks on an aggregate level should not be applied for investment firms subject to the initial capital requirement laid down in Article 9(1) of Directive (EU) 2019/2034: these firms subject to higher initial capital requirements should be assessed in terms of risks with a measurement per risk category and on a risk-by-risk basis.
- (9) To ensure consistency in the measurement of material risks investment firms may pose to others or face themselves, competent authorities should rely on certain qualitative metrics. Considering that risks are evolving throughout the business cycle of a firm, it is necessary that competent authorities, not only take into account static assessment but also perform a historical trend analysis of such metrics. To appropriately capture all the relevant risks, different metrics should be used for investment firms with different business models and activities. Furthermore given that these metrics are of an indicative nature, under certain conditions, and having taken into account the business and operating models, legal form, and availability of reliable data, competent authorities may not apply or adjust the application of these metrics.
- (10) This Regulation is based on the draft regulatory technical standards submitted to the Commission by the European Banking Authority.
- (11) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based and analysed the potential related costs and benefits and requested the advice of the Banking Stakeholder Group established in accordance with Article 10 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council⁸.

HAS ADOPTED THIS REGULATION:

Article 1

Risk of unorderly wind-down

1. Competent authorities shall, having regard to the legal form, business model, the business and risk strategy and the scale and complexity of the activities of an investment firm, measure during their supervisory review and evaluation process carried out in accordance with Article 36 of Directive (EU) 2019/2034 the risk of unorderly wind-down of the investment firm's business, by determining the amount of capital that would be considered adequate for that firm to be orderly wound-down under plausible scenarios.
2. The measurement referred to in paragraph 1 shall be proportionate to the complexity, risk profile, and scope of operation of the investment firms and to the potential impact of its wind-down on clients and markets and shall include:
 - (a) an estimation of the realistic timeframe to wind-down the investment firms;

⁸ Regulation (EU) No 109x/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)

- (b) an assessment of operational and legal tasks the investment firm will have to undertake during the wind-down process over a realistic timeframe;
 - (c) the identification and assessment of material fixed and variable costs;
 - (d) the identification and assessment of material risks or elements of risks that could materialize during the wind-down process; and
 - (e) any other aspect relevant for the winding-down process.
3. Where Directive 2014/59/EU applies, available information on recovery actions and governance arrangement in the investment firm's recovery or group recovery plan shall be taken into account by competent authorities for the purpose of paragraph 2, points (b) and (c), if competent authorities consider that information sufficiently credible and reliable.
 4. For investment firms subject to the initial capital requirement laid down in Article 9(1) of Directive (EU) 2019/2034, competent authorities shall include in their measurement:
 - (a) the closure costs including litigation costs for the purpose of paragraph 2, point (c); and
 - (b) the loss in revenues and the loss in net realizable value of assets expected to be incurred due to the wind-down process for the purpose of paragraph 2, point (d).
 5. Competent authorities shall identify and quantify material costs, risks or elements of risks and determine the capital considered adequate to absorb them as set out in paragraphs 1 and 2. To assess the materiality and perform the measurement, competent authorities shall use the relevant indicative metrics referred to in Article 6(1) and combine them with static and historical trend analysis exerting thereupon expert judgment, as appropriate.
 6. The capital considered adequate to cover the risk of unorderly wind-down of an investment firm's business measured in accordance with this Article shall be at least equal to the fixed overheads requirement of that firm calculated in accordance with Article 13 of Regulation (EU) 2019/2033.

Article 2

Material risks or elements of risks not captured or not fully captured by K-Factor requirements

1. Where the investment firm does not meet the conditions for qualifying as small and non-interconnected investment firm set out in Article 12(1) of Regulation (EU) 2019/2033, competent authorities shall, having regard to the business model, legal form, business and risk strategy, and the scale and complexity of the activities of an investment firm, measure during their supervisory review and evaluation process carried out in accordance with Article 36 and 37 of Directive 2019/2034 any material risk or material element of risk deriving from the firm's on-going activities, which that firm poses to itself, to its clients and to the market and which it is not captured or not fully captured

by the K-factor requirement, and determine the capital that would be considered adequate to cover the relevant risks related to K-factor requirement.

2. The measurement referred to in paragraph 1 shall be made separately for each risk category set out in Article 15 of Regulation (EU) 2019/2033 (risk-to-clients, risk-to-firm, risk-to-markets).

For investment firms subject to an initial capital requirement lower than the requirement laid down in Article 9(1) of Directive (EU) 2019/2034, where more granular quantification is deemed by competent authorities as not feasible or as overly burdensome, the measurement need not be performed at the level of each risk category but on an aggregate level.

3. The measurement referred to in paragraph 2 shall aim at identifying and quantifying material risks or elements of risks for each risk category, including risks from the use of internal models as referred to in Article 22 of Regulation (EU) 2019/2033, based on the indicative metrics set out in Article 6(2) to (4) and on expert judgment to be exerted by competent authorities.
4. Competent authorities shall ensure that the capital considered adequate to cover material risks related to K-factor requirement is not lower than the total K-factor requirement.

Article 3

Material risks or elements of risks not captured by the own funds requirements set out in Part Three and in Part Four of Regulation (EU) 2019/2033

1. Where the investment firm does not meet the conditions for qualifying as small and non-interconnected investment firm set out in Article 12(1) of Regulation (EU) 2019/2033, competent authorities shall, having regard to the business model, the legal form and the business and risk strategy and the scale and complexity of the activities of an investment firm, measure during their supervisory review and evaluation process set out in Article 36 of Directive 2019/2034 any material risk or material element of risk deriving from any of the firm's on-going activities other than those assessed under Article 2 and not already covered by the own funds requirements of that firm set out in Parts Three and Four of Regulation (EU) 2019/2033, by determining on a risk-by-risk basis the additional capital considered adequate to cover material risks or elements of risks.
2. The measurement referred to in paragraph 1 shall include, but not be limited to, the identification, assessment and, where appropriate, the quantification of the following risk areas:
 - (a) the risks posed to the security of the investment firm's network and information systems to ensure confidentiality, integrity and availability of their processes, data, and assets; and
 - (b) the interest rate risk and credit risk arising from non-trading book activities.

For investment firms subject to an initial capital requirement lower than the requirement laid down in Article 9(1) of Directive (EU) 2019/2034, where more granular

quantification is deemed by competent authorities as not feasible or as overly burdensome, the measurement need not be performed on a risk-by-risk basis but on an aggregate level.

3. To perform the measurement referred to in paragraphs 1 and 2, competent authorities shall use the relevant indicative metrics referred to in Article 6(5) and combine them with static and historical trend analysis exerting thereupon expert judgment, as appropriate.

Article 4

Total material risk not captured or not fully captured by the own funds requirements set out in Part Three and in Part Four of Regulation (EU) 2019/2033

1. Competent authorities shall calculate the total additional capital considered adequate to cover material risks or material elements of risk deriving from the investment firm's ongoing activities as the sum between the capital considered adequate calculated in accordance with Articles 2 and 3.
2. Competent authorities shall measure the total material risk not captured or not fully captured by the own funds requirements set out in Part Three and in Part Four of Regulation (EU) 2019/2033 by determining the level of additional own funds required as the difference between the highest of the amounts calculated in accordance with Article 1 or with paragraph 1 of this Article and the own funds requirements set out in Part Three or Four of Regulation (EU) 2019/2033.

Article 5

General qualitative principles for the determination of additional own funds requirement

1. To ensure that the legal form, business model, scale and complexity of activities and appropriateness of internal governance arrangements and controls of an investment firm has been taken into account when the amount of the additional own fund requirements is determined for the purposes of application of Articles 1 to 3, competent authorities shall have regard to the following:
 - (a) the internal capital adequacy assessment process and internal risk-assessment process by the investment firm set out in Article 24 of Directive (EU) 2019/2034 and the outcomes of the supervisory review and evaluation process assessment of these processes by the competent authority;
 - (b) data reported in accordance with Part Seven of Regulation 2019/2033;
 - (c) the outcome of the reviews carried out in accordance with Article 36 and 37 of Directive (EU) 2019/2034;
 - (d) the results of any other supervisory activities;
 - (e) other relevant inputs, including supervisory judgement.

2. Competent authorities shall apply the provisions of this Regulation in a consistent manner and shall ensure comparability in the quantification of the additional own funds requirement imposed across all investment firms under their supervisory remit.

Article 6

Indicative qualitative metrics

1. For the purposes of Article 1, the metrics shall be the following:
 - (a) the number of tied agents compared to total staff;
 - (b) the average duration of a wind-down in the jurisdiction considering complexity of the investment firm's business;
 - (c) the share of non-cancellable contracts and residual duration of these contracts;
 - (d) identification of markets where the investment firm is the main service provider;
 - (e) the value and liquidity of fixed assets that the investment firm would have to dispose of during a wind-down;
 - (f) the average severance payments payable in case of a wind-down considering employment legislation and contracts with employees.

2. For the purposes of Article 2 with regards to the measurement of the risks-to-client, the metrics shall be the following:
 - (a) the amount of client money held over the past five years;
 - (b) the amount of assets of clients under management over the past five years;
 - (c) the amount of assets safeguarded and administered for clients over the past five years;
 - (d) the amount of losses or damages incurred by the investment firm due to breaches of its legal or contractual obligations over at least the past five years, including losses arising from the following:
 - i. unsuitable advice made to the investors and related investors' compensation;
 - ii. failure to establish, implement and maintain appropriate procedures to prevent breaches;
 - iii. trading or valuation errors;
 - iv. business disruption, system failures, failure of transaction processing or process management;
 - v. an act of the investment firm's tied agents or appointed representatives for which the investment firm is liable.
 - (e) specifically for investment firms holding client money, any inability of the investment firm to timely return client money when required and associated financial consequences over the past five years.

3. For the purposes of the application of Article 2 with regard to the measurement of the risks-to-market, the metrics shall be the following:
 - (a) the variability of the value of the positions, including due to changing market conditions;
 - (b) the share of complex and illiquid products in the investment firm's trading book, in terms of volume and net income; and
 - (c) specifically for investment firms using internal models, the availability of regular back-testing of models used for regulatory purposes.

4. For the purposes of the application of Article 2 with regard to the measurement of the risks-to-firm, the metrics shall be the following:
 - (a) the daily trading flow and average daily trading flow over the past five years;
 - (b) any significant operational events related to daily trading flow and associated financial losses over the past five years, including processing errors;
 - (c) the variability of the investment firm's income and revenues over the past five years;
 - (d) any losses incurred due to variations in positions in financial instruments, foreign currencies and commodities over the past five years;
 - (e) the rate of clients or counterparties' default, and associated losses over the past five years;
 - (f) any losses due to material changes in the book value of assets, including due to changes in market conditions and in creditworthiness of counterparties;
 - (g) the amounts and variability of payments or contributions under defined benefit pension scheme over the past five years;
 - (h) any concentration of the investment firm's assets, including clients and counterparties concentration, as well as sectoral and geographical concentration; and
 - (i) the share of off-balance sheet exposure compared to the investment total assets and related credit risk.

5. For the purposes of application of Article 3, the metrics shall be the following:
 - (a) any indications of significant financial risks not addressed by own funds requirements set out in Article 11 of Regulation (EU) 2019/2033, in particular:
 - i. the average of total operational risk losses over gross income over the past five years;
 - ii. any significant operational events and associated financial losses over the past five years;

- iii. the share of the investment firm's net income coming from businesses or activities that are not listed under Directive 2014/65/EU, such as corporate finance businesses or insurance distribution;
 - (b) any indication of significant information and communication technology (ICT) risk, in particular:
 - i. the overall complexity of ICT architecture, including share of out-sourced ICT services;
 - ii. the number of material changes within the ICT environment over the last five years;
 - iii. any losses due to disruption due to incidents touching critical ICT services over the last five years; and
 - iv. the number of cyberattacks and related losses over the last five years;
 - (c) any indication of significant interest rate risk arising from non-trading book activities, in particular:
 - i. the volume of transactions based on interest rates or otherwise depending on interest rate, outside of the trading book of the investment firm; and
 - ii. the investment firm's hedging policy and potential misalignments between the position and the hedge, outside of the trading book of the investment firm.
- 6. The metrics referred to in paragraphs 1 to 6 shall not be used or shall be used with adjustments while other metrics shall be used as appropriate by competent authorities, where any of the following conditions apply:
 - (a) the metric is not appropriate considering the specific legal form, structural changes, business and operating model of the investment firm;
 - (b) the estimation of the metric is overly burdensome considering the size and complexity of activities of the investment firm;
 - (c) the estimation of the metric is not feasible due to lack of reliable data, where such data do not fall under Articles 54 and 55 of Regulation (EU) 2019/2033 or Article 39 (2), point (j) of Directive (EU) 2019/2034;
 - (d) the estimation of the metric is not feasible due to the lack of reliable historical data rendering the historical analysis period irrelevant. In such cases, competent authorities shall limit the period of the historical analysis to the time passed since the last supervisory review and process set out in Article 36 of Directive (EU) 2019/2034.
- 7. Competent authorities could extend the list of indicators pursuant to paragraphs 1 to 6 while ensuring that such additional indicators are proportionate to the investment firm's size, complexity, business, and operating models.

Article 7

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

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

Done at Brussels,

For the Commission
The President

[For the Commission
On behalf of the President

[Position]

4. Accompanying documents

.4.1 Draft cost-benefit analysis / impact assessment

Article 40(6) of Directive (EU) 2019/2034 mandates the EBA to develop draft RTS to specify how to measure the risks and elements of risks that are not covered or are insufficiently covered by the own funds requirements set out in Part Three and Four of Regulation (EU) 2019/2033, including risks that are explicitly excluded from these requirements.

As per Article 10(1) of Regulation (EU) No 1093/2010 (EBA Regulation), any RTS developed by the EBA shall be accompanied by an analysis on the potential related costs and benefits.

This section presents the cost-benefit analysis of the provisions included in the draft RTS. The analysis provides an overview of problems identified, the proposed options to address these problems and the potential impact of such options. Given the nature and the scope of the draft RTS, the analysis is high-level and qualitative in nature.

A. Problem identification

Until 25 June 2021, the prudential rules for investment firms were part of the wider European Union prudential framework which applies to credit institutions, as set out in Regulation (EU) No 575/2013 and Directive 2013/36/EU. The minimum own funds requirements of an investment firm were based on its prudential categorisation, which was primarily determined by its investment services and activities under Directive 2014/65/EU, as well as its ability to hold money and securities belonging to its clients.

Under Article 104(a)(1) of Directive 2013/36/EU, competent authorities had the power to require from certain categories of investment firms to hold own funds in excess of the own funds requirements set out in Chapter 4 of Title VII of the Directive 2013/36/EU and in the Regulation (EU) No 575/2013 relating to risks and elements of risks not covered by Article 1 of that Regulation. The appropriate level of these additional own funds requirement was determined on the basis of the supervisory review and evaluation process (SREP), for which the EBA has issued Guidelines to promote common procedures and methodologies applied in the supervision of all institutions across the European Union⁹

On 26 June 2021, most investment firms became subject to a new prudential framework, composed of Regulation (EU) 2019/2033 and Directive (EU) 2019/2034. As a result, the existing Guidelines for common procedures and methodologies for the SREP and supervisory stress testing are not fit for

⁹ [EBA/GL/2022/03](#)



purpose and the EBA has been mandated under Article 45(2) of the Directive (EU) 2019/2034 to develop dedicated Guidelines for investment firms on the common procedures and methodologies for SREP. In addition, under Article 40(6) of Directive (EU) 2019/34 the EBA has been mandated to develop these draft RTS, specifying how to determine additional own funds requirement based on the outcomes of SREP.

The SREP Guidelines help competent authorities to understand if the investment firm is exposed to risks or elements of risks or poses risks to others that are material and are not covered or not sufficiently covered by the minimum own funds requirements. However, they do not provide a harmonized methodology on how to measure these risks and determine the adequate level of additional own funds investment firms need to hold to cover them. This can create an unlevel playing field across the European Union, where competent authorities adopt different methodologies for the purposes of setting additional own funds requirement. Therefore, more specific clarifications with regard to the determination of additional own funds requirement are included in these draft RTS.

B. Policy objectives

Investment firms throughout the European Union are an important element of a well-functioning economy, thanks to their key role in capital allocation. Adequate supervisory requirements are therefore necessary to reduce the likelihood of failure of an investment firm, or, in the event that it does fail, to limit the risk of disorderly wind-down that could bring disruption to clients, counterparties or to the markets in which it operates.

The specific objective of these draft RTS is to establish a harmonised methodology for the determination of adequate additional own funds requirement investment firms should hold to cover any risks or elements of risks that are not covered or not sufficiently covered by the own funds requirements set out in Part Three and Four of Regulation (EU) 2019/2033. Generally, the draft RTS aim to create a level playing field by setting common requirements for the measurement of risks and elements of risks arising from investment firms' various businesses and activities.

The methodology specified in these draft RTS promotes the application of supervisory requirements better aligned with the investment firm's size, complexity and business model that should also help improve the efficiency and stability of financial markets, as well as market confidence in the sector overall. The draft RTS should also have a positive impact on investor protection while strengthening capital requirements against a disorderly failure and therefore against the investment firm's inability to restore client money and assets, placing therefore less reliance on investor compensation schemes.

C. Baseline Scenario

On 26 June 2021, most investment firms became subject to a new prudential framework, composed of Regulation (EU) 2019/2033 and Directive (EU) 2019/2034. As a result, the EBA has been

mandated to draft Guidelines for common procedures and methodologies for the SREP, complemented by draft RTS, to ensure harmonisation and level playing field with regard to the supervisory determination of additional capital requirement.

In that context, the regulatory requirements under Directive (EU) 2019/2033 and Regulation (EU) 2019/2034, as well as the current market conditions are an appropriate baseline, as absent those proposed Guidelines for the SREP and RTS on the determination of additional capital requirement, such existing requirements will continue to apply.

D. Options considered

This section presents the main policy options discussed during the development of the draft RTS, as well as the preferred options retained.

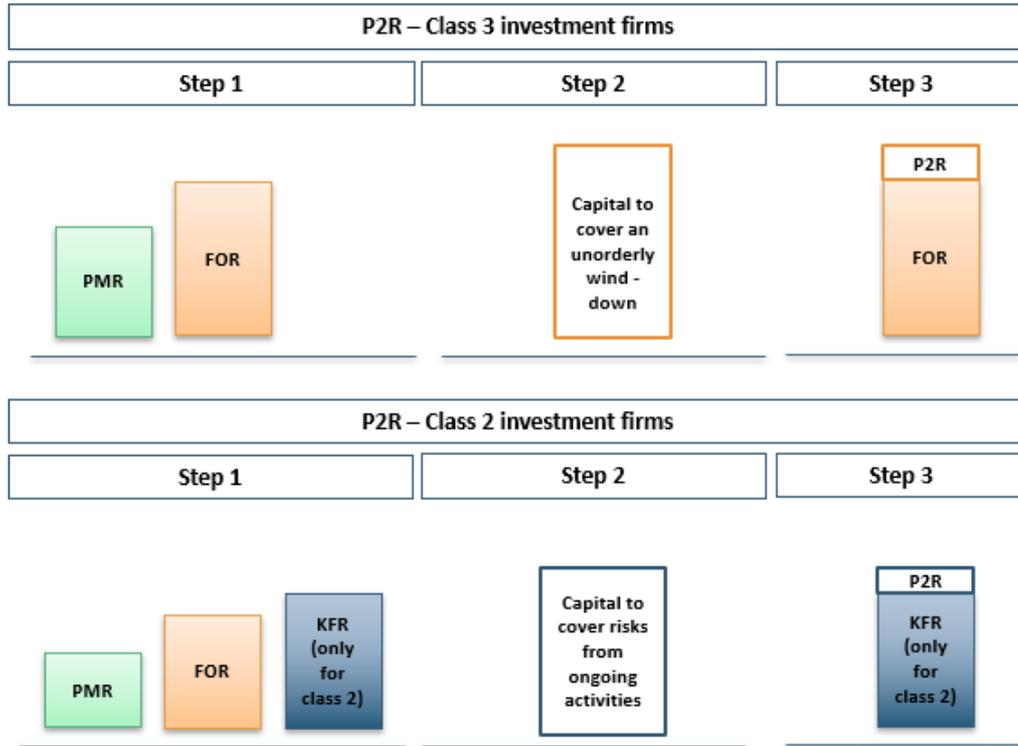
Determination of additional own funds requirement

The EBA considered two policy options regarding the determination of additional own funds requirement:

Option 1a: Determine the Pillar 2 add-on by calculating the capital considered adequate:

- **for class 3 investment firms, only the capital considered adequate to cover the risk of an unorderly wind-down, and**
- **for class 2 investment firms, only the capital considered adequate to cover the risks-to-clients, the risks-to-firm and the risks-to-markets arising from its ongoing activities.**

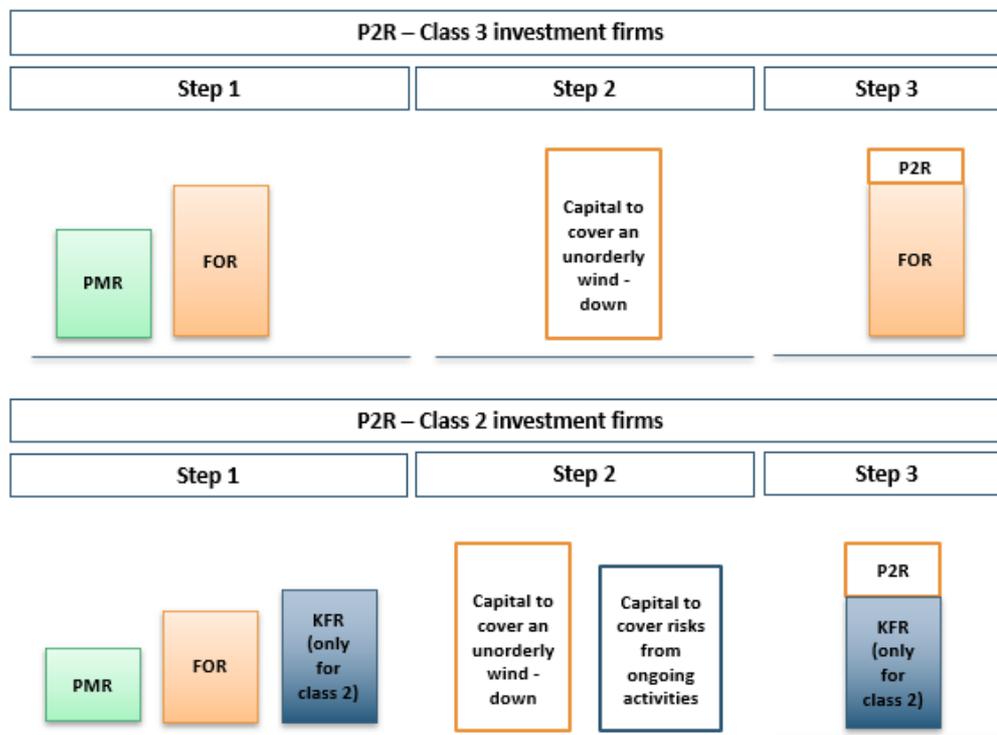
Figure 5: Schematic illustration of Option 1a



Note: The size of the PMR, FOR, KFR and P2R is not meaningful/indicative only.

Option 1b: Determine the Pillar 2 add-on by calculating separately the capital considered adequate (i) to cover all risks and elements of risks arising from the investment firm’s ongoing activities, and (ii) to cover the risk of unorderly wind-down for class 2 firms.

Figure 6: Schematic illustration of Option 1b



Note: The size of the PMR, FOR, KFR and P2R is not meaningful/indicative only.

Option 1a is a simplified approach focusing on K-factor requirement for class 2 investment firms, considering that this is the most risk sensitive part of minimum own funds requirements. However, such approach lacks consistency with the structure of Article 11 of Regulation (EU) 2019/2034, therefore could affect the level playing field and result in the imposition of disproportionate Pillar 2 add-on, considering that an equivalent share of class 2 investment firms is bound by the fixed overheads requirement or by K-factor requirement (see Table 1). Furthermore, such simplified approach may not be sufficiently prudent as not capturing appropriately the risk of unorderly wind-down.

Table 1: Number of investment firms broken down by constraining requirement, by class

Class	PMCR	FOR	K-factors	Total
Class 2	46	80	69	195
Class 3	40	119	-	159
Total	86	199	69	354

Source: 2020 EBA data collection for investment firms and EBA calculations.¹⁰

¹⁰ For more information on the 2020 EBA data collection for investment firms see the [Final draft RTS on prudential requirements for Investment Firms \(EBA/RTS/2020/11\)](#).

Option 1b is consistent with Regulation (EU) 2019/2033 by distinguishing between class 2 and class 3 investment firms, the latter not being subject to K-factors requirement. The structure of minimum own funds requirements as set out in Article 11 of Regulation (EU) 2019/2033 is duplicated under the Pillar 2 framework by distinguishing the capital considered adequate to cover the risks of an unorderly wind-down, and to cover the risks arising from the investment firm’s ongoing activities, the latter being only calculated for class 2 investment firms. Therefore, this option is both more prudent and more proportionate than option 1a.

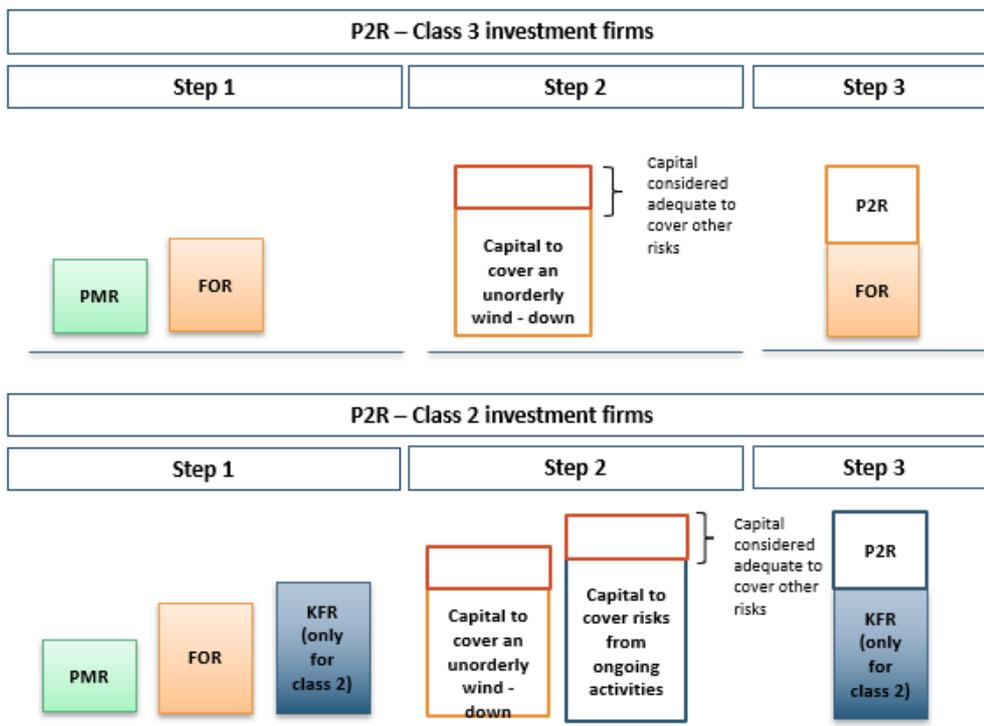
Option 1b is the preferred option.

Determination of additional own funds requirement to cover risks or elements of risks not covered by Pillar 1 requirements

The EBA considered three policy options regarding the determination of additional own funds requirement for risks not covered by own funds requirements set out in Part Three and Four of Regulation (EU) 2019/2033:

Option 2a: Determine the Pillar 2 add-on as the difference between the capital considered adequate, including the capital considered adequate to cover other risks not covered by Pillar 1, and Pillar 1 requirements;

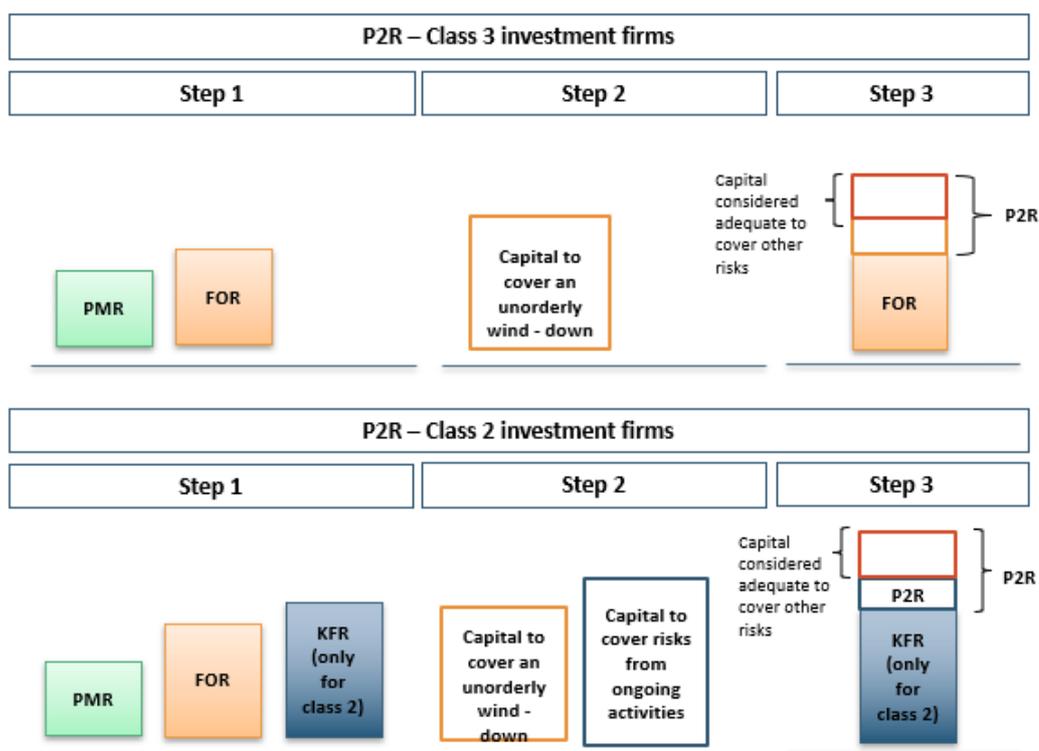
Figure 7: Schematic illustration of Option 2a



Note: The size of the PMR, FOR, KFR and P2R is not meaningful/indicative only.

Option 2b: Isolate the capital considered adequate to cover other risks not covered by Pillar 1 requirements and add it to the difference between the highest between the capital considered adequate to cover an unorderly wind-down or to cover risks arising from ongoing activities and Pillar 1 requirements.

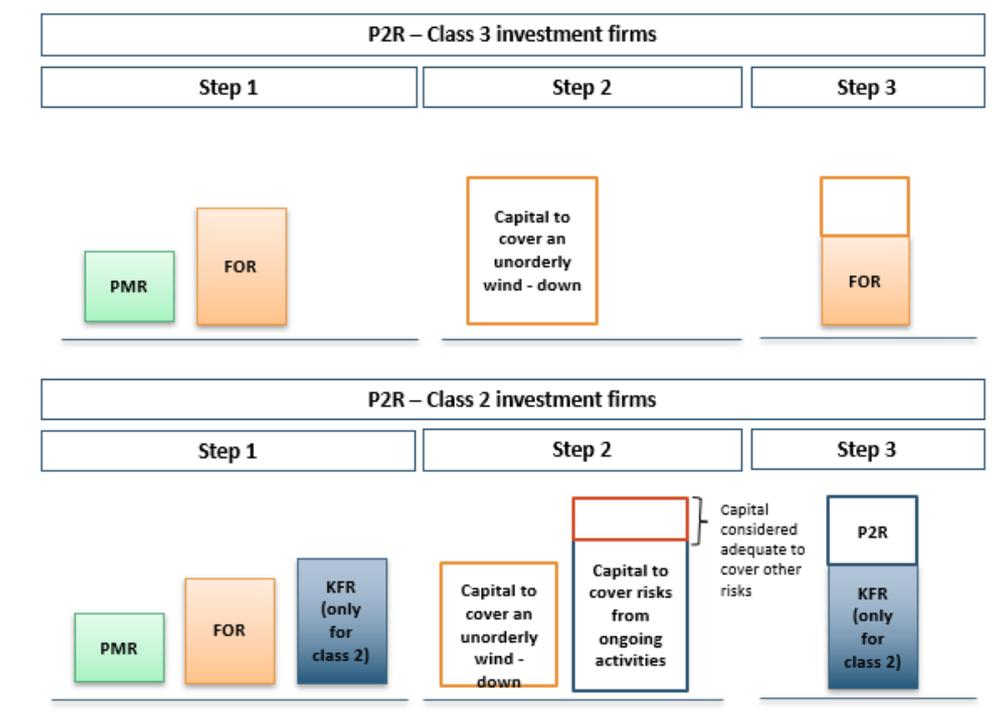
Figure 8: Schematic illustration of Option 2b



Note: The size of the PMR, FOR, KFR and P2R is not meaningful/indicative only.

Option 2c: The Pillar 2 add-on is the result of the difference between the capital considered adequate to cover the risks of an unorderly wind-down or the capital considered adequate to cover risks from ongoing activities, including the capital considered adequate to cover other risks arising from ongoing activities.

Figure 9: Schematic Illustration of option 2c



Note: The size of the PMR, FOR, KFR and P2R is not meaningful/indicative only.

Under option 2a, the Pillar 2 add-on is the difference between the capital considered adequate to cover the risks and elements of risks not covered or not sufficiently covered by own funds requirements set out in Part Three or Four of Regulation (EU) 2019/2033, in line with Article 40(3) of Directive (EU) 2019/2034, in an aggregate manner. Such approach allows to use components of own funds requirements to cover potential material risks that cannot reasonably be attributed to any Pillar 1 requirements.

Under option 2b, the Pillar 2 add-on presents a dual structure. Its first component is computed as the difference between the capital considered adequate to cover the risks and elements of risks not sufficiently covered by own funds requirements set out in Part Three or Four of Regulation (EU) 2019/2033, in line with Article 40(3) of Directive (EU) 2019/2034. Its second component is equal to the capital considered adequate to cover risks that are not covered by own funds requirements. This ensures that any risks the investment firm is facing or poses to others that cannot reasonably be attributed to any own funds requirements are adequately covered by a dedicated Pillar 2 add-on.

Under option 2c, the Pillar 2 add-on is computed, in line with Article 40(3) of Directive (EU) 2019/2034, as the difference between the capital considered adequate, either to cover an unorderly wind-down or to cover risks arising from the investment firm's ongoing activities including risks that are not otherwise covered by own funds requirements set out in Part Three or Four of Regulation (EU) 2019/2033, and Pillar 1 requirements. Considering that risks not covered

by Pillar 1 requirements being risks arising from ongoing activities, such risks do not impact the capital considered adequate to cover an unorderly wind-down.

Option 2c is the preferred option.

Use of indicative qualitative metrics to support the determination of the Pillar 2 add-on

The EBA considered three policy options regarding the use of indicative qualitative metrics to support the identification and assessment of material risks and determination of the Pillar 2 add-on:

Option 3a: Determine a set of mandatory metrics;

Option 3b: Determine a set of mandatory metrics whose application is conditioned to a set of criteria;

Option 3c: Determine a set of optional metrics.

Under option 3a, the draft RTS specify a set of mandatory metrics to support competent authorities in the identification, assessment and quantification of material risks and elements of risks not covered or not sufficiently covered by Part Three or Four of Regulation (EU) 2019/2033. Nevertheless, this option does not adequately capture the terms of the mandate requiring taking into account the range of different business models and legal forms that investment firms may take, as well as the implementation burden on both investment firms and competent authorities.

Option 3b solves the issue stated in option 3a by providing a set of mandatory metrics to support competent authorities in the identification, assessment and quantification of material risks while permitting to adjust or disregard some metrics under specific conditions linked to the size, complexity of activities, business models of the investment firms, as well as the availability of data and implementation burden for both the investment firms and the competent authorities. It therefore ensures harmonisation, while allowing sufficient flexibility to competent authorities to take into account the specificities of the investment firm and other circumstances.

Under Option 3c the draft RTS specify a set of optional metrics to support competent authorities in the identification, assessment and quantification of material risks and elements of risks not covered or not sufficiently covered by Part Three or Four of Regulation (EU) 2019/2033. Nevertheless, leaving full discretion to competent authorities to select the metrics relevant for their analysis would not contribute to consistency of supervisory practices and would not fulfil the mandate granted to the EBA for developing these draft RTS.

Option 3b is the preferred option.

E. Cost-Benefit Analysis

Articles 10 and 16 of Regulation (EU) No 1093/2010 establishing the European Banking Authority (EBA), require the EBA to publish a cost-benefit analysis that will arise from the provisions of the draft RTS.

The proposed regime for supervisory review, through these RTS and the SREP Guidelines for investment firms, is deemed to be more appropriate, consistent, and proportionate to their business model compared to the previously applicable requirements under Regulation (EU) No 575/2013 and Directive 2013/36/EU. Such regime will improve the financial sector overall, reducing the costs associated with any discontinuity of services or with insolvency proceeding, but will also have a positive impact on clients' protection while ensuring the likelihood of restoring clients' positions and therefore reducing the reliance on investor's compensation schemes.

In order to assess the impact of the implementation of the draft RTS, a qualitative survey has been addressed to EU competent authorities. This survey focuses on the costs of implementation of these RTS, considering that their benefits, as abovementioned, will likely build over time. In the absence of available supervisory quantitative information, the EBA did not perform a more detailed quantitative analysis of the respective costs and benefits arising from the implementation of such draft RTS.

The outcomes of the qualitative survey show that most investment firms were previously subject to own funds requirements, including additional own funds requirement, under Regulation (EU) No 575/2013 and Directive 2013/36/EU. Such former treatment allowed for a limited impact in terms of additional own funds requirement that is expected to remain mostly stable after the implementation of such draft RTS. Overall, the implementation costs of the draft RTS are expected to be low to moderate, with the costs of training identified as the main expense.

Proportionality

Data has been collected from competent authorities on the categorisation of investment firms under their remit. The majority of investment firms is expected to be allocated to category 3 and to the category encompassing small and non-interconnected investment firms in accordance with Article 12 of Regulation (EU) 2019/2033, as defined in the SREP Guidelines for investment firms, with the latter appearing as predominant (circa 60% while category 3 should cover circa 35% of investment firms). Such categories of investment firms benefit from a proportionate approach with regard to the determination of additional capital requirement (P2R), and thus the purpose of the proportionality provisions introduced in the draft RTS would be fulfilled.

Expected impact on Pillar 1 requirements



The vast majority of investment firms (circa 76%) were fully or partially subject to requirements under Regulation (EU) No 575/2013 and Directive 2013/36/EU before the entry into force of Regulation (EU) 2019/2033 and Directive (EU) 2019/2034.

The impact on Pillar 1 requirements for investment firms previously subject to Regulation (EU) No 575/2013, except for Article 95, is heterogeneous. Such heterogeneity is explained by the variety of sizes and business activities of the investment firms, mainly belonging to Class 2, as well as by their constraining requirements under Regulation (EU) 2019/2033¹¹, as already confirmed in the EBA draft regulatory technical standards related to the implementation of a new prudential regime for investment firms¹². On the one hand (47% of the responses), mainly considering investment firms subject to permanent minimum capital requirement and fixed overhead requirement, Pillar 1 requirements are expected to be subject to a medium-low decrease. On the other hand (29% of the responses), mainly considering investment firms subject to K-factor requirement, Pillar 1 requirements are expected to be subject to a medium-increase. Such impact on Pillar 1 requirements is measured as the percentage change in Pillar 1 requirements occurring with the implementation of Regulation (EU) 2019/2033 and Directive (EU) 2019/2034.

In contrast with the above, Pillar 1 requirements for investment firms with limited authorisation to provide investment services, previously subject to Article 95 of Regulation (EU) No 575/2013, are expected to remain stable (48% of the responses) or to be subject to a medium decrease (34% of the responses), confirming a more appropriate, consistent, and proportionate regulatory regime for less complex investment firms.

Expected impact on additional own funds requirement

The draft RTS pertains to the determination of additional own funds requirement to cover risks or elements of risk that are not covered or not sufficiently covered by Pillar 1 requirements. In accordance with the provisions of these draft RTS, for investment firms previously subject to Regulation (EU) No 575/2013 and Directive 2013/36/EU, additional own funds requirement should remain globally stable compared to previous level under Regulation (58% of the cases), or slightly increase (26% of the responses). Only 16% of such investment firms are expected to be subject to a medium-high increase of their additional own funds requirement. The new regime under Regulation (EU) 2019/2033 and Directive (EU) 2019/2034 is better aligned with investment firms' business models and risks and therefore improves prudential outcomes. Such increases in additional own funds requirement ensures a better risk coverage at investment firms' level, therefore improving overall confidence in the financial resilience of investment firms among clients, counterparties, and where relevant shareholders.

Costs of implementation

¹¹ A requirement is referred as constraining if it imposes the largest amount of capital requirements among the requirements stated in Article 11 of Regulation (EU) 2019/2034, i.e. the permanent minimum requirement, the fixed overhead requirement, and the K-factor requirement.

¹² [EBA/RTS/2020/11](#)

In 68% of the cases, the estimated total implementation costs encountered by competent authorities are expected to be moderate. Such implementation costs include the time and resources spent by competent authorities familiarising and implementing the provisions of these draft RTS. Among the main costs encountered by competent authorities, training costs are expected to be moderate to high (respectively for 56% and 24% of the respondents). Such training costs encompass information provided to competent authorities, ranging from notes on methodology to oral training. The impact on IT costs is heterogenous among competent authorities. For 36% of the respondents, IT costs remain low. For respectively 36% and 28%, such costs are expected to be moderate to high. In such cases, competent authorities will incur costs updating their IT systems to comply with updated regulatory and supervisory requirements. Such costs are expected to be one-off costs. Other costs incurred by competent authorities are expected to remain moderate to low (for 60% of the respondents). Such costs encompass, for most authorities, the development of policies and methodologies with regard to supervisory assessment, and for few competent authorities, additional labour costs.

Costs of implementation per area

The costs of implementing the provisions of the draft RTS are moderate to low, independently of the type of provision. Some competent authorities (circa 30%) have identified the calculation of qualitative indicative metrics, in accordance with Article 6 of the draft RTS, as the most difficult provision to implement. Taking into account such difficulties, Article 6(6) of the draft RTS allows competent authorities, under certain conditions including burdensomeness, to disregard such metrics.

.4.2 Feedback on the public consultation

The EBA publicly consulted on the draft proposal contained in this report.

The consultation period lasted for three months and ended on 18 February 2022. Five responses were received, all published on the EBA website.

This paper presents a summary of the key points and other comments arising from the consultation, the analysis and discussion triggered by these comments and the actions taken to address them if deemed necessary.

In many cases, several industry bodies made similar comments, or the same body repeated its comments in the response to different questions. In such cases, the comments, and EBA analysis are included in the section of this paper where EBA considers them most appropriate.

Changes to the draft RTS have been incorporated as a result of the responses received during the public consultation.

Summary of key issues and the EBA's response

The main feedbacks to the consultation on the draft RTS touched upon three areas: the assessment of risks that are excluded from own funds requirements, the expression of additional capital requirement (P2R), and the metrics relative to risks-to-clients.

The assessment of risks that are excluded from own funds requirements

Respondents argued that risks not captured by own funds requirements set out in Parts Three and Four of Regulation (EU) 2019/2033 are potential risks arising from the investment firm's ongoing activities. Based on that definition, and to avoid distortion of competition compared to investment firms subject to Regulation (EU) No 575/2013 and to Directive 2013/36/EU, the capital considered adequate to cover such risks should have no impact on the capital considered adequate to cover an unorderly wind-down.

The EBA has revised the draft RTS on that basis. Such revision impacted the P2R computation methodology that shall be determined as the difference between the highest of the capital considered adequate to cover an unorderly wind-down or the total capital considered adequate to cover risks from on-going activities, including other risks not otherwise covered by own funds requirements, and the own funds requirements set out in Part Three or Four of Regulation (EU) 2019/2033.

The expression of P2R

Some respondents contested expressing P2R using a relative amount as it may increase P2R proportionally to any increase of own funds requirements without supervisory assessment. Such expression may be particularly detrimental to trading firms with market making obligation, as any



automatic increase of P2R, notably under stress, may endanger the supply of liquidity in the market. Respondents proposed therefore to express P2R using an absolute expression only.

The EBA removed paragraph 3 of Article 4 on P2R expression as not directly in the mandate of Article 40(3) of Directive (EU) 2019/2034 and maintained guidance on such expression only in the SREP Guidelines for investment firms under Directive (EU) 2019/2034.

The metrics relative to risks-to-clients

One respondent suggested to align the metrics relative to risks-to-clients with the approach taken under the Commission Delegated Regulation (EU) No 231/2013, focusing on the risks of losses or damages to the clients due to negligent performance for which the investment firm is liable.

The EBA has revised the RTS following the approach taken under the Commission Delegated Regulation (EU) No 231/2013.



Summary of responses to the consultation and the EBA's analysis

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Responses to questions in Consultation Paper EBA/CP/2021/34			
Question 1. Do you have any comments on the structure and elements included in this Consultation Paper for the computation of Pillar 2 add-ons?			
Use of information from recovery plans	One respondent considered that Article 1(3) of the draft RTS should be further specified ensuring that recovery plans should only be requested from investment firms under the scope of Directive (EU) 2014/59/EU.	Article 63 of Directive (EU) 2019/2034 amended the definition of investment firms in Directive 2014/59/EU. As a result of such amendment, only the investment firms subject to the initial capital requirement laid down in Article 9(1) of Directive (EU) 2019/2034 are in the scope of Directive 2014/59/EU and shall set up recovery plans.	Article 1(3) of the draft RTS amended clarifying that recovery plans should be requested from investment firms only where applicable.
Assessment of material risks	According to one respondent, despite the headings of Articles 2 and 3 of the draft RTS, it remains unclear if any material risks should be assessed for the determination of additional own funds requirement.	Competent authorities are expected to identify and assess the materiality of each risk the investment firm is exposed to or poses to other, in line with the methodology set out in the EBA SREP Guidelines for investment firms under Directive (EU) 2019/2034. Where identified risks are deemed material by competent authorities and are not covered or not sufficiently covered by Pillar 1 requirements, competent authorities should determine additional own funds requirement, in accordance with Article 40(1)(a) of Directive (EU) 2019/2034.	Articles 2 and 3 amended ensuring that P2R is determined only to cover material risks that are not covered or not sufficiently covered by Pillar 1 requirements.
Materiality assessment	With regard to the assessment of the materiality of the risks the investment firm is exposed to or poses to others, one respondent suggested to factor, in	In line with the mandate in Article 40(6) of Directive (EU) 2019/2034, the draft RTS shall specify how the risks that are material shall be measured for the	No changes.



Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	Articles 2(2) and 3(2) of the draft RTS, the likelihood of the risk occurring.	<p>determination of additional capital requirement. The materiality assessment is therefore out of the scope of such draft RTS.</p> <p>Nevertheless, in line with the current provisions of the EBA SREP Guidelines for investment firms under Directive (EU) 2019/2034, competent authorities should assess and score the material risks the investment firms are exposed to or poses to others. The assessment and score should reflect the likelihood of the risks materialising.</p>	
IRRBB calculations	One respondent sought confirmation that there is no obligation for investment firms to set up interest rate risks calculation for non-trading book activities, unless legally requested.	<p>Mandatory framework on interest rate risks for banking book (IRRBB) has been introduced neither in the Regulation (EU) 2019/2033 nor in the Directive (EU) 2019/2034. There is therefore no obligation for investment firms to introduce IRRBB calculation in their risk management framework.</p> <p>Nevertheless, investment firms are encouraged to have in place sound, effective and comprehensive internal arrangements, strategies, and processes to assess and maintain on an ongoing basis the amounts, types, and distribution of internal capital that they consider adequate to cover such risk within their ICARAP, in accordance with Article 24 of Directive (EU) 2019/2034.</p>	No changes.
Capital considered adequate for risks not captured by Pillar 1 requirements	The respondents argued that risks not captured by the own funds requirements set out in Parts Three and Four of Regulation (EU) 2019/2033, as presented in the draft RTS, are potential risks arising from the investment firm's ongoing activities.	In accordance with Article 3 of the draft RTS and Title 6 of the SREP Guidelines for investment firms under Directive (EU) 2019/2034, risks or elements of risk not captured by the own funds requirements set out in Parts Three and Four of Regulation (EU) 2019/2033	Articles 3 and 4 amended.



Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>Therefore, in cases where competent authorities determine capital considered adequate to cover such risks, such capital should only be added to the capital considered adequate to cover risks from on-going activities. The respondents considered that such risks should not be considered while computing the capital considered adequate to cover an unorderly wind-down, as this may overestimate actual wind-down costs and distort competition with other investment firms, notably the ones subject to the Regulation (EU) n° 575/2013 and to the Directive 2013/36/EU.</p>	<p>are risks or elements of risk deriving from any of the investment firm’s ongoing activities. As such, the capital considered adequate to cover such risks shall be added to the capital considered adequate to cover risks from on-going activities calculated in accordance with Article 2 of the draft RTS.</p> <p>On that basis, additional capital requirement shall be determined as the difference between the highest of the capital considered adequate to cover an unorderly wind-down or the total capital considered adequate to cover risks from on-going activities and the own funds requirements set out in Part Three or Four of Regulation (EU) 2019/2033.</p>	
<p>Classification of risks not captured by Pillar 1 requirements</p>	<p>The respondents sought clarifications on the types of risks considered not captured by Parts Three and Four of Regulation (EU) 2019/2033.</p> <p>More particularly, the respondents expressed concerns on operational risks and ICT risks as being considered as risks not covered by K-Factor requirement. Some respondents remarked that operational risks of investment firm dealing on own account or executing orders on behalf of clients in its own name, including ICT risks, are covered by K-DTF.</p>	<p>Risks that are not covered by Parts Three and Four of Regulation (EU) 2019/2033 are investment firm-specific, depending on its business and operating model. Since the provisions of the draft RTS apply to all investment firms, a specific list of risks cannot be provided in the draft RTS. Nevertheless, competent authorities are expected to assess, in accordance with Article 36 of Directive (EU) 2019/2034, at least risks posed to the security of the investment firm’s network and information systems and interest rate risk arising from non-trading book activities.</p> <p>While K-DTF, in accordance with recital 26 of Regulation (EU) 2019/2033, captures operational risks relating to the value of trading activities an investment firm conducts, such K-factor does not cover the whole scope of IT risks the investment firm</p>	<p>No changes.</p>



Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		may face, requiring competent authorities to perform additional supervisory assessment.	
ICT risks	One respondent suggested reviewing the provisions relating to the internal risk management requirements of supervised entities regarding ICT risks and activities since it will be specified in the new Regulation on digital operational resilience for the financial sector (DORA).	The EBA will issue further guidance in line with the mandates received in the upcoming Directive.	No change.
P2R expression	<p>Some respondents contested any automatic increase of P2R, without supervisory assessment. Such potential automatic increase is linked to the proposed P2R expression in the draft RTS and in the SREP Guidelines for investment firms under Directive (EU) 2019/2034, using both an absolute and a relative amount, with the highest of the two being, at all times, the effective additional capital requirement. An increase of own funds requirements determined in accordance with Parts Three and Four of Regulation (EU) 2019/2033 will therefore automatically increase the investment firms' P2R.</p> <p>Such respondents remarked that this proposal would be particularly detrimental to trading firms with market making obligations, whose capital requirements vary depending on trading volumes and market volatility, notably in case of stress by impeding their business and endangering the supply of liquidity in the market.</p>	<p>While Article 40(3) of Directive (EU) 2019/2034 specifies the determination of additional capital requirement, the Directive is silent on the expression of such additional capital requirement. To achieve higher degree of harmonisation and ensure level playing field, such expression should be clarified. As the mandate in Article 40(6) of Directive (EU) 2019/2034 does not include any provisions relative to the expression of P2R, such expression should be clarified exclusively in the SREP Guidelines for investment firms under Directive (EU) 2019/2034.</p> <p>The SREP Guidelines for investment firms require expressing additional capital requirement using both an absolute and a relative amount, as a percentage of own funds requirements determined in accordance with Article 11 of Regulation (EU) 2019/2033. On the one hand, the relative expression allows for additional capital requirement to properly reflect changes in business activities and in the riskiness of an investment firms, translated into an increase in Pillar 1 requirements. On the other hand, the</p>	Article 4 paragraph 3 deleted.



Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>Moreover, one respondent noted that this proposal is not fully in line with Article 40(3) of Directive (EU) 2019/2034, defining P2R as an absolute amount resulting from the difference between the capital considered adequate to cover risks or elements of risks not covered by own funds requirements and the own funds requirements set out in Parts Three or Four of Regulation (EU) 2019/2033.</p>	<p>absolute amount sets an adequate minimum level of additional capital requirement to be complied with at all times, especially for the years where SREP assessment is not conducted.</p> <p>The EBA is aware of the different business and operating models of investment firms within the EU and their sensitivities to various macroeconomic scenarios. However, the methodology for the determination of additional capital requirement should neither be firm-specific nor scenario-specific.</p> <p>Competent authorities should, at any time, perform an ad hoc SREP assessment and review P2R to take into account investment firm-specific circumstances.</p>	
<p>Question 2. Do you agree with the proposed indicative qualitative metrics? Are there any other aspects or situations not sufficiently taken into account in this proposed approach?</p>			
<p>Metrics covering risks-to-client</p>	<p>One respondent suggested to use a more general approach regarding the indicative qualitative metrics covering risks-to-client, as disclosed in Article 6(2) of the draft RTS. Such general approach should align with the approach taken under the Commission Delegated Regulation (EU) No 231/2013, focusing on the risk of losses or damages caused by a relevant person through the negligent performance of activities for which the investment firm has legal responsibility and which are not already covered by Parts Three and Four of Regulation (EU) 2019/2033.</p>	<p>While assessing risk-to-clients, competent authorities shall consider liability risks arising from breaches of the investment firm’s legal or contractual obligations. This is the risk that an investment firm can incur a liability to compensate a third party for its financial losses arising from such breach.</p> <p>Such liability risks could occur broadly due to two categories of events. The first category covers liability risks in relation to the business and investors, such as providing unsuitable advice. The second category covers the breach of legal and regulatory rules that would include the breach of the investment mandate or the failure to prevent by means of adequate</p>	<p>Article 6(2) amended gathering under one indicator the different situations where professional liability risks could occur.</p>



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		internal control procedures. The draft RTS has been amended taking a more general approach with regard to professional liability risks.	
Metrics covering risks-to-client	One respondent contested the use of the metrics <i>'the amount of assets under management'</i> , as disclosed in Article 6(2)(c) of the consultation paper on the draft RTS. Such respondent considers that such metrics should not support competent authorities to identify risks that are not covered or not sufficiently covered by Part Three of Regulation (EU) 2019/2033, as K-AUM is computed on a volume basis. The respondent applied the same reasoning with regard to the metrics disclosed in Articles 6(2)(a) and 6(2)(c), respectively <i>'the amount of client money held'</i> and <i>'the amount of assets safeguarded and administered'</i> .	<p>The indicator <i>'the amount of assets of clients under management over the past five years'</i> is covering both the level of assets under management and its evolution through time. Such indicator therefore aims at capturing potential significant variations of assets under management that could increase the risk of operational events, such as frauds, that are unusual in nature, and may therefore not covered by K-AUM. Moreover, such indicator aims at supporting competent authorities in their assessment and shall not trigger any automatic determination of additional capital requirement.</p> <p>The same reasoning applies to the indicators <i>'the amount of assets safeguarded and administered for clients over the past five years'</i> and <i>'the amount of client money held over the past five years'</i>. Moreover, competent authorities should also assess any potential risks arising from client money or asset safeguarded and administered detained in the context of non-MiFiD business.</p>	No changes.
Metrics covering risks-to-client	One respondent contested the use of the metrics <i>'the number of unsuitable investment advices and associated clients' compensation'</i> , as disclosed in Article 6(2)(g) of the consultation paper on the draft RTS. Such respondents suggested to link the risk of unsuitable advice on which the investment firm is	The indicator <i>'the number of clients complaints and amount of clients' compensations over the past five years'</i> aims at tackling losses or damages caused by negligent performance, notably misrepresentations or misleading statements made to the investors, on which the investment firm is liable over time.	Article 6(2) amended, enriching the list of indicative metrics as a support for competent



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	<p>liable with a potential failure to establish, implement and maintain sound and appropriate internal standards to prevent such situations.</p>	<p>Nevertheless, the EBA acknowledges the importance for the investment firm to establish, implement and maintain sound and appropriate policies and procedures to prevent any fraudulent or dishonest acts. The absence of such policies and procedures shall therefore complete the proposed indicators, as a trigger of potential competent authorities' assessment.</p>	<p>authorities' assessment.</p>
ICT risks metrics	<p>The respondents suggested to remove the ICT risks metrics from Article 6(5)(b) of the consultation paper on the draft RTS, as ICT risks should not be considered as not captured by Parts Three or Four of Regulation (EU) 2019/2033.</p>	<p>In accordance with Article 36 of Directive (EU) 2019/2034, competent authorities should assess separately the risks posed to the security of investment firms' network and information systems to ensure confidentiality, integrity, and availability of their processes, data, and assets. Such risks therefore dispose of specific metrics supporting competent authorities to evaluate the materiality of the risks and potentially determine additional capital requirements.</p> <p>While K-DTF, in accordance with recital 26 of Regulation (EU) 2019/2033, captures operational risks relating to the value of trading activities an investment firm conducts, such K-factor does not cover the whole scope of IT risks the investment firm may face, requiring competent authorities to perform additional supervisory assessment.</p>	<p>No changes.</p>

