

EBA/RTS/2022/11

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Final report

Draft regulatory technical standards on specific liquidity measurement for investment firms in accordance with Article 42(6) of Directive (EU) 2019/2034

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1. Executive summary

In accordance with Article 42(1) of Directive (EU) 2019/2034 (IFD), competent authorities may impose specific liquidity requirements on an investment firm based on the outcome of the supervisory review and evaluation process (SREP).

Article 42(6) of the IFD mandates the EBA to develop draft regulatory technical standards to specify, how the liquidity risk and elements of liquidity risk are to be measured in a manner that is appropriate to the size, structure and internal organisation of investment firms and the nature, scope and complexity of their activities.

The EBA has therefore developed these draft regulatory technical standards (RTS) with the aim of establishing a harmonised approach that defines the relevant elements of liquidity risk to be considered for the purposes of the specific liquidity requirements.

These draft RTS set out all-encompassing elements that may raise major concerns in respect of investment firms' liquidity risk and which the competent authorities shall take into account when assessing the materiality of those risks. The assessment aims to ensure that an investment firm maintains adequate levels of liquid resources in respect of addressing liquidity risk that may impact the investment firm itself and ultimately markets and clients.

These draft RTS acknowledge that these elements should be assessed independently as well as considering the interconnectedness of an investment firm's exposures to liquidity risk related to its market, operational and credit risks. Specifically, such elements relate to liquidity risk stemming from trading activities, loss of income from portfolio management, funding, external events, operational events, reputational risk, inadequate management or controls on liquidity risk and certain dependencies on the group structure. In general, competent authorities are required to consider those elements under normal, as well as stressed conditions.

The assessment of the elements of liquidity risk is risk-based and in certain cases may lead to a burdensome process. Therefore, in order to ensure proportionality, competent authorities should be required to assess only a smaller range of elements in relation to small and non-interconnected investment firms.

Next steps

The draft regulatory technical standards will be submitted to the Commission for endorsement following which they will be subject to scrutiny by the European Parliament and the Council before being published in the Official Journal of the European Union. The technical standards will apply from 20 days after the publication in the Official Journal.

2. Background and rationale

1. Background

1. Liquidity requirements are set out on a risk-based approach in Part V of Regulation (EU) 2019/2033 of the European Parliament and of the Council¹ and supervised in accordance with Directive (EU) 2019/2034 of the European Parliament and of the Council². Article 42(1) of Directive (EU) 2019/2034 states that competent authorities may impose specific liquidity requirements on investment firms that are exposed to liquidity risk or elements of liquidity risk that are material and are not covered, or not sufficiently covered, by the liquidity requirements set out in Regulation (EU) 2019/2033. Furthermore, competent authorities may impose specific liquidity requirements on investment firms that do not meet the liquid assets and governance requirements set out in Articles 24 and 26 of Directive (EU) 2019/2034, respectively, where other administrative measures are unlikely to sufficiently improve the arrangements, processes, mechanisms, and strategies within an appropriate timeframe.

2. Regulatory approach within the draft RTS

2. These draft RTS specify how the liquidity risk and elements of liquidity risk referred to in Article 42(2) of Directive (EU) 2019/2034 are to be measured, acknowledging that the exposure of an investment firm to liquidity risk is strongly connected with the activities it performs. Therefore, the draft RTS cover individually each core service³ of Directive 2014/65/EU⁴ of the European Parliament and of the Council and specify the elements those competent authorities should assess.
3. Special emphasis is devoted to investment firms authorised to deal on own account or underwriting on a firm commitment basis. That is because, losses of assets' value due to price fluctuations are most relevant to liquidity risk when an investment firm holds assets on its own account on its own name or for its clients. Nonetheless, liquidity risk may be influenced by an investment firm's exposure to other risks, such as credit, operational or reputational risks.

¹ Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014 (OJ L 314, 5.12.2019, p. 1)

² Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU (OJ L 314, 5.12.2019, p. 64)

³ Annex I, Section A of Directive 2014/65/EU.

⁴ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU Text with EEA relevance (OJ L 173, 12 June 2014, p. 349)

4. Operational risk may affect an investment firm's liquidity when an investment firm is unable to trade, to issue commercial paper or to access credit lines, but also because it exposes the assets to legal risk, including fraud, which may lead to liquidity risk.
5. Reputational risk affects liquidity, when, for example, market counterparties reduce their exposure to the investment firm in over-the-counter operations that provided liquidity to the investment firm through cash or collateral.
6. Since all these risks are strongly interconnected, competent authorities, when setting specific liquidity requirements, should also assess the possible combined impact of these risks on the liquidity of an investment firm.
7. Among the ancillary services specified in Directive 2014/65/EU,⁵ only 'providing credit and loans to investors' is explicitly addressed in the draft RTS because of the relevance it might have in the liquidity management of an investment firm. In practice, investment firms may grant credit and loans to investors, exposing these firms to specific liquidity risk connected to the volatility of the value of the collaterals and the default of the borrowers. The other ancillary services are usually considered not significant and the draft RTS do not envisage specific assessments.
8. Investment firms' funding is different from credit institutions since the latter have a different source of funding via clients' deposits. An investment firm's funding comes from external or internal sources, which may be less stable or of variable nature in terms of access, security, price, credit sensitivity and maturity. Therefore, the draft RTS envisage that the liquidity risk that stems from an investment firm's liabilities should make up part of the overall assessment.
9. Furthermore, competent authorities should consider not only normal market conditions in which funding is expected to be stable, but also stressed conditions. Such conditions, to be considered for the whole market or specific to an investment firm, may lead to losing access to funding. Certain severe, but still plausible, conditions may not only affect investment firms' access to stable funding, but also have an impact on liquidity due to asset depreciation. Therefore, a competent authority should consider macroeconomic, including geopolitical, and microeconomic situations where an investment firm provides services, or has exposures, on its own account or in clients' names.
10. An investment firm belonging to a group may carry out significant activities or may have concluded arrangements that may affect the investment firm's liquidity, such as profit and loss transfer agreements, with its parent or other entities within the group. These exposures should be reflected in the assessment of the investment firm's specific liquidity requirement.
11. In accordance with Article 24 of Directive (EU) 2019/2034, an investment firm should have, proportionally to the complexity of its activities, a liquidity management framework in place to enable the monitoring, control and assessment of its liquidity at all times. Such framework

⁵ Annex I, Section B of Directive 2004/39/EC.

should include sound processes, systems and arrangements such as documented procedures, clearly defined reporting lines and internal control mechanisms. Competent authority should therefore assess failures or limitations in the liquidity management framework of an investment firm in order to determine specific liquidity requirements.

12. Small and non-interconnected investment firms offer a limited set of services, and their liquidity risk is often limited when compared to other investment firms. To ensure that these draft RTS introduce a proportional approach to the specific liquidity measures, when assessing the liquidity risk of a small and non-interconnected investment firm, competent authorities are required to consider only a limited set of elements.

3. Draft regulatory technical standards on the specific liquidity measurement for investment firms in accordance with Article 42(6) of Directive (EU) 2019/2034

COMMISSION DELEGATED REGULATION (EU) No .../..**of XXX****supplementing Directive (EU) 2019/2034 of the European Parliament and of the Council with regard to regulatory technical standards on the specific liquidity measurement for investment firms under Article 42(6) of Directive (EU) 2019/2034**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU⁶, and in particular Article 42(6) thereof,

Whereas:

- (1) To ensure that competent authorities apply for the purposes of Article 42(1), point (a) of Directive (EU) 2019/2034 a common approach in addressing all the relevant elements of liquidity risk, this Regulation clarifies how liquidity risk, and elements affecting this risk, should be measured depending on the size, structure and internal organisation of investment firms and the nature, scope and complexity of their activities.
- (2) To ensure proportionality, the common approach laid down in this Regulation for the assessment of the elements of liquidity risk, should be risk-based and should provide the minimum criteria for the assessment. To that end, this Regulation specifies that the assessment of the liquidity risk elements should be performed by the competent authorities based on size, structure and internal organisation of the investment firm and whilst also having regard to the nature, scope and complexity of that firm's activities.
- (3) This Regulation requires the assessment of elements of liquidity risk that are deemed material for investment firms. However, to further ensure proportionality, the 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 of the European Parliament and of the Council⁷ have a limited liquidity risk relative to other investment

⁶ Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU (OJ L 314, 5.12.2019, p. 64)

⁷ Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014 (OJ L 314, 5.12.2019)

firms because of the limited set of services they offer and the volume of their activities. Against this background, this Regulation provides that, for these firms, competent authorities should at a minimum assess the liquidity risk stemming from a limited set of activities. This assessment should cover the investment firm's loss in income from providing portfolio management, the liquidity risk from operating an MTF or OTF, the liquidity risk from granting credits and loans to investors, the funding risk, and the group structure's relevance to liquidity risk.

- (4) Paragraph 3 of Article 7 of the Regulation (EU) 2019/2033 lays down that the application of the liquidity requirements set out in Part Five of that Regulation also apply at consolidated level. As for a single investment firm, a union parent may be exposed, in a consolidated situation, to liquidity risk or elements of liquidity risk that are material and are not covered or not sufficiently covered by those liquidity requirements. Similarly, a union parent may not meet, in a consolidated situation, the requirements set out in Articles 24 and 26 of Directive (EU) 2019/2034 whilst other administrative measures are unlikely to sufficiently improve the arrangements, processes, mechanisms and strategies within an appropriate timeframe. Therefore, there is a need for the competent authorities to apply this Regulation on a consolidated basis.
- (5) Several activities performed by investment firms may affect their liquidity profile. Therefore, this Regulation should provide specific criteria for each service or activity listed in Annex I, Section A of Directive 2014/65/EU of the European Parliament and of the Council⁸ that competent authorities should consider when assessing the liquidity risk of an investment firm. Changes in the value of asset prices may generate losses and affect investment firms' balance sheets and liquidity position, despite these firms not holding clients' assets on own account. Firms providing portfolio management services may be sensitive to market fluctuations that can create or sharpen the cash flow mismatches between inflows from payment of fees typically received on a quarterly or semi-annual basis and outflows for the payment of liabilities as they fall due. Against this backdrop, this Regulation provides that competent authorities should factor in this increased risk for investment firms providing certain investment services or performing activities that are most sensitive to market fluctuations.
- (6) Investment firms that are authorised to grant credits or loans to investors as an ancillary service are exposed to specific liquidity risk: late repayment of debts by investors may impair the firm's ability to meet its obligations, while the liquidation of collaterals with deteriorated liquidity profile may result in lower liquid assets to deploy on ordinary operations. Therefore, competent authorities should assess the increased risk for investment firms performing this service.
- (7) Funding is a primary source of liquidity for an investment firm and limited or suspended access to it may result in the discontinuation of its services, with a potential negative impact on markets and clients. Having regard to the different nature of the funding of an investment firm compared to the funding one of a deposit-taking credit institution and to the fact that accessing funding by this firm may entail risks in certain circumstances, this Regulation specifies the elements that competent authorities should take into account when setting specific liquidity requirements.

⁸ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014)

- (8) The adverse deterioration of macroeconomic and geopolitical situations may lead an investment firm to face severe restriction in accessing funding. Competent authorities should therefore assess the consequences that the occurrence of those conditions might have on the funding sources of an investment firm, including wholesale funding and credit lines. Against this background, this Regulation specifies the elements to be assessed by the competent authority in correspondence to external events, whose occurrence may increase the liquidity risk of an investment firm.
- (9) To enable competent authorities to determine operational events may have a material impact on the investment firm's liquidity, this Regulation identifies those events expected to be the most relevant for investment firms as a subset of the list of operational risk events in Article 324 of Regulation (EU) No 575/2013 of the European Parliament and of the Council⁹. However, in order to reduce the burden for competent authorities and investment firms, competent authorities should not be expected to assess all the event types in that list. Therefore, this Regulation does not include in the assessment those operational risk events that are expected to be less material for investment firms.
- (10) Increased liquidity risk may arise from reputational risk, which may in turn affect the operations of an investment firm. While some effects of the reputational risk are not readily predictable, others, like reduced market access or accessing liquidity from counterparties, are foreseeable and their potential impact on the liquidity risk of an investment firm should be assessed by the competent authority.
- (11) Liquidity risk should be closely monitored by an investment firm, given its potential impact on its functioning. In accordance with Article 29 of Directive (EU) 2019/2034, an investment firm should have in place sound strategies, policies and processes, which includes monitoring of liquidity risk and confronting liquidity shortages. Therefore, this Regulation provides the elements that competent authorities should assess in order to evaluate the effectiveness of the liquidity risk management and control of an investment firm.
- (12) Whereas a group, as defined in point (11) of Article 2 of Directive 2013/34/EU, may provide additional liquidity to an investment firm, it might also use significant parts of liquid resources belonging to the firm through agreements and other asset-transfer mechanisms between. In that context, this Regulation lays down that competent authorities should assess the overall group structure and consider the implications that such agreements and other asset-transfer mechanisms may have on the liquidity risk of the investment firms that are part of a group.

This Regulation is based on the draft regulatory technical standards submitted to the Commission by the European Banking Authority.

The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the advice of the Banking Stakeholder Group

⁹Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013)

established in accordance with Article 37 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council¹⁰,

HAS ADOPTED THIS REGULATION:

Article 1

Liquidity risk and elements of liquidity risk justifying specific liquidity requirements

1. The specific liquidity requirement referred to in Article 42 of Directive 2019/34 shall be measured by determining, the adequate amount of liquid assets that an investment firm should hold in order to cover liquidity needs resulting from the factors and liquidity risk elements listed in paragraph 2.
2. Competent authorities, taking into account the size, scope and complexity of the investment firm's activities, shall assess, at a minimum:
 - (a) liquidity risk stemming from the provision of investment services, and activities and specific ancillary services in accordance with Article 2;
 - (b) liquidity risk stemming from the unavailability of funding resources in accordance with Article 3;
 - (c) external events affecting liquidity in accordance with Article 4;
 - (d) operational risk affecting liquidity in accordance with Article 5;
 - (e) reputational risk affecting liquidity in accordance with Article 6;
 - (f) inadequate management and controls of liquidity risk in accordance with Article 7; and
 - (g) the structure of the group as defined in Article 3(1), point (13), of Directive (EU) 2019/2034 and its impact on liquidity.

For 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, competent authorities shall, at a minimum, assess points (a), (b) and (g), while the assessment under point (a) may cover solely liquidity risk stemming from loss in income from portfolio management, liquidity risk from operating a multilateral trading facility or an organised trading facility as defined respectively in points (22) and (23) of Article 4.1 of Directive 2014/65/EU of the European Parliament and of the Council, and from granting credits or loans to investors.

¹⁰ 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).

3. The assessment referred to in paragraph 2 shall:
- (a) take into account all the elements which may have a material adverse effect on an investment firm's liquidity needs under normal and stressed circumstances, where stressed conditions shall be understood as covering market stress and stress inherent to an investment firm where funding may not be accessible on a timely or cost-effective basis.
 - (b) take into account the available historical data on: (i) mismatches between liquid assets or other liquidity resources and liquidity needs, (ii) the historical trends in liquidity capacity (iii) the observed material variations of liquid assets and liquidity needs for a period of time over which, sufficient information is available.
 - (c) take into account the existence of contractual netting agreements subject to the conditions laid down in Article 31 of Regulation (EU) 2019/2033 or other risk mitigation mechanisms that would effectively reduce the potential net liquidity outflow an investment firm has towards central counterparties, clearing members, credit institutions or other investment firms;
 - (d) determine whether the investment firm has sound processes, mechanisms and strategies in order to measure, monitor and manage its liquidity risk as set out in Articles 24 and 26 of Directive (EU) 2019/2034;
 - (e) have regard to potential interconnections among the factors referred to in paragraph 2;
 - (f) be based on reliable, accurate and up to date information.
4. When article 7(3) of Regulation (EU) 2019/2033 of the European Parliament and of the Council applies, competent authorities assessing the union parent investment firm, union parent investment holding company, or union parent mixed financial holding company's liquidity risks and elements of liquidity risk on the basis of their consolidated situations, shall apply Articles 2 to 7 of this Regulation.

Article 2

Liquidity risk stemming from the investment services and activities and ancillary services

1. For investment firms providing any of the services or performing any of the activities of Annex I, Sections A and B, point (2) of Directive 2014/65/EU, competent authorities shall assess the level of liquidity needs that need to be covered by liquid assets by taking into consideration all the criteria in paragraphs 2 to 6 of this Article.

2. For investment firms performing any of the activities of Annex I, Section A, points (1) and (2) of Directive 2014/65/EU, when assessing the liquidity needs in accordance with paragraph 1, competent authorities shall consider:

- (a) the specific features of the services provided to clients, in particular the time mismatch between fees received by clients and fees paid to trading platforms for transmission or execution of orders on behalf of clients;
- (b) the liquidity outflow due to increased fees charged to access the trading platforms, or due to less favourable arrangements such as reduced days of accounts payable by the investment firm;
- (c) delays in the payment of fees due from clients.

3. For investment firms performing any of the activities referred to in Annex I, Section A, point (3) or (6) of Directive 2014/65/EU, competent authorities shall consider:

- (a) the assessment of intraday liquidity risk for their trading book positions;
- (b) the liquidity risk arising from the risk of a price change of the instrument concerned due to factors related to its issuer or the issuer of the underlying instrument and from the price change of an instrument due to a change in the level of interest rates or to a broad equity market movement unrelated to any specific attributes of the individual securities;
- (c) the specific features of the trading activities, in particular the maturity profile of the transactions, the possible occurrence of long-term transactions and the currencies of the transactions;
- (d) the level of asset encumbrance, the characteristics of the collateral to be provided, in particular its maturity and currency, and whether assets provided as collateral can be re-used or rehypothecated by the investment firm's counterparties;
- (e) the level of intraday margin that the investment firms may be required to post under normal and stressed circumstances;
- (f) the availability of sufficient liquid assets or other liquidity resources to maintain trading activities in case of settlement fails or interruption of services at custodians or cash correspondents; and
- (g) the failure of a trade to settle on the agreed settlement date either because the seller does not deliver the securities or because the buyer does not deliver funds at the appropriate time;

4. For investment firms performing any of the activities of Annex I, Section A, points (4), (5) and (7) of Directive 2014/65/EU, when assessing the liquidity needs in accordance with paragraph 1, competent authorities shall consider:

- (a) the contractual arrangements regarding fees received related to the performance of the clients' portfolios;
- (b) the time mismatch between fees received from clients and fees paid to providers of services such as market analysis, specialised reports, general or customised portfolio analysis, and aggregation services;
- (c) when the investment firm delegates the management of assets, the time mismatch between fees received from clients and fees paid to the delegated financial entity;
- (d) when another financial entity has formally delegated the management of assets to the investment firm, the time mismatch between fees received from the delegating entity and expenses paid by the investment firm in relation to the delegation;
- (e) contractual arrangements between the investment firm and the tied agents, including the timing of the payments and the recurrence of fees;
- (f) delays in the payment of fees due from clients.

5. For investment firms performing any of the activities of Annex I, Section A, points (8) and (9) of Directive 2014/65/EU, when assessing the liquidity needs in accordance with paragraph 1, competent authorities shall consider:

- (a) the time mismatch between fees received from clients and fees paid to service providers;
- (b) delays in the payment of fees due from clients.

6. For investment firms performing the ancillary service of Annex I, Section B, point (2) of Directive 2014/65/EU, when assessing the liquidity needs in accordance with paragraph 1, competent authorities shall consider:

- (a) the outstanding amount of credits and loans granted to clients;
- (b) the liquidity profile of the collaterals, and the market and legal limits to their liquidation;
- (c) the outstanding amount of defaulted credits and loans granted to clients.

Article 3

Liquidity risk stemming from funding

1. When assessing the availability and quality of the funding sources of an investment firm, competent authorities shall consider:

- (a) the availability of existing funding sources and the access to pre-arranged emergency funding sources;
- (b) whether such funding sources are secured or unsecured;

- (c) the currency of such funding sources;
- (d) the amount of unencumbered assets that would be available to obtain secured funding;
- (e) the different maturities of such funding sources according to the closest of their maturity date and the earliest date at which they can contractually be called upon;
- (f) the risk of disruption to the investment firm's daily cash flows caused by an interruption in the investment firm's credit facilities; and
- (g) other committed but undrawn funding sources provided to the investment firm.

Article 4

External events affecting liquidity

1. Competent authorities shall assess whether the investment firm's liquidity level would allow it to continue to comply with its liquidity requirement in adverse macroeconomic, microeconomic, and geopolitical conditions.
2. When assessing the conditions referred to in paragraph 1, competent authorities shall consider, at a minimum, the following scenarios in order to assess the adequacy of the liquidity requirement of the investment firm under stressed conditions:
 - (a) a partial or total loss of unsecured funding capacity, including received committed or uncommitted liquidity or credit lines;
 - (b) a partial or total loss of secured, short-term funding;
 - (c) potential obligation to buy-back debt or to honour non-contractual obligations.
3. In assessing such external events, competent authorities shall consider a combination of market-related events and idiosyncratic stresses related to the situation of the issuers of the investment firm's assets or related to the funding providers of the investment firm.
4. Where the investment firm is part of a group, competent authorities shall determine how the adverse conditions referred to in paragraphs 2 and 3 may affect the liquidity situation of the group as a whole and the conclusions of the assessment performed under Article 8 of this Regulation.

Article 5

Operational risk affecting liquidity

Competent authorities shall assess the consequences of any of the following operational events on the investment firm's liquidity:

- (a) unavailability of the investment firm's systems used to access the market or funding sources;

- (b) interruption of services at custodians and cash correspondents;
- (c) external or internal frauds; and
- (d) compensations and claims related to order execution errors.

Article 6

Reputational risk affecting liquidity

Competent authorities shall assess how any of the following events related to a loss of reputation can affect the investment firm's liquidity risk:

- (a) the investment firm's market access is reduced;
- (b) the investment firm's funding sources are reduced by its counterparties;
- (c) market counterparties reduce their exposures to the investment firm in over-the-counter operations.

Article 7

Sound management and controls of liquidity risk

Competent authorities shall assess whether an investment firm has robust and sound risk management and controls of its liquidity resources in place, as set out in Articles 24 and 26 of Directive (EU) 2019/2034. Competent authorities shall consider at least:

- (a) the systems for measuring, managing and reporting liquidity risk and its governance framework, including the adequacy of the risk management function;
- (b) any mitigating actions, including the reduction of activities requiring large cash outflows, the setup of credit lines, the capital increase in cash and the use of assets as collateral in repo transactions;
- (c) the robustness of the investment firm's recovery plan, where the obligation to draw up and maintain a recovery plan in accordance with Article 5(1) of Directive 2014/59/EU of the European Parliament and of the Council¹¹ applies.

Article 8

Group structure relevant to liquidity risk

¹¹ Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

1. Where an investment firm is part of a group as defined in Article 3(1), point (13) of Directive (EU) 2019/2034, competent authorities shall assess the risk posed by an excessive concentration of liquidity resources among the entities of the group.
2. Competent authorities shall assess whether there are mechanisms in place that request the investment firm to transfer part or all of its liquidity resources to any parent undertaking or to any other entities of the group.
3. Competent authorities shall assess the mechanisms used within the group to provide the investment firm with access to market or funding liquidity or to mitigate the investment firm's liquidity risk, and in particular, their effectiveness based on whether these are formal pre-arranged agreements.

Article 9

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

13. Article 42(6) of Directive (EU) 2019/2034 (IFD) mandates the EBA to develop draft RTS to specify how to measure the liquidity risk and elements of liquidity risk that are not covered, or are insufficiently covered, by the liquidity requirements set out in Part Five of Regulation (EU) 2019/2033 (IFR).
14. 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 of ‘the potential related costs and benefits’.
15. This section presents the cost-benefit analysis of the provisions of the draft RTS. The analysis provides an overview of the problems identified, the options proposed to address this problem and the potential impact of these options. Given the nature and scope of the draft RTS, the analysis is high-level and qualitative in nature.

Problem identification and baseline scenario

16. Until 25 June 2021, the prudential rules for investment firms were part of the wider EU prudential framework that 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.
17. The CRR/CRD did not impose harmonised EU level liquidity requirements on all types of investment firms. Pursuant to paragraph 4 of Article 6 of the 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 2014/65/EU had to comply with the liquidity requirements on an individual basis if the competent authority did not exempt such investment firms from liquidity requirements on an individual basis, taking into account the nature, scale and complexity of their activities. Investment firms with limited authorisations to provide investment services were not subject to liquidity requirements on an individual basis. Moreover, Article 11(3) CRR extended the exemption from liquidity requirements on a consolidated basis where the group comprises only investment firms. The justification for these exemptions stemmed from 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 risk to which an investment firm is or might be exposed.

18. On 26 June 2021, investment firms authorised 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. Under the application of the IFD/IFR, liquidity requirements became mandatory for investment firms unless the competent authority granted an exemption for small and non-interconnected investment firms.
19. Under Article 43 of the IFR, all investment firms are subject to the requirement to hold liquid assets. The specified amount of liquid assets is equivalent to at least one-third of an investment firm's fixed overhead requirement.
20. In addition, pursuant to Articles 39(1)(k) and 42 of the IFD, competent authorities can impose specific liquidity requirements on investment firms that are exposed to liquidity risk or elements of liquidity risk that are material and are not covered, or not sufficiently covered, by the liquidity requirement set out in Part Five IFR or that do not meet the requirements set out in Articles 24 and 26 IFD, where other administrative measures are unlikely to sufficiently improve the arrangements, processes, mechanisms and strategies within an appropriate timeframe. In this way, taking into account the extremely diverse universe of EU investment firms, the IFD acknowledges that some investment firms may be exposed to higher liquidity risk given their size, structure, internal organisation and nature and the complexity of their activities. This higher liquidity risk should be covered by specific liquidity requirements in addition to the minimum liquidity requirements.
21. However, the IFD does not provide a harmonised approach on how to measure the liquidity risk and elements of liquidity risk. This can create an unlevel playing field across the EU, where competent authorities adopt different methodologies for the purposes of setting specific liquidity requirements. Therefore, more specific clarifications with regard to determining the specific liquidity requirements are included in these draft RTS.

Policy objectives

22. Investment firms throughout the EU are an important element of a well-functioning capital market due to their key role in efficient capital allocation. Adequate liquidity requirements are therefore necessary to meet any immediate or additional liquidity needs that an investment firm may have (e.g. due to operational expenses, etc.), thus contributing to sound financial stability.
23. The specific objective of these draft RTS is to establish a harmonised approach to measuring liquidity risk or elements of risk that are not covered, or not sufficiently covered, by the liquidity requirements set out in Part Five of Regulation (EU) 2019/2033. Generally, the draft RTS aim to create a level playing field across the EU, as well as to promote the consistency of market practices and convergence of supervisory practices across competent authorities.

24. These draft RTS take into account the proportionality principle by setting specific liquidity requirements that are better aligned with an investment firm's size, structure and internal organisation, as well as the nature, scope, and complexity of its activities. This should help to reduce any additional burden on investment firms and competent authorities.

Options considered, cost-benefit analysis and preferred options

25. This section presents the main policy options discussed during the development of the draft RTS, the costs and benefits of these options, as well as the preferred options retained in the final draft RTS.
26. Overall, the draft RTS are not expected to create any direct cost impact for investment firms that are subject to IFD requirements. As for competent authorities, the draft RTS are considered a necessary intermediate step between the supervisory review and assessment process defined in Articles 36 and 37 of the IFD and the imposition of specific liquidity requirements pursuant to point (k) of Article 39(2). Besides, Article 42(2) of the IFD requires that the determination of specific liquidity requirements be based on the internal liquidity adequacy assessment performed by investment firms in accordance with Article 24(1) of the IFD.

Mitigating actions with respect to liquidity risk

27. The EBA considered two policy options regarding any mitigating actions taken by the investment firm to effectively reduce liquidity risk.

Option 1a: competent authorities should not take into account in their assessment any mitigating actions taken by the investment firm with respect to liquidity risk

Option 1b: competent authorities should take into account, in their assessment, any mitigating action taken by the investment firm with respect to liquidity risk

28. Option 1a considers the intrinsic liquidity risks to which an investment firm is exposed without taking into account any mitigating mechanisms taken by the investment firm to manage and reduce such risks. While this option takes the most prudent approach, it can result in overly conservative requirements.
29. In contrast, Option 1b takes into account mitigating actions taken by the investment firm to effectively reduce its liquidity risks. In this way, this option promotes sound processes, mechanisms and strategies to manage and reduce liquidity risk. Option 1b has been retained.

Approach to measuring liquidity risk

30. The EBA considered two policy options regarding the approach to measuring liquidity risk:

Option 2a: using a rule-based approach

Option 2b: using an approach where some level of supervisory judgement is allowed

31. Option 2a ensures fully harmonised outcomes across the EU by establishing specific rules for measuring liquidity risk. However, it is difficult to cover under a single set of rules all aspects of liquidity risk which can be relevant for the highly diverse universe of investment firms in the EU. According to the impact assessment of the final draft RTS on prudential requirements for investment firms (EBA/RTS/2020/11), there were around 2500 investment firms in the EU as at December 2019. They vary greatly in terms of size, business model, risk profile, complexity and interconnectedness, ranging from one-person companies to large internationally active groups.
32. On the other hand, Option 2b provides competent authorities with a uniform set of elements that needs to be assessed when measuring liquidity risk, while allowing for certain degree of supervisory judgement depending on the business model and group structure of the relevant investment firm. Although this level of flexibility provided to competent authorities does not ensure full harmonisation, it is desirable due to the wide variety of investment firms operating across the EU.
33. Option 2b has been retained.

Proportionality in specific liquidity risk requirements

34. The EBA considered two policy options with respect to the assessment of liquidity risk for small and non-interconnected investment firms:

Option 3a: competent authorities should consider the full set of elements specified in the RTS when assessing liquidity risk for small and non-interconnected investment firms

Option 3b: competent authorities should consider a limited set of elements specified in the RTS when assessing liquidity risk for small and non-interconnected investment firms

35. Option 3a takes a prudent approach and requires competent authorities to include all elements related to liquidity risk in their assessment for small and non-interconnected investment firms. Option 3b, recognises that liquidity risk is often limited for small and non-interconnected investment firms due to the limited set of services they provide and offers a more proportionate approach. Under this option, only a limited set of elements can be assessed when measuring liquidity risk for small and non-interconnected investment firms, reducing the burden competent authorities.
36. Option 3b has been retained.

Data collection with competent authorities

37. In parallel with the consultation, the EBA has carried out a data collection with competent authorities in the form of a qualitative questionnaire, with the aim of assessing the impact of this RTS. The results of the qualitative questionnaire are presented below and complement the previous cost-benefit analysis already included in the consultation paper.

Main findings of the qualitative questionnaire

38. It should be noted that, in the analysis that follows, it is not always possible to disentangle the impact due to the introduction of the liquidity requirements under the IFD/IFR and the impact of these specific draft RTS, as that would have required a much more granular data collection. Moreover, the EBA has yet to set up a regular collection of supervisory information on investment firms that could support a more detailed quantitative analysis of respective cost-benefits of the impact of regulatory products addressed to competent authorities supervising investment firms.

39. The qualitative questionnaire addressed primarily the following aspects:

- liquidity requirements before and after IFR
- expected availability and reliability of ILAAP
- costs for investment firms
- costs for competent authorities

40. The results show that most of the investment firms were not subject to liquidity requirements before the application of the IFR. Nonetheless, going forward, competent authorities expect available and reliable ILAAP for a good number of investment firms, although a lower percentage than those who are expected to have an ICAAP in place.

41. Competent authorities have different expectation on the implementation costs for the investment firms, so that it cannot be excluded that the impact may be significant. Nonetheless, since these draft RTS focus only on the specific liquidity measurements, and not on the overall liquidity requirements set out in the IFR, the impact of these specific draft RTS should be limited. For competent authorities, the implementation costs are expected to be low and should not raise specific concerns.

42. The following sections provides detailed results of the qualitative questionnaire.

43. Overall, the impact assessment on the draft RTS on liquidity risk measurement under Article 42(6) of the IFD suggests that the possible impact is low to moderate and that the expected benefits are higher than the expected costs.

Liquidity requirements before and after IFR

44. Most competent authorities (68% of the answers) inform that the investment firms under their remit were not subject to national liquidity requirements before the date of application of the IFR and IFD. For the investment firms subject to liquidity requirements before the application of the IFR/IFD, the expectations of the competent authorities regarding such liquidity requirements after the entry into force of IFR/IFD are split and based on few answers (for 37% of the answers mention that the investment firms need to hold higher amount of liquidity; whereas 25% mention that investment firms need to hold lower amount of liquidity).

Availability of ILAAP

45. The Internal capital adequacy and risk assessment process (ICARAP) means the arrangements, strategies and processes referred to in Article 24 of Directive (EU) 2019/2034. The ICARAP can be further split into an internal capital adequacy process (ICAAP) and an internal liquidity adequacy process (ILAAP) in place to assess the amount of internal capital and liquid assets that investment firms should hold to cover the harms they may cause to consumers, markets or to themselves, and which have not been adequately mitigated for by other risk tools. Competent authorities indicate that investment firms under their remit dispose of an ICARAP in most of the cases (all or a majority in 60% of the answers), or at least half of the investment firms (4% of the answers). The Competent authorities that indicate that none of the investment firms under their remit dispose of an ICARAP are only in 16% of the answers. Therefore, the Internal capital adequacy and risk assessment process (ICARAP) is known and implemented by the majority of the investment firms.
46. For ILAAP, almost half of competent authorities (44% of the answers) mention that all or the majority of the investment firms have an ILAAP in place. Nevertheless, ILAAP is in place for half of the investment firms in the remaining 42% of the answers of the competent authorities.
47. For competent authorities of investment firms that dispose of an ICARAP, the majority expect the ICARAP to be sufficiently reliable (90% of the answers). Regarding investment firms disposing of an ILAAP, competent authorities expect the following elements to be included:
- the risk identification and qualitative assessment is expected to be performed by all investment firms or in the majority of them (52% of the answers) or in few of them (24% of the answers);
 - regarding the quantitative assessments, similar results are expected;
 - only (respectively) 11% and 12% of the competent authorities expect qualitative and quantitative assessments will not be covered;

- only 38% of the competent authorities expect that most of the investment firms will include an assessment of wind-down impact on liquidity resources.

Costs for investment firms

48. For most of the competent authorities, investment firms under their remit were not subject to national liquidity requirements before the date of application of the IFR and IFD. This could imply that the application of the IFR and IFD could produce a significant impact, however the expectations of the Competent Authorities regarding such liquidity requirements after the entry into force of IFR/IFD are split (based on few answers): 37% of the answers mention that the investment firms need to hold higher amount of liquidity; whereas 25% mention that investment firms need to hold lower amount of liquidity.

Costs for competent authorities

49. The one-off costs encountered by competent authorities due to the implementation of these draft RTS, namely costs of training and consultancy are negligible, low, or moderate (76% of the answers). The IT and other costs are also low or moderate (respectively, 72% and 85% of the answers) Thus, the total cost of implementing the RTS on Liquidity Requirements in the EU banking sector is restrained (low or moderate for 80% of the answers).
50. The level of costs encountered by competent authorities due the implementation of this draft RTS per area, compared to the costs encountered before the entry into force of IFR/IFD shows the following. For several areas such as business model analysis, governance arrangements and firm-wide controls, risk of unorderly wind-down, risks from ongoing activities and other risks, the level of costs encountered by competent authorities are negligible, low, or moderate (between 88% and 96% of the answers).
51. The one-off costs encountered by competent authorities due to the implementation of the RTS on Liquidity Requirements provide additional information. Costs of training and consultancy, IT and Other Costs are negligible, low, or moderate. The level of costs encountered by competent authorities due the implementation of the RTS on liquidity requirements per area, compared to the costs encountered before the entry into force of IFR/IFD are also negligible, low, or moderate for the following areas: business model analysis, governance arrangements and firm-wide controls, risk of unorderly wind-down, risks from ongoing activities and other risks. One area in which the costs are expected to be higher (nevertheless negligible, low, or moderate for most of the answers) is: liquidity and funding risks.

4.2 Views of the Banking Stakeholder Group (BSG)

The Banking Stakeholder Group did not provide any comment during the public consultation.

4.3 Feedback on the public consultation

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

The consultation period lasted for three months and ended on 10 March 2022. Three responses were received, of which two were 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 some cases, several industry bodies made similar comments or the same body repeated its comments in response to different questions. In such cases, the comments and the EBA's analysis are included in the section of this paper where the 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 small number of respondents to the public consultation seem to share the view that the applicable liquidity requirements should in many cases be sufficient without any specific liquidity measure.

The respondents provided very focused remarks. Firstly, it was noted that market makers provide most of the operations vis-à-vis central counterparties, prime brokers and clearing members and therefore on a net basis. They therefore suggested that this aspect consistently limits the investment firms' liquidity risk and should be taken into account when setting the specific liquidity requirements.

Second, respondents sought clarifications concerning the liquidity aspects that may be related to the loss of income for investment firms providing portfolio management and advisory services, as the text in the consultation paper was potentially misleading regarding its intentions.

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

Summary of responses received	EBA analysis	Amendments to the proposals
<p>One respondent noted that where a market-making firm holds derivatives positions, these are typically traded under an ISDA Master Netting Agreement or Master Clearing Agreement that creates a single contract under which transactions can offset each other. All trades are, therefore, aggregated and replaced with a single net amount. Derivatives are also carried at mark-to-market value and collateral is posted daily with the clearing member on a net basis.</p> <p>The net amount is a net payable or net receivable and only margin requirements on the net portfolio would represent a funding requirement, whereas derivatives payables do not represent claims or assets in a market-making firm's trading book, and do not represent resources to creditors.</p>	<p>The draft RTS in the consultation paper do not imply that netting agreements should not be considered.</p> <p>Existing netting agreements and related risk mitigation mechanisms used by a clearing member, intermediaries or CCPs should indeed be considered in the assessment of any specific liquidity measures.</p>	<p>Article 1(3) was amended (adding an additional sub-point (c)) to recognise the potential risk mitigation effect of netting and collateral agreements.</p>
<p>One respondent suggested clarifying the meaning of 'liquidity risk stemming from loss of income from portfolio management'. It was recommended that only the loss of income that affects the company and that is related to providing portfolio management services would be relevant to the specific liquidity requirements. The respondent mentioned 'loss of fees' or 'loss of the client due to poor service provision' as examples.</p> <p>Instead, any loss of income for clients would not be relevant as it does not raise liquidity risks to which the investment firm would be exposed.</p>	<p>The wording in the consultation paper seems to be subject to misinterpretations.</p> <p>The intention was indeed not to refer to clients' loss of income, but only to the potential losses attributable to the investment firm.</p>	<p>Recital (4) and Article 2 were amended accordingly.</p>
<p>One respondent noted that any risk to which an investment adviser is exposed must be linked to the question of whether this is based on a lack of internal standards. The respondent noted that, in its</p>	<p>Similar examples such as the ones provided in the previous comments would be valid here, such as</p>	<p>The draft RTS were corrected to clarify that the loss of income should relate to</p>

Summary of responses received

EBA analysis

Amendments to the proposals

view, this question is not linked to a specific liquidity risk that is not already covered by the IFD/IFR framework.

‘loss of fees’ or ‘loss of the client due to poor service provision’.

the investment firm. Articles 1, 2 and Recital 4 were amended accordingly.

Although in many cases these events may not increase the liquidity requirements of an advisory company, this can still happen and should be addressed accordingly.