

EBA/Op/2017/11

29 September 2017

# Opinion of the European Banking Authority in response to the European Commission's Call for Advice on Investment Firms

## Background and legal basis

1. The EBA competence to deliver an opinion is based on Articles 8(2) and 34(1) of Regulation (EU) No 1093/2010<sup>1</sup>, as prudential requirements for investment firms relate to the EBA's area of competence.
2. In accordance with Article 14(5) of the Rules of Procedure of the Board of Supervisors<sup>2</sup>, the Board of Supervisors has adopted this Opinion.
3. Following the EBA report on investment firms<sup>3</sup> (henceforth 'the Report') published on 15 December 2015, the EBA received a second call for advice (henceforth 'CfA') from the Commission<sup>4</sup> in June 2016 to provide further technical advice on the first two recommendations included in that Report.
4. The first two recommendations of the EBA 2015 Report may be summarised as follows:
  - a) The first recommendation stressed the necessity to make a distinction between those investment firms for which the CRD and CRR provide appropriate prudential requirements and the investment firms for which those requirements are not appropriate;

<sup>1</sup> 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).

<sup>2</sup> Decision adopting the Rules of Procedure of the European Banking Authority Board of Supervisors of 27 November 2014 (EBA/DC/2011/01 Rev4).

<sup>3</sup> [Report on investment firms response to the Commission's call for advice of December 2014, EBA/op/2015/20](#), issued on 14 December 2015.

<sup>4</sup> [Call for advice to the EBA for the purposes of the report on the prudential requirements applicable to investment firms](#), issued on 13 June 2016. This follows the 'Call for advice to the EBA for the purposes of the report on the prudential requirements applicable to investment firms' issued by the European Commission on 22 December 2014.

- b) The second recommendation proposed that a specific prudential regime should be designed for those investment firms for which the CRD and CRR would not be applicable.
5. In this regard, in the first part of its CfA the Commission sought advice on: a) the criteria to identify the class of investment firms for which the CRD and CRR would be applicable and b) the specific rules which should apply to them. The EBA provided its response to this part on 19 October 2016<sup>5</sup>, recommending that Class 1 investment firms should be those identified as G-SII or O-SII in accordance with the current regulatory framework and should be subject to the full CRR and CRD. Nevertheless, the EBA acknowledged that the O-SII guidelines were designed and developed within a different regulatory framework, and that it was premature to conclude that they perfectly fit the purpose of the identification of investment firms in that class. Therefore, the EBA recommended that the suitability of the O-SII guidelines for the purpose of identifying the investment firms that should be subject to the full CRR and CRD is revised after the new prudential framework for investment firms is completed.
6. The second part of the Commission's CfA in June 2016 sought advice regarding the new prudential regime for Class 2 and Class 3 firms, and in particular on:
- a) The criteria for identifying Class 2 and Class 3 firms;
  - b) The appropriate design and calibration of all the relevant aspects of the new prudential regime, which should include, but not necessarily be limited to, capital requirements;
  - c) The appropriate level of initial capital requirements;
  - d) The necessity of any liquidity requirements and the appropriate liquidity regime;
  - e) The impact of the proposed prudential regime;
  - f) The suitability of the proposed prudential regime for specialised commodity derivatives firms and in case this is not possible an alternative new regime for these firms.
7. In addition, the Commission sought advice in relation to the application of the CRD and CRR remuneration requirements and corporate governance rules to the investment firm population, distinguishing, where relevant, between the proposed investment firm classes.
8. This document constitutes the EBA's response to the second part of the Commission's CfA.

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<sup>5</sup> [Opinion on the First Part of the Call for Advice for investment firms, EBA-Op-2016-16](#), issued on 19 October 2016.

## Recommendations

### General recommendations

- Recommendation 1. It is recommended to develop a consolidated single rulebook, separate from the one applied to credit institutions, for all MiFID investment firms not falling in Class 1 based on the recommendations given in this Opinion.
- Recommendation 2. In order to ensure a stable transition to the new regime, the capital requirements on an individual and consolidated basis can be limited to twice the level of the capital requirements under the current regime for three years after the entry into force of the new regime. To make use of the transitional requirement, the investment firm must also calculate the capital requirements under the current regime. For firms previously subject only to the initial capital requirements, the capital requirements can be limited to twice the level of the current initial capital. For firms not previously subject to capital requirements, the capital requirements can be limited to twice the level of the fixed overheads requirement. After two years, the EBA stands ready to report to the Commission on the appropriateness, in particular the calibration, of the new regime, as part of the review referred to in Recommendation 62.

### Categorisation

- Recommendation 3. It is recommended to introduce a new categorisation of MiFID investment firms distinguishing between:
- a) systemic investment firms or investment firms which are exposed to the same types of risks as credit institutions (Class 1) to which the full CRD/CRR requirements should be applied;
  - b) other non-systemic investment firms (Class 2) above specific thresholds that should be subject to a more tailored prudential regime based on K-factors; and
  - c) small and non-interconnected investment firms (Class 3) providing limited services in terms of number and size to which a very simple regime should be applied.
- Recommendation 4. In order to identify Class 1 firms<sup>6</sup>, the EBA should develop dedicated Level 2 Regulatory Technical Standards in order to carry out such identification, taking into account the specificities of investment firms.
- Recommendation 5. All the investment firms that fulfil one or more of the following conditions ('categorisation thresholds') should be excluded from Class 3:

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<sup>6</sup> [Opinion of the European Banking Authority on the First Part of the Call for Advice on Investment Firms](#), EBA-Op-2016-16, Recommendation 2, p. 3.

- a) K-AUM (for assets under management under both discretionary portfolio management and non-discretionary (advisory) arrangements) is higher than EUR 1.2 billion;
- b) K-COH (client order handled) – is higher than EUR 100 million a day for cash trades and/or higher than EUR 1 billion a day for derivatives;
- c) K-ASA (for assets safeguarded and administered) is higher than zero;
- d) K-CMH (for client money held) is higher than zero;
- e) K-NPR or K-CMG, K-DTF, K-TCD are higher than zero;
- f) Balance sheet total is higher than EUR 100 million;
- g) Total gross revenues is higher than EUR 30 million;
- h) The thresholds under (a), (b), (f) and (g) should be applied on a combined basis for all investment firms that are part of the same group. The threshold under (c), (d) and (e) should be applied on a solo basis.

Recommendation 6. All the investment firms that are not included in Class 1 or Class 3 should be categorised as Class 2 firms.

Recommendation 7. All the investment firms should meet the prudential requirements on an ongoing basis. Investment firms should be reclassified to Class 2 immediately if one of the categorisation thresholds is exceeded, except for the K-AUM and K-COH where firms should be allowed three months from the date they exceed the categorisation thresholds before being reclassified to Class 2; however, a Class 2 firm should meet the criteria for being in Class 3 for at least six months before being re-categorised in Class 3.

### Consolidated supervision

Recommendation 8. For the consolidated supervision of investment firm-only groups the following should be considered:

- a) A group should be considered an investment firm-only group if it does not include any credit institutions or Class 1 investment firms.
- b) The composition of entities that should be included within the scope of consolidated supervision of such a group should include all investment firms, financial institutions and any other prudentially regulated entity and should also include tied agents where they are owned by the investment firm.
- c) The parent company should always be subject to a group capital test to address situations of excessive leveraging risks and multiple gearing of capital. Such test should be developed based on the conditions required under Article 15 and 17 of the CRR

where this test is foreseen in form of derogation from consolidated supervision.

- d) The ultimate parent company in a Member State should be responsible for all the prudential requirements of the group at the consolidated level. In particular, it should have in place systems to monitor and control the sources of capital and funding of all regulated entities within the group; this should include the compliance with the liquidity requirements.

Recommendation 9. Competent authorities should be granted the power to require the application of capital requirements on a consolidated basis to an investment firm-only group under certain conditions such as:

- a) An investment firm-only group has deliberately structured itself into separate entities so that each individual investment firm in the group would fall underneath the categorisation thresholds and so avoid the application of the capital requirements based on K-factors on a solo basis;
- b) The individual investment firms are inter-connected in their operations and would otherwise be subject to the capital requirements under the K-factor formula in a very material way if the relevant metrics are measured on an aggregated basis;
- c) The group consists of multiple investment firms that deal on own account or execute customers' orders on their own name, which are so inter-connected in terms of their risk management that it is more appropriate to consider the application of the K-factors on a consolidated basis.

Recommendation 10. All investment firms part of a group containing a credit institution and/or a Class 1 investment firm should be subject to all of the following requirements:

- a) If they are Class 2 or Class 3 firms, they should be subject to the new prudential regime for investment firms on a solo basis unless waived in accordance with a provision equivalent to Article 7 of the CRR; and
- b) all the CRR requirements on a consolidated basis, as part of any obligations for consolidated supervision that fall upon institutions subject to the CRR;
- c) the waiver referred to in point a) should only be applicable to Class 3 firms.

Recommendation 11. Subject to the existence of centralised liquidity management functions, competent authorities may waive individual entities from liquidity requirements as long as the liquidity requirements are met at consolidated or sub-consolidated level. Concentration limits should apply at solo level.

## Capital definition and composition

- Recommendation 12. The new prudential regime should identify only one single definition and composition of regulatory capital for all types of investment firms. The definition of the regulatory capital in the new prudential framework should be aligned to the one in the CRR for credit institutions including CET1, Additional Tier 1 and Tier 2 instruments as defined in Articles 25 to 71 of the CRR, while the composition should be adapted to the new framework.
- Recommendation 13. The following composition of capital should be eligible for meeting the capital requirements:
- a) CET 1 should constitute at least 56% of capital requirements;
  - b) Additional Tier 1 is eligible up to 44% of capital requirements;
  - c) Tier 2 capital is eligible up to 25% of capital requirements.
- Recommendation 14. The use of prudential filters should be aligned to the treatment suggested in the EBA Opinion EBA/Op/2014/05 where it is recommended not to deviate from the prudential treatment which is currently applied at the international level for credit institutions and under the CRR and which consists in deducting from regulatory capital fair value gains and losses arising from the institution's own credit risk related to derivative liabilities.
- Recommendation 15. Investment firms should always be required to deduct the items referred to in Articles 37 to 47 of the CRR, in particular intangible assets and deferred tax assets, from regulatory capital. Such deductions should always be applied in full and should not be subject to any of the thresholds currently applied in the CRR. Non-significant holdings of capital instruments in financial sector entities should be exempted from such deductions if held for trading purposes; significant holdings of capital instruments in financial sector entities should always be deducted. Holdings of capital instruments in financial sector entities should not be deducted if those entities are included in the scope of the group capital test or of consolidated supervision.
- Recommendation 16. Taking into account that the legal form of MiFID investment firms is not prescribed under Union law, the new prudential regime should include a mechanism to recognise less common legal forms of investment firms, such as limited liability partnerships (LLPs), partnerships and sole-traders. It is recommended that such mechanism is designed in a similar way to the one included in the CRR for the approval of CET1 instruments. This mechanism should ensure that the forms of capital available to such non-joint stock companies meet the principles of permanence and loss absorbency.

## Capital requirements

- Recommendation 17. It is recommended that the definition of capital used for the purposes of meeting the minimum levels required as a condition for initial authorisation of an investment firm under MiFID should be aligned with the definition of capital for the purposes of meeting the on-going capital adequacy requirements of investment firms (i.e., Permanent Minimum Capital, fixed overheads requirements and, where applicable, capital requirements under the K-factor formula).
- Recommendation 18. The new prudential regime for Class 2 and Class 3 investment firms should include provisions for the application of an Initial Capital Requirement (IC) for the authorisation phase; IC may be defined via Level 2 legislation and rely on MIFID list of investment services and activities in Annex 1 of MiFID.
- Recommendation 19. It is also recommended requiring that investment firms meet the Permanent Minimum Capital (PMC) requirements and the minimum level of Fixed Overheads Requirement (FOR) on an ongoing basis. PMC and FOR should be set as a minimum to the capital requirements for all investment firms.
- Recommendation 20. It is recommended setting the levels of IC for the authorisation of an investment firm to:
- a) EUR 750 000 for firms that are authorised to provide one or more of the investment services and activities listed in points (3), (6), (8) and (9) of Section A of Annex I to Directive 2014/65/EU;
  - b) EUR 75 000 for firms that are not permitted to hold money or securities belonging to their clients and are authorised to provide one or more of the investment services and activities listed in points (1), (2), (4), (5) and (7) of Section A of Annex I to Directive 2014/65/EU;
  - c) EUR 150 000 for all the other investment firms.
- Recommendation 21. It is recommended setting the levels of PMC differentiating between classes:
- a) EUR 5 million for Class 1 investment firms;
  - b) Equal to IC for all other investment firms.
- Recommendation 22. A transitional period should be envisaged to allow investment firms for which the IC is currently the binding capital requirement and are in Class 3 under the new regime to afford the new level of PMC and the FOR requirements, whichever will be applicable to them. Those investment firms should be required to comply with the capital requirements only after a transitional period of five years, in which the required level of capital increases by a fixed amount each year.

Recommendation 23. The FOR requirement should be set to at least at 25% of the fixed overheads of the previous year, calculated using the methodology in Delegated Regulation 488/2015. The consistency of the current methodology for the calculation of FOR should be reviewed in light of the new prudential regime.

### **K-factors methodology for the calculation of capital requirements**

Recommendation 24. Investment firms in Class 2 should be subject to a minimum capital requirement equal to the higher of:

- a) the Permanent Minimum Capital (PMC) requirement;
- b) the Fixed Overheads Requirement (FOR);
- c) the requirements based on the K-factor formula;

Recommendation 25. Class 3 investment firms should be subject to a minimum capital requirement equal to the higher of:

- a) the Permanent Minimum Capital (PMC) requirement;
- b) the Fixed Overheads Requirement (FOR).

Recommendation 26. The total capital requirements for Class 2 investment firms should be based on the following elements:

- a) They should consider the potential risk that individual investment firms can pose to their customers (RtC);
- b) They should consider the potential impact an investment firm can have on the markets in which it operates, should the firm fail or otherwise need to exit that market, in particular where a failure or exit leads to a sudden and/or a temporary dislocation in market access or market liquidity or a loss of market confidence (RtM);
- c) Any risk to the firm itself (RtF).

Recommendation 27. The new prudential regime should include all the following elements:

- a) Specific capital requirements for the Risk to Customers (RtC), Risk to Market (RtM) and Risk to Firm (RtF), based on appropriate proxies (K-factors);
- b) The formula for the calculation of the capital requirements that takes into consideration all those elements.
- c) The following formula is recommended:

$$\text{K-factors Capital Requirements} = \text{RtC} + \text{RtM} + \text{RtF}.$$

Recommendation 28. The factors that are relevant to capture the risk to customers (K-factors for RtC) and their respective metrics are the following:

- a) K-AUM: amount of assets under management – under both discretionary portfolio management and non-discretionary (advisory) arrangements;
- b) K-CMH: amount of client money held;



- c) K-ASA: amount of assets safeguarded and administered;
- d) K-COH: volume of customer orders handled (value of transactions of execution-only in name of client and reception and transmission of orders). The MTF/OTF operator should not count the operations of an MTF/OTF as K-COH. For cash trades value means the absolute gross settlement and for derivatives value means notional amount of trades executed.

Recommendation 29. For K-CMH (client money held) it is recommended that a harmonised definition is provided making unequivocally clear that the K-CMH factor applies to investment firms that have control of money belonging to clients, regardless of the legal arrangements on asset segregation and irrespective of the accounting treatment under national law of client money held by an investment firm.

Recommendation 30. For the calculation of the capital requirements for RtM, the new prudential regime should specify all the relevant factors and their calculation. It is recommended to calculate RtM as follows:

- a) K-NPR: an RtM requirement for net position risk for investment firms, calculated on (net open) positions end-of-day, measured on the basis of the methodology for market risk under the European Commission's proposal for amending the CRR ('CRR II proposal')<sup>7</sup>;
- b) The K-NPR factor should be applied only to the trading book positions and the trading book definition should be aligned with the CRR II proposal;
- c) The K-NPR factor should apply to underwriting positions held in the trading book and should be subject to similar requirements as set out in Article 345 of the CRR.

Recommendation 31. For the calculation of the capital requirements for RtF, the new prudential regime should specify all the relevant factors and their calculation. The factors that are relevant to capture the risk to firm (K-factors for RtF) and their respective metrics are the following:

- a) K-TCD: a trading counterparty default requirement in order to capture the counterparty credit risk for investment firms that trade in their own name, calculated based on the simplified approach described in Section 5.7.2 of the Annex to this Opinion.
- b) K-DTF: a daily trading flow (value of transactions where the firm is trading in their own name) requirement in order to capture the operational risk for investment firms with any trading activity,

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<sup>7</sup> [European Commission, Proposal for a Regulation of the European Parliament and of the Council amending Regulation \(EU\) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation \(EU\) No 648/2012, 23.11.2016, COM\(2016\) 850 final](#)

measured on the basis of the same methodology and calibration used for the RtC of K-COH. For cash trades ‘value’ means the absolute gross settlement and for derivatives ‘value’ means notional amount of trades either averaged or the highest reached over a period of time.

- c) K-CON: a concentration risk requirement in order to capture single name concentration for investment firms that trade in their own name, measured according to Recommendation 48.

Recommendation 32. Specific characteristics of investment firms may justify the introduction of some adjustment in the calculation of K-NPR, such as removing the relative thresholds for using the Simplified Standardised Approach.

Recommendation 33. A reduced sensitivities-based method is currently under consultation at BCBS<sup>8</sup> and its appropriateness for investment firms should be reviewed after that proposal is finalised.

Recommendation 34. It is recommended calculating the K-factors capital requirements using the following formula:

$$\text{K-factors capital requirements} = \text{Sum } a_i * K_i$$

where  $K_i$  are the K-factors and the coefficients  $a_i$  are specified in the following table:

K-Factor		Coefficient
Assets under management– under both discretionary portfolio management and non-discretionary (advisory) arrangements	K-AUM	0.02%
Client money held	K-CMH	0.45%
Assets under safekeeping and administration	K-ASA	0.04%
Client orders handled	K-COH cash trades	0.1%
	K-COH derivatives	0.01%
Daily trading flow	K-DTF cash trades	0.1%
	K-DTF derivatives	0.01%

Recommendation 35. Subject to the decision of the competent authority and provided that a number of conditions are met, RtM can (alternatively to Recommendation 30) be set as  $\max(K\text{-NPR}, K\text{-CMG})$ . The metric for K-CMG (for clearing member guaranteed) would be the highest total intra-day margin posted by the trading firm with the (general) clearing member in a previous period (e.g. the preceding three months). K-CMG could be used under the following conditions:

- a) The execution and settlement transactions of the trading firm take place under the responsibility of a (general) clearing member

<sup>8</sup> [Consultative Document Simplified alternative to the standardised approach to market risk capital requirements](#), BCBS, June 2017

and are either guaranteed by that clearing member or are otherwise settled on a delivery-versus-payment basis;

- b) The trading firm is outside the scope of prudential consolidation of a banking group (i.e. the trading firm is not part of a banking group);
- c) The calculation of the margin posted by the trading firm with the (general) clearing member is based on an approved internal model, which is used for the regulatory capital calculations of this (general) clearing member; and
- d) The (general) clearing member is subject to full CRD and CRR (or – if relevant – supervisory and regulatory arrangements of a third country that are at least equivalent).

Recommendation 36. The new prudential regime should specify a ‘smoothing mechanism’ for the calculation of K-factors, in order to aid capital planning and avoid cliff effects. Such smoothing should be based on rolling averages and a deferral period between the date of calculation of capital requirements and the date of their application. The extent of such smoothing may vary by individual K-factor, according to the relative extent of volatility in the underlying metric and the relative degree of risk posed to customers or markets or to the firm itself.

### Liquidity requirements

Recommendation 37. The application of the liquidity coverage requirements set out in Commission Delegated Regulation (EU) 2015/61 on LCR should be extended to all Class 1 investment firms. This recommendation should not be intended as applying also to the NSFR, because the design of the NSFR is still under development and, at this juncture, it is not possible to conclude whether its application is suitable for Class 1 investment firms or not.

Recommendation 38. Class 2 and Class 3 investment firms should have internal rules and procedures that allow them to monitor, measure and manage exposures and liquidity needs to ensure the adequacy of liquidity resources.

Recommendation 39. Class 2 and Class 3 investment firms should be required to hold an amount of liquid assets equal to one third of the FOR requirements.

Recommendation 40. The liquid assets eligible to meet the liquidity requirements under the new prudential regime for investment firms should be aligned with the list of high quality liquid assets (HQLAs) of Level 1, 2A and 2B assets as set out in the Delegated Regulation on the Commission Delegated Regulation 2015/61 with regard to liquidity coverage requirement for

Credit Institutions ('LCR Delegated Regulation'),<sup>9</sup> supplemented by unencumbered cash resources of the firm (which cannot include any client money). There should be no limit regarding the composition of liquid assets to be held to meet the minimum liquidity requirements.

- Recommendation 41. Haircuts should be applied to the market value of assets held by investment firms for the purposes of meeting the minimum liquidity requirements. The level of haircuts should be aligned with the one prescribed in the LCR Delegated Regulation. Unencumbered own cash of the firm should receive a 0% haircut.
- Recommendation 42. The level of liquidity requirements should be adjusted by deducting from the amount of liquid assets held 1.6 percent of the total amount of guarantees provided to customers.
- Recommendation 43. For Class 3 firms, trade debtors and fees or commissions receivable within 30 days should be allowed to meet the minimum liquidity requirements, subject to the following conditions:
- a) They may account up to one third of the minimum liquidity requirements;
  - b) They should not be allowed to meet any of the liquidity requirements above the level set at one third of FOR, such as additional liquidity requirements requested on a firm-specific basis (Pillar 2);
  - c) They should be subject to a haircut of 50%.
- Recommendation 44. During exceptional and unexpected circumstances, investment firms may monetarise their liquid assets to cover liquidity needs, even if such a use of liquid assets may result in the amount of liquid assets held falling below the minimum liquidity requirements. In such cases, investment firms should notify their competent authority immediately.

### **Concentration risk**

- Recommendation 45. The new prudential framework for investment firms should require all investment firms to identify, manage and monitor any concentration risk, including in respect of RtC.
- Recommendation 46. It is recommended that Class 2 investment firms report to competent authorities concentration risk, and in particular (where applicable) :
- a) concentration risk associated with the default of counterparties for trading exposures, both on an individual counterparty and aggregate basis;

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<sup>9</sup> [Commission Delegated Regulation \(EU\) 2015/61 of 10 October 2014 to supplement Regulation \(EU\) No 575/2013 with regard to liquidity coverage requirement for Credit Institutions, Articles 10 to 16.](#)

- b) concentration risk towards institutions where client money is held;
- c) concentration risk towards institutions where client securities are deposited;
- d) concentration risk towards institutions where the investment firm's own cash is deposited ; and
- e) concentration risk from earnings.

Recommendation 47. Class 3 firms should not be subject to reporting requirements on concentration risk.

Recommendation 48. Class 2 firms with a trading book position or exposure that arises when the investment firm is dealing on its own account or trading in its own name when executing client orders should be subject to the following concentration risk requirements:

- a) The maximum exposure should be set to a limit equal to 25 percent of capital;
- b) Where the exposure is to a credit institution, an investment firm or a group including one or more credit institutions or investment firms the maximum exposure should not exceed 25 percent of capital or EUR 150 million, whichever is the higher, provided that the sum of exposure values to all connected clients that are not credit institutions or investment firms does not exceed 25 percent of capital. When the EUR 150 million limit is higher than 25 percent of capital the limit shall not exceed 100 percent of capital.
- c) The limits laid down in (a) and (b) may be exceeded if the additional capital requirements K-CON are met, which is calculated as a multiple of the amount of any K-NPR and K-TCD attributed to the relevant exposure and according to the relative size of the excess.

### **Additional requirements on an individual firm basis (Pillar 2)**

Recommendation 49. It is recommended to set out a requirement for investment firms to be also responsible for assessing the adequacy of the new minimum requirements to their own risk situation and for competent authorities to undertake individual firm-specific assessments (i.e. a proportionate Pillar 2 tool for investment firms). It is also recommended to provide competent authorities with appropriate supervisory powers and the possibility to take actions, notably the possibility to increase capital and liquidity requirements and limit concentration risk.

Recommendation 50. It is recommended to pursue harmonization via Level 2 legal instruments addressed to competent authorities for the individual assessment of investment firms, including concentration risk, which are

sufficiently flexible and proportionate and take into account the proposed categorisation for investment firms.

## Reporting

- Recommendation 51. The new prudential framework for investment firms should include a simplified reporting framework for Class 2 and Class 3 investment firms. Class 1 investment firms should be subject to the same reporting requirements of credit institutions.
- Recommendation 52. The new reporting framework for Class 2 and Class 3 investment firms should be based on the following elements:
- a) It should be addressed to all investment firms without any exemptions for any types of firm or business model;
  - b) All investment firms should report the key metrics highlighted in this Opinion, including the level of capital, the level of capital requirements and K-factors, and all the parameters needed for the firm's categorisation;
  - c) The reporting requirements should be proportional to the size and complexity of the firm;
  - d) Class 2 firms should be required to report granular information including all the following metrics:
    - i) Capital composition;
    - ii) Capital requirement calculations;
    - iii) Liquidity requirements;
    - iv) Concentration risk;
    - v) Additional requirements for specific business models.
- Recommendation 53. It is recommended reducing public disclosure requirements (Pillar III) to the minimum; in particular:
- a) Class 3 firms should have no disclosure requirements;
  - b) Class 2 firms should have disclosure requirements limited to the level of capital and capital requirements.

## Commodity derivatives investment firms

- Recommendation 54. Commodity derivatives investment firms in the scope of MiFID II should be subject to the prudential requirements of the new framework.
- Recommendation 55. The new prudential framework should be tailored to some of the specificities of commodity derivatives investment firms trading in specific markets or to specific aspects of their accounting practices.
- Recommendation 56. A transitional regime or phase-in period for the introduction of the new prudential regime should be envisaged considering that the scope of the commodity derivatives investment firms under MiFID II is still unclear

and that a number of firms are currently completely exempted from prudential requirements.

Recommendation 57. The new prudential regime may include criteria that would allow the exemption from certain prudential requirements of positions that are objectively measurable as reducing risks directly related to commercial activities.

### Remuneration and governance

Recommendation 58. In the context of governance the following recommendations should be considered:

- a) No change to the provisions on group application as foreseen under Article 109 CRD is recommended in the context of this review, regardless of the category of investment firms involved.
- b) The governance requirements set out in CRD should fully apply to Class 1 firms, while a lighter governance framework should be applied to Class 2 and Class 3 firms.
- c) It is not considered necessary to apply Article 74 CRD to Class 2 and Class 3 investment firms, as MiFID's governance requirements are deemed to be sufficient to ensure robust governance arrangements.
- d) Additional risk management requirements as developed in Article 76 (1) CRD and the requirement to commit sufficient time for risk management within Article 76 (2) CRD should be applied to Class 2 firms that are authorised to hold clients assets.
- e) Whether or not the creation of committees (risk, nomination remuneration) would be required from Class 2 firms should be left to the discretion of Member States or competent authorities'.
- f) The investment firms that deal on own account and are at the same time allowed to hold client assets should be subject to the provisions of Article 83 CRD on market risks.
- g) Article 85 CRD should be applied to Class 2 firms and competent authorities supervising them.
- h) The application of Article 89 CRD (country by country reporting) is recommended for Class 2 firms only.

Recommendation 59. In the context of remuneration the following elements should be considered:

- a) Class 1 investment firms should fully remain under the remuneration framework set out by the CRD.
- b) The new remuneration framework should differentiate between Class 2 and Class 3 firms and not between different business activities.

- c) Class 3 firms should only be subject to the remuneration provisions of MiFID, no additional requirements are deemed necessary.
- d) The remuneration requirements for Class 2 firms should be similar to Articles 92 to 94 CRD and apply to the staff that has a material impact on the firms risk profile. Class 2 firms should still be subject to MiFID remuneration provisions for sales staff. Institutions should have the discretion to use a mix of instruments, where this is appropriate, but they should have the possibility to pay the entirety of the variable remuneration in one category of instrument. Waivers should be available for small Class 2 firms and staff that received a low level of remuneration.
- e) The European Commission should carefully consider the advantages and disadvantages of a restriction of variable remuneration provided for in Article 94 (1)(g)(i) and (ii), when proposing a legal framework for Class 2 firms. In any case, Class 2 firms should specify the level of variable remuneration that can be paid within their remuneration policy.
- f) Class 2 firms should be subject to simpler and less granular disclosure requirements. A benchmarking of the disclosed information by the EBA should not be required. However, the collection of data on high earners by Member States and its publication by EBA is recommended for Class 2 firms.

### **A macro-prudential perspective for investment firms**

Recommendation 60. The new prudential regime for investment firms should include a macroprudential perspective. In this regard, the importance of mitigating the build-up and the materialisation of systemic risks should be emphasised with a view to determining whether appropriate macroprudential tools to address those risks should be developed.

Recommendation 61. A detailed analysis assessing the potential systemic impact of the three classes of investment firms is needed. In this regard, it should be considered whether the macroprudential perspective ought to be tailored to the specificities of investment firms' business models.

### **Quantitative analysis and impact assessment**

Recommendation 62. It is recommended that a legislative proposal for a new prudential framework for Class 2 and Class 3 investment firms contains a review clause, e.g. three years after the date of application of this new regime, based on a monitoring report.