The impact of the European Commission´s proposals for a new prudential capital framework on MiFID Investment Firms

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How does the Commission's proposed legislative package impact investment managers in the EU-27 and what pre-emptive steps can stakeholders take to stay ahead of the curve?

In December 2017, the European Commission (the Commission) issued the legislative proposals for prudential requirements for investment firms: the Investment Firms Regulation (**IFR**) and the Investment Firms Directive (**IFD**). The aim of the proposals is to create a new simpler and more risk-sensitive prudential capital regime for MiFID investment firms built around quantitative metrics, called **K-Factors**, that define regulatory capital levels.

It is anticipated that the proposed package comes into force in mid to late 2019 at the earliest. However, the shift in prudential requirements may merit many needing to take early pre-emptive action to either source new regulatory capital or to put in place arrangements to limit risks that could flow into the K-Factors, which might lead to looking at rearranging regulated activities and who does what where.

This Client Alert highlights the Commission´s December 2017 legislative proposals to establish a more tiered and proportionate[1] prudential capital regime for certain "Investment Firms" as such term is used in the context of the CRR/CRD IV Framework and ultimately the MiFID II/MiFIR Framework that entered into force on 3 January 2018. With supervisory policymakers having intimated during the spring of 2018 that the K-Factors are an important future supervisory tool, this is a development that affected firms ought to watch let alone take preparatory action to be ready to seize opportunities.

In summary, the proposed legislation aims to create a more risk-focused regime that is tailored and reflective of the activities of an Investment Firm rather than to continue to treat all Investment Firms in an identical fashion. Two core changes to how prudential requirements apply to Investment Firms are at the heart of the proposal:

1. Creation of classes of Investment Firms. These can be distinguished between those that are:
   a. **Class 1 = systemic firms that undertake bank like activity** and which will be reclassified as credit institutions and continue to be subject to the full CRD IV/CRR Framework. The IFR/IFD regime will not apply to them;
   b. **Class 2 = other non-systemic Investment Firms** whose activity places these above quantitative thresholds that are used to categorise Class 3 entities;
   c. **Class 3 = smaller and non-interconnected entities** to which a simplified version of the regime applies;
2. Setting of capital requirements in a manner that is more proportionate to the risks specific to the Class of Investment Firms. This is done using specific methodology in each of the **"K-Factors"**, which are described in the table below. In practice, this may translate into many firms needing to raise capital to meet such new relevant regulatory capital requirements or cause many to reconsider how and into which Class of Firm their activities cause them to fit into.

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[1] Applying a greater degree of proportionality in regulatory reform is now a key priority for policymakers when advancing supervisory convergence across the EU. See specifically statements from Roberto Gualtieri, MEP, Chair of the Committee on Economic and Monetary Affairs (ECON), European Parliament in a Keynote Speech given at the ESMA Annual Conference on 17 October 2017 in Paris. This also assists in the overarching aim to get to the desired ‚end-state' of how financial services are regulated across the EU, with a much more ‚level playing field' driven by a Single Market built upon a Single Rulebook that is much more uniform

Supervisory objectives – tailoring rules yet widening supervision

The practical aim of this new regime is to ensure that the prudential i.e. the regulatory capital framework applicable to Investment Firms "better captures and regulates risks[2] that are specific to MiFID business". Such a new regime equally aims to differentiate itself from the prudential regulation framework for banks, including as applied in the Eurozone-19's Banking Union in which the European Central Bank leads in the Single Supervisory Mechanism (**ECB-SSM**). However, the differentiation is not complete as Class 1 Investment Firms that undertake "banking sector comparable activities" will be exempt from the new rules and will continue to fall under the CRR/CRD IV prudential regime for banks. For firms headquartered in the Banking Union, this will mean being supervised by the ECB-SSM. This is aligned with the intention of the Eurozone bank supevisor which, in the context of BREXIT-relocations and otherwise, has stated that it should have supervisory oversight over "investment banks" i.e., often firms that are MiFID Investment Firms, in order to ensure a level playing field.

Whilst most of the proposed Recommendations apply to all Class 2 and 3 Investment Firms, some apply specifically only to those that are "Commodity Derivatives Investment Firms" (**CDIFs**) i.e., as such term is used within the meaning of the MiFID II/MiFIR Framework. The proposals do not apply to funds and their managers that fall within the AIFMD or UCITS Frameworks. That being said, the proposed legislation will impact any group that includes one or more Investment Firms, categorised as Class 2 or 3. Both banking and fund sector participants often split MiFID business either by choice or because regulatory requirements make it an obligation to do so into MiFID Investment Firms that are then affiliated entities in the same group. Consequently, a number of groups may want to check their legal entity structuring and possibly the options on how to optimise their regulatory capital requirements.

The affected Investment Firms, including their counterparties, may want to take note of the economic and regulatory costs of the new rules. Those considerations are however not self-contained. Rather, they will have a host of spillover effects including in what this might mean for various financial models and financing needs. However, these proposals may also present opportunities to streamline or optimise financing or standby-facilities prior to the relevant changes applying and a host of competitors needing financing.

What is certain is that any change in the prudential regulation of Investment Firms will likely redraw the map for existing as well as new market participants. These potential changes come on top of any MiFID II/MiFIR compliance priorities that will continue to impact "change the business" along with „run the business" workstreams as well as strategic projects for Investment Firms.

How do the K-Factors amend the landscape?

The Commission recognised the wide-reaching scope of application of the regime and breadth of changes required to implement the new rules by granting a three year transition period. During this period, the capital requirements will be limited to twice what they would have been under the old regime.

The new proposed prudential capital rules are likely to be of relevance to those Investment Firms within the EU-27, including the Eurozone-19 and ultimately those relocating, whether from the UK or elsewhere, to the EU.

A move to a much more tiered and proportionate capital regime will potentially be costly. Aside from regulatory capital in terms of minimum own funds, it will equally place a greater emphasis on firms and their risk controls so as to minimise individual risk types with an aim to reduce their risk capital. This is especially the case given the importance Investment Firms' exposures to certain risks will play in calculating regulatory capital needs in this new regime. These risk types are referred to as "K-Factors" and are based on quantitative indicators.

The "Class" that an Investment Firm will fall into will trigger the relevant minimum amount of regulatory capital levels. The allocation to a specific Class is driven by both the type of MiFID Investment Activity (i.e., qualitative consideration) and the K-Factor values (i.e., quantitative considerations). For many firms, especially for so called "exempt CAD" advisory firms such as those relocating from the UK, the regulatory capital could go from EUR 5,000 to 75,000. For the breadth of other Investment Firms, the increases could go from EUR 50,000 to 75,000, possibly 150,000 up to a maximum of EUR 5 million for so-called Class 1 Investment Firms and/or credit institutions.

In short, K-Factors are clearly costly in terms of increased own fund requirements but will also likely be costly in terms of investment in systems and resources needed to identify, mitigate and manage risks generally as well as those specifically relevant to the K-Factors. A number of affected firms will most likely look to recoup the costs elsewhere.

[2] including an ability to account for an orderly wind down.

Below is an overview of the K-Factors, which have been grouped into three catagories, reflecting three risk types:

K-Factor type proposed in IFR	Overall K-Factor(s) – relevant components and coefficients not discussed	Description
Risk to Customers (RtC)	**K-AUM**	Assets under management – under both discretionary portfolio management and non-discretionary (advisory) arrangements.
	K-CMH	Client money held.
	K-ASA	Assets safeguarded and administered.
	K-COH	Client orders handled - execution only in name of customer and reception and transmission of orders.
Risk to Market (RtM)	**K-NPR**	Net position risk - based on the market risk requirements of the CRR II Proposal and made appropriate for investment firms (only applicable to trading book positions).
	K-CMG	Clearing member guarantee – amount of initial margins posted with a clearing member, where the execution and settlement of transactions of an investment firm dealing on own account take place under the responsibility of a general clearing member.
Risk to Firm (RtF)	**K-DTF**	Daily trading flow - value of transactions where the firm is trading on own name (on own account or in execution of client orders) (only applicable to trading book positions).
	K-TCD	Trading counterparty default - based on the BCBS proposals for counterparty credit risk and simplified for investment firms (only applicable to trading book positions). Takes into account OTC derivatives (presume this is ought to be MiFID II instruments), "long-settlement transactions" (undefined), "repurchase transactions" (repurchase and reverse repurchase transactions but not those that are Securities Financing Transactions for the purposes of the same named Regulation), and "securities or commodities lending or borrowing transactions" (again - no clarity on whether these include Securities Financing Transactions for the purposes of the same named Regulation).
	K-CON	Concentration - taking inspiration form the CRR large exposures regime for trading book and simplified for investment firms (only applicable to trading book positions).

How does this interlink with BREXIT and Investment Firms' preparations?

Many Investment Firms may want to consider varying their permissions or apply for new permissions prior to these new rules taking effect and the prudential capital regime possibly making business "more expensive". These rules should also be read in conjunction with the supervisory principles on relocation (**SPoRs**) as collectively these developments will affect BREXIT-proofing plans in terms of strategy as well as which legal entities will do what where and with whom.

This is the case not only for those standalone Investment Firms that are subject to ESMA's SPoRs and the ESMA SSOs, but also to those Investment Firms that are part of a group with a banking licence and subject to EU-27 relevant supervisory expectations. More importantly these considerations also apply within the Eurozone-19 and firms will need to assess how these changes interact with the supervisory priorities and expectations of the Banking Union and its Single Supervisory Mechanism (**SSM**) led by the European Central Bank.

How can affected Investment Firms stay ahead of the curve?

The continous regulatory changes, including amendments to the CRD IV/CRR Framework as well the SPoRs will keep Investment Firms extremely busy. Thus, sourcing and allocating committed resources will be a priority and one that will help market participants to stay ahead of the curve.

Setting-up dedicated internal project teams and early channels of communication to counsel should ease the compliance burden. It will also help scenario plan all various impacts of the K-Factors and how to calibrate risk controls to reduce both conduct of business but more directly the prudential capital charges.

Linking these priorities into BREXIT-proofing workstreams, might mean that Investment Firms may wish to consider retaining appropriate legal and regulatory specialists, both within internal and external project teams that can draft, implement and ensure compliance with EU, Eurozone, respective national levels as well as third-country regimes. This dedicated workstream, whilst needing to be interoperable with regulatory authorisation applications and relocation workstreams, might be beneficial in running separately so as to ensure it has a sufficient degree of independence and an ability to challenge assumptions made by those advising on the relocation plans.

So any chance that this will all go away? Quite unlikely. This workstream has been a longstanding supervisory priority and one that also delivers on the overarching convergence goals as part of the wider Capital Markets Union project. That being said, the EU legislative process takes time. The timeline is likely to be protracted as a lot of the fine details are ironed out in the Regulatory Technical Standards. As other regulatory reform projects have shown, forward planning helps stay ahead of the curve and can be done with a view to what already exists in other areas where similar regulatory/supervisory concepts exist.

So will supervisors have enough resources to police? One point that is not clear from the September Opinion is whether the reference to „competent authorities" is deliberate. Typically, in EU regulatory parlance the reference to competent authorities refers to these as those national bodies. If this oversight is deliberate then is this a nod towards centralised oversight of Investment Firms by a pan-EU authority rather than national supervisors? Given that the September Opinion takes a forward-looking view on a number of developments, is this the anchoring of concepts pending institutional reform of supervisors and their mandates? As above, if other policymakers and supervisors enter the fray, any final regime building on the September Opinion's Recommendations could change further.

Moreover, it is worth noting that in the margins of the ESMA Annual Conference on 17 October 2017 in Paris, statements indicated a policy consideration whereby Class 1 Investment Firms, possibly some Class 2 Investment Firms could become subject to centralised supervision at some future undefined date. That would be a massive change and reintroduces wider questions on whether a single Capital Markets Union supervisor comparable to the Banking Union and its SSM might be a longer-term supervisory policy goal in delivery or merely at the planning stage. Indeed, the European Banking Authority's (**EBA**) General Opinion on Supervisory Principles on Relocations[3], which is aimed at improving supervisory convergence in light of BREXIT, specifically calls for Class 1 Investment Firms to be subject to centralised supervision and proposes that the ECB-SSM is in the lead.

In conclusion, the IFR and IFD proposal is the beginning of the end of a long process to make Investment Firms subject to prudential regulatory capital levels that are more reflective of their actual and potential risk profile. It comes on top of a full agenda and merits early action especially if this workstream is a building block for more widespread change that remains on the policymakers' agendas as they progress the completion of the Single Market, the Single Rulebook and delivery of the Capital Markets Union.

[3] See a full list of our Client Alert series on the SPoRs available from our dedicated Eurozone Hub resources.

If you would like to receive more analysis from our wider Eurozone Group or in relation to the topics discussed above or in the text of the European Commission's proposed IFR and IFD, then please do get in touch with any of our Eurozone Hub key contacts below.

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Appendix

The following table sets out an overview of the key takeaways from each of the Recommendations in the EBA Opinion on the design of a new prudential framework for investment firms from 29 September 2017 which formed the basis of the Commission's proposals.

The Commission only divereged from one of EBA's recommendations: Recommendation 4 below on developing criteria to identify Class 1 investment firms. Rather than alllowing the EBA to develop guidelines on identification of Class 1 Investment Firms at a later stage, the Commission decided to clarify this aspect in its December 2017 proposals and to include Class 1 systemic investment firms in the definition of credit institutions under CRR, subjecting Class 1 firms to direct prudential supervision by the ECB-SSM under the CRR/CRD framework. The Commission stated that the decision was motivated by the need to ensure regulatory level playing field between credit institutions and investment firms, as well as by Brexit.

EBA's Recommendations to Commission		
# and RAG Status	**Key takeaways**	**Impact on relevant Investment Firms**
1 R	Development of a consolidated EU-27 version of the "Single Rulebook" applicable to all Investments Firms other than those that are designated as "Class 1" (see below) and which is separate to that applied to credit institutions.	For groups that include affected Investment Firms this new regime will have spillover effects for treasury planning. Consolidated supervision will thus differ between those groups that have only one or more Investment Firms and those that also include one or more credit institutions (for Class 2 and 3 firms).
2 G	Transition arrangement(s) (applicable up to three years) for individual and consolidated capital requirements available to certain Investment Firms in limited circumstances.	Entities that might be able to apply for waivers and transitional arrangements may need to start putting together "packs" to evidence the strength of relevant safeguards and why they should benefit from such arrangements.
3 A	Introduction of a new MiFID Investment Firm categorisation distinguishing between those that are: • Class 1: systemic Investment Firms which are exposed to the same types of risks as credit institutions and to which the full CRD IV/CRR Framework should be applied; • Class 2: other non-systemic Investment Firms which where above specific thresholds should be subject to a more tailored prudential regime based on "K-Factors" (see below); and • Class 3: relevant for small and non-interconnected Investment Firms providing limited services and thus to whom a proportionate application of the prudential capital regulatory regime should be made applicable.	Affected Investment Firms will need to assess which Class they fall in and weigh-up the cost of compliance of running as a Class 1 firm versus the investment in systems and controls to ensure one remains a Class 2 or Class 3 Investment Firm.

4 R	The Commission diverged from the EBA's proposal to develop Regulatory Technical Standards, containing criteria in order to identify Class 1 Investment Firms. The Commission's proposal suggests an amendment to the definition of a credit institution in the CRR to include firms whose business includes dealing on own account or underwriting or placing financial instruments on a firm commitment basis with assets over EUR 30 billion.	Investment Firms which classify as systemic will need to seek authorisation as a credit institution by the ECB-SSM and will be subject to direct supervision by the ECB.
5 A	The following thresholds determine whether Investments Firms are capable of qualifying as Class 3 Investment Firms instead of Class 2 or Class 1 Investment Firms. If an Investment Firm can satisfy one or more of the following (on a consolidated basis unless stated otherwise) they will qualify as a Class 2 Investment Firm: • assets under management (**K-AUM**) for both discretionary and non-discretionary portfolio management is higher than EUR 1.2 billion; • client orders handled (**K-COH**) is higher than EUR 100 million a day for cash trades and/or higher than EUR 1 billion (notional) for derivatives; • assets (we presume client assets) that are safeguarded and administered (on a solo basis) are higher than zero (**K-ASA**); • client money held (on a solo basis) is higher than zero (**K-CMH**); • K-NPR or K-CMG, K-DTF or K-TCD (each calculated on a solo basis) are higher than zero; • balance sheet total is higher than EUR 100 million; and • total gross revenues is higher than EUR 30 million.	Investment Firms may need to consider putting in place controls to ensure they are capable of flagging when they near a relevant threshold.
6 G	All Investment Firms that are not Class 1 or Class 3 should be categorised as Class 2 Firms.	Same consideration as with Recommendation 5.

7 A	All Investment Firms must meet their prudential requirements on an on-going basis. A breach of the exemptions in Recommendation 5 will require the firm to be automatically recategorised unless the threshold breach is in respect of assets under management or client orders handled, which shall result in having a three-month grace period before being recategorised.	Same consideration as with Recommendation 5.
8 R	Consolidated supervision of Investment Firms for prudential capital purposes will be permitted if the following is true: • the group does not include any credit institutions or Class 1 Investment Firms; • consolidated supervision will look at all Investment Firms, MiFID, "any other prudentially regulated entity", financial institutions and should include tied agents where they are owned by the Investment Firm; • the parent company should always be subject to a group capital test to ensure control of leveraging and to ensure that the ultimate parent company located in an EU Member State should have appropriate control functions to manage sources of capital, funding and liquidity of all regulated entities within the group.	The change here to what can be consolidated and quite possibly that the scope of consolidation goes beyond EU entities is worth noting.
9 A	Competent authorities, ought to be able to exercise the power to require capital requirements on a consolidated basis to an Investment Firm- Only Group where: • the structure applied has been deliberately chosen to avoid appropriate capital charges; • the individual Investment Firms are interconnected and there risk contributions would be material if their individual risk profiles were aggregated; or • 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, so that it would be prudent to consolidate their supervision.	

10 A	Certain investment firms that contain a credit institution or a Class 1 firm, may allow for prudential capital waivers for the Class 2 and Class 3 components of the group;	Similar to current rules/principles.
11 A	Subject to centralised liquidity management functions and concentration limits, competent authorities may waive individual entities from liquidity requirements and these are met at a consolidated or sub-consolidated level.	Similar to current rules/principles.
12 R	The new prudential capital regime should have only one single definition and composition of regulatory capital for all types of Investment Firms and aligned with the CRD IV /CRR Framework.	Further coverage on this from our Eurozone Hub will follow as this change develops.
13 R	CET 1 capital should constitute at least 56% if capital requirements. Additional Tier 1 is eligible up to 44% of capital requirements, Tier 2 capital is eligible up to 25% of capital requirements.	Whilst this change will be driven by firm specific attributes, it may cause many to source standby or draw actual financing from stable channels.
14 A	The use of prudential filters should be aligned with the approach proposed in EBA/Op/2014/05 which recommends	This will be driven by firm specific decisions but may prompt early scenario and impact planning
15 G	Investment Firms should always be required to deduct items in full referred to in Arts. 37 to and including 47 of CRR when calculating their regulatory capital. Non-significant holding in financial sector entities should be exempted if held for "trading purposes".	The definition of what will satisfy "trading purposes" will follow similar regulatory developments in other fields and may merit redocumenting trading arrangements as well as policies of risk and control functions.
16 G	The new prudential regime will include a mechanism to recognise less common legal forms of Investment Firms (such as limited liability partnerships, partnerships and sole traders). This aims to provide an easier method of recognising loss absorbing capabilities of various financial instruments issued by such entities.	This is a very welcome development and will allow for more flexibility in terms of structuring.
17 A	Minimum Capital Requirements (**MCR**) for Investment Firms for initial authorisation should be aligned with on-going capital requirements.	Meeting MCR levels may become more costly for certain firms.
18 A	Class 2 and Class 3 Investment Firms will have a specific level (to be defined) of Initial Capital Requirements (**ICR**).	This Recommendation may be subject to further amendments.
19 R	Investment Firms will need to meet the Permanent Minimum Capital (**PMC**) requirements and the minimum level of Fixed Overhead Requirements (**FOR**) on an ongoing basis. The September Opinion states that "PMC and FOR will be set as a minimum to the capital requirements for all Investment Firms."	

20 R	ICR is proposed to be set at: EUR 750,000 for Investment Firms undertaking any of the following one or more MiFID II activities: • dealing on own account; • underwriting/placing of financial instruments; • operating a MTF; • operating an OTF; EUR 75,000 for firms that are not permitted to hold client money or securities belong to their client and are permitted to provide one or more of the following MiFID II activities: • reception and transmission of orders; • execution of orders on behalf of clients; • portfolio management; • investment advice; • placing financial; • instruments on a firm commitment basis; and EUR 150,000 for all other Investment Firms.	
21 R	Recommended setting of PMC: • Class 1 Investment Firms = EUR 5 million; and • all other Investment Firms = to ICR level.	
22 R	Class 3 Investment Firms may be eligible to benefit from a five year phased transitional period to allow them to move to PMC and FOR requirements.	
23 R	FOR levels will be set to at least 25% of the fixed overheads of the previous year using the methodology in Commission Delegated Regulation 488/2015.	
24 R	MCRs for Class 2 Firms should be the higher of the following requirements: PMC; FOR; or those based on the K-Factor formula (see below).	

25 R	MCR for Class 3 Firms should be the higher of the PMC or the FOR.	
26 R	The total capital requirements for Class 2 Investment Firms should consider: • risk to customer levels (**RtC**); • risks posed to the market should they fail (**RtM**); and • any risks to the firm itself (**RtF**).	
27 R	The methodology for calculating capital requirements in this new prudential regime thus bases itself on: "K-Factors Capital Requirements" = RtC+ RtM + RtF	
28 R	This Recommendation details the K-Factors relevant for RtC. These cover those introduced in Recommendation 5 and specifically K-AUM, K-CMH, K-ASA and K-COH.	
29 R	The EBA recommends that a harmonised definition be introduced to make it clear that the K-CMH factor include all client money held regardless of the legal arrangements on asset segregation or the accounting treatment under national law of client money held by an Investment Firm.	
30 R	Introduces the K-Factors relevant for RtM calculations. These include: • the net position risk for Investment Firms measured by reference to the (net open) position end of day and in accordance with the proposed methodology of CRR II[4] (**K-NPR**); • K-NPR should only apply to the „trading book" as such term is used in the CRR II proposal; and • the K-NPR factor should apply to underwriting positions held in in the trading book and the requirements of Art. 345 are to be applied.	

[4] 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 – see: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2016:0850:FIN

31 R	RtF calculations assess the following metrics in calculating the K-Factors: • trading counterparty default requirement (**K-TCD**); • daily trading flow (value of transactions where the firm is trading in their own name) and capture of the relevant operational risk (**K-DTF**); and • risk capture of single name concentration and relevant requirements (**K-CON**).	
32 R	Investment Firm – specific characteristics may justify the introduction of some adjustments of K-NPR such as removing thresholds for using the Simplified Standardised Approach.	
33 R	The EBA points to the BCBS workstream on the use of a reducedsensitivities-based method.	
34 R	This Recommendation introduces the following formula: "K-Factors Capital Requirements" = Sum a I *K I where K I are the K-Factors and a I the coefficients (ranging from 0.01% to 0.45%) are specified in the table on page 10 of the September Opinion.	
35 R	If a number of preconditions are met and if the competent authority decides, then the RtM factor can alternatively to Recommendation 30 be set as: max(K-NPR, K-CMG). The metric K-CMG i.e., clearing member guaranteed would be the highest total intraday margin posted by the trading firm with the (general) clearing member in a previous period (e.g. three months).	
36 R	The K-Factors should be subject to a ‚smoothing mechanism', in order to aid capital planning and to avoid ‚cliff effects'. Such mechanism should be based on rolling averages and a deferral period between the date of capital requirements and the date of their application. The extent of such smoothing may vary by individual K-Factor, the volatility and the risk posed in the RtC, RtM or RtF etc	

37 A	The Liquidity Coverage Ratio pursuant to Commission Delegated Regulation (EU) 2015/61 (the **LCR CDR**), but at present not the Net Stable Funding Ratio (**NSFR**), should be applied to all Class 1 Investment Firms.	In future the NSFR may be rolled out to all Class 1 Investment Firms.
38 A	Class 2 and 3 Investment Firms are expected to have internal rules and processes that allow them to monitor measures and manage exposures and liquidity needs to ensure their resources are adequate.	For smaller firms, irrespective of their Class in the new regime, this will translate into costs and allocation or resources.
39 R	Class 2 and 3 Investment Firms should hold liquid assets liquid to one-third of the FOR level.	For many this will possibly merit a recalibration of FOR levels.
40 R	Eligible liquid assets should meet the liquidity requirements applicable to those that are „high quality liquid assets" (**HQLA**) of Level 1, 2A and 2B assets as set out in the LCR CDR.	This might cause Investment Firms to need to source additional capital by either raising new or transforming existing assets into HQLA.
41 R	Haircuts should be applied to the market value of assets held by Investment Firms for the purposes of meeting minimum liquidity requirements and aligned with the levels in the LCR CDR. Unencumbered own cash of the firm should, according to this Recommendation, receive a 0% haircut.	Further coverage on this development will be made available as and when the various haircuts and liquidity requirements (incl. coefficients) proposed by the new regime are finalised.
42 R	The level of liquidity requirements are proposed to be adjusted by deducting 1.6% of the total amount of guarantees provided to customers from the sum of liquid assets.	
43 A	Specifically for Class 3 Investment Firms, any trade debtors, fees or commissions receivable within 30 days would, subject to certain preconditions, be able to meet minimum liquidity requirements.	Further clarification is expected as to what does and what does not fully qualify as receivables for the purpose of this proposed rule.
44 G	During exceptional and unexpected circumstances and subject to a regulatory notification requirement, all Investment Firms are permitted to monetise their liquid assets to cover their liquidity assets even if this causes the amount of liquid assets to fall below minimum liquidity requirements.	It remains to be seen what circumstances will be permitted to allow the application of this fire sale derogation.

45 A	All Investment Firms will be required to monitor their concentration risk including in respect of their RtC.	
46 A	Class 2 Investment Firms are recommended by the EBA to report to competent authorities their concentration risk levels in respect: • of default risk for individual counterparties on an aggregate basis; • institutions where client money is held; • institutions where securities (but strangely not where client assets?) are held; • institutions where the own cash (but not other funds) is deposited; and • risk from earnings.	For a number of firms, this might prompt a need to revisit their own policies and procedures including ability to report.
47 A	Class 3 Investment Firms will not be subject to concentration risk reporting requirements.	
48 A	Class 2 Investment Firms with a trading book exposure arising from its MiFID II activity dealing on own account or trading on own name when executed client orders will also have the following concentration risk limits: • maximum exposure limit of 25% of capital; • counterparty exposures to one or more credit institutions or Investment Firms or a group thereof should not exceed the higher of 25% of capital or EUR 150 million; and • counterparty exposures to connected clients that are not credit institutions or investment firms should not exceed 25% of capital. When the EUR 150 million level is higher than 25% of capital, than the limit of counterparty exposures shall not exceed 100 percent of capital. The limits laid down in respect of the above may be exceeded if the additional capital requirements of K-CON are met.	In keeping with existing prudential regulatory principles, Affected firms will need to assess the degree of their actual and potential concentration risk exposure.
49 Unknown	Pillar 2 capital requirements will continue to be applied to introduce firm specific capital requirements.	The impacts of this development will be, as presently, quite firm driven. Specialist advice should be taken.

50 A	Pillar 2 methodology will be harmonised by issuance of further Regulatory Technical Standards aiming at achieving supervisory convergence.	Further coverage will be made available from our Eurozone Hub once the Regulatory Technical Standards and the "simplified reporting framework" are finalised.
51 A	Class 2 and 3 Investment Firms will be able to benefit from a "simplified reporting framework". Class 1 Investment Firms are envisioned to be subject to the same reporting framework as credit institutions.	
52 A	This Recommendation sets out the reporting requirements proposed by the EBA for the Class 2 and 3 Investment Firm "Simplified Reporting Framework".	This list is not comprehensive of all other standing and/or event driven reporting requirements. The impacts will be specific to the nature and type of firm and its regulated business activity.
53 A	Pillar III public disclosure requirements will still play a role for Class 2 Investment Firms who will need to disclose level of capital and their capital requirements. Class 3 Investment Firms are set to be excluded from reporting requirements for the purposes of this new prudential capital regime.	As with considerations above, indirect costs of ensuring the correct Class allocation will drive the Pillar III disclosure issue.
54 (CDIFs only) R	CDIFs will be subject to the proposed new prudential regulatory regime.	This may introduce a number of issues for CDIFs in setting adequate capital levels depending on how the overall new proposed regime is extended to them and where there trading takes place.
55 (CDIFs only) R	The new prudential capital regime will be tailored to the specifics of CDIFs and their business activities.	
56 (CDIFs only) R	CDIFs will benefit from a transitional regime that is driven by the finalisation of the MiFID II/MiFIR Framework's rules applicable to CDIFs.	
57 (CDIFs only) A	The EBA recommends that CDIFs might benefit from exemptions from certain prudential requirements in relation to those positions that are "...objectively measureable as reducing risks directly related to commercial activities."	This proposed exemption mirrors a similar "hedging" and "end-user" exemption in the EU's regulatory framework in EMIR. As with EMIR, focus will lie both on supervised and supervisors defining what activity will satisfy the qualitative criteria.

58 (CDIFs only) G	Governance and remuneration requirements contained in Art. 109 CRD IV remain applicable to all Investment Firms. That being said: Class 2 and 3 Investment Firms may apply "...a lighter governance framework..." (undefined) than those that are Class 1 Investment Firms; Art. 74 CRD IV's provisions will only apply to Class 1 and will not apply to Class 2 and 3 Investment Firms; Class 2 Investment Firms that hold client assets will need to comply with Art. 76 CRD IV; Member States and competent authorities will have discretion as to whether Class 2 Investment Firms will need to create relevant committees (risk, nomination and remuneration) as required in the CRD IV/CRR Framework. For Class 1 Investment Firms, they will need to continue to comply and Class 3 Investment Firms are deemed out of scope of this requirement; All Investment Firms that deal on own account and which are also allowed to hold client assets will need to comply with Art. 83 CRD IV on market risks; Class 2 Investment Firms and their supervisors will need to comply with Art. 85 CRD IV; and Country by country reporting for purposes of Art. 89 CRD IV will only be recommended for Class 2 Investment Firms.	This is a welcome development that could open up easier and more proportionate compliance on rules on remuneration.
59 G	Class 1 Investment Firms will need to fully comply with the CRD IV/CRR Framework on remuneration. Class 2 and 3 Investment Firms may apply a lighter touch regime (including with respect to disclosure and variable remuneration i.e. bonus components), with Class 2 Investment Firms applying similar requirements to Art. 92 to and including 94 CRD IV and focus on their material risk takers and Class 3 Investment firms only requiring to apply the MiFID II/MiFIR Framework rules on remuneration.	

60 unknown but likely to be A	The EBA recommends that the new prudential capital regime also include a macroprudential supervisory element and interface with existing or new tools.	Further coverage on this will be made available from our Eurozone Hub as this workstream continues to develop.
61 unknown but likely to be A	This Recommendation assesses whether a tiered approach should be adopted in respect of the macroprudential interface.	
62 no present impact	As with other EU legislative and regulatory regime, this Recommendation calls upon the EC or indeed the EBA to undertake a review process three years after the application of the new regime.	No present impact.

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