

Prudential supervision of investment firms

2017/0358(COD) - 20/12/2017 - Legislative proposal

PURPOSE: to establish a proportionate and risk-based European prudential framework for investment firms.

PROPOSED ACT: Regulation of the European Parliament and of the Council.

ROLE OF THE EUROPEAN PARLIAMENT: the European Parliament decides in accordance with the ordinary legislative procedure and on an equal footing with the Council.

BACKGROUND: investment firms play an important role in facilitating savings and investment flows across the EU. They offer investors (retail, professional, corporate) various services that give them access to the securities and derivatives markets (investment advice, portfolio management, brokerage, execution of orders, etc.). Unlike credit institutions, investment firms do not take deposits or make loans. This means that they are **a lot less exposed to credit risk and the risk of depositors withdrawing their money** at short notice.

There were 6 051 investment firms in the European Economic Area (EEA) at the end of 2015. Most EEA investment firms are **small or medium-sized enterprises**. At present, these companies are concentrated in the United Kingdom, but considering relocating part of their operations in the EU-27, particularly to the Member States participating in the banking union. The UK decision to leave the EU highlights the need to modernise the EU's regulatory architecture.

As one of the new priority actions to strengthen capital markets, the Commission announced in its [mid-term review of the Capital Markets Union action plan](#), that it would propose a more effective prudential and supervisory framework, calibrated to the size and nature of investment firms.

This proposal for a directive and the accompanying [proposal for a regulation](#) aim to ensure that **investment firms that are not systemically important** (the majority of them) are subject to capital and liquidity requirements and other key prudential requirements and supervisory measures that are tailored to their activities, but sufficiently stringent not to jeopardize the stability of the EU's financial markets.

The proposals are the outcome of a review mandated by [Regulation \(EU\) No 575/2013](#) (Capital Requirements Regulation, or CRR) which, together with [Directive 2013/36/EU](#) (Capital Requirements Directive IV, or CRD IV), constitutes the current prudential framework for investment firms. The prudential framework applicable to investment firms set out in CRR / CRD IV works in conjunction with the [MiFID II Directive](#) / [MiFIR Regulation](#) on markets for financial instruments.

Systemically important investment firms, some of which qualify as globally important companies, would remain subject to the existing framework set out in CRR / CRD IV.

IMPACT ASSESSMENT: the review of the prudential framework for investment firms was carried out in consultation with the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the competent national authorities represented in these European Supervisory Authorities.

A working document accompanying the proposal concludes that, overall, the EBA recommendations **represent a step towards a prudential framework for investment firms**, which ensures that they operate on a sound financial basis, without hindering their commercial prospects.

CONTENT: the proposal for a directive **revises and simplifies existing EU rules governing the prudential treatment of investment firms** in order to (i) better accommodate and address risks in their business models; (ii) improve the level playing field among firms; and (iii) enhance supervisory convergence.

It applies to all investment firms covered by MIFID II, whose application is scheduled to begin in January 2018. In specific, the proposal:

- requires Member States to **designate an authority to exercise the prudential supervisory powers** provided for in this directive, transferring the relevant provisions of CRD IV to the proposed directive;
- revises and harmonises throughout the EU the **initial capital levels**, based on the services and activities that investment firms are authorised to provide in accordance with MIFID, from the levels stipulated in CRD IV to take into account inflation since these levels were set. Transitional arrangements are made to allow **smaller firms** in particular to attain the new amounts of initial capital where necessary;
- confers the powers set out in CRD IV on the authorities of **home and host countries** for the prudential supervision of investment firms and establishes the arrangements for cooperation between these authorities;
- introduces provisions for the **exchange of information** between the competent authorities on prudential supervision and professional secrecy on the basis of CRD IV;
- requires Member States to establish administrative **penalties** and other administrative measures that are effective, proportionate and dissuasive in order to deal with infringements of the provisions of the directive;
- introduces **simplified requirements** for investment firms and competent authorities to assess the adequacy of arrangements and procedures to ensure that firms comply with the provisions of the Directive;
- gives competent authorities the power to **review and evaluate the prudential status of investment firms** and to request, where appropriate, changes in areas such as governance and internal controls, risk management processes and procedures and, where necessary, set additional requirements, including capital and liquidity requirements;
- revise the rules on **corporate governance and remuneration** to prevent excessive risk taking by the staff of investment firms; however, small, non-interconnected investment firms would be exempt from these rules. The proposal requires investment firms to establish **appropriate ratios** between variable and fixed components of remuneration. In addition, it sets a threshold at firm and staff levels below which investment firms and/or staff members will benefit from the **derogations** from the application of the rules on the deferral and pay-out in instruments;
- provides for the possibility for the Union to conclude **agreements with third countries** regarding the means of supervising compliance with the group capital test. Administrative cooperation arrangements with third countries supervisory authorities may be concluded by the Member States and EBA to facilitate the exchange of information.

DELEGATED ACTS: the proposal contains provisions empowering the Commission to adopt delegated acts in accordance with Article 290 of the Treaty on the Functioning of the European Union.