

Prudential requirements of investment firms

2017/0359(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 regulation and the accompanying [proposal for a directive](#) 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 regulation lays down **requirements** in terms of own funds, levels of minimum capital, concentration risk, liquidity, reporting and public disclosure for all investment firms **that are not systemic**.

Level of application: the prudential regime for investment firms that are not considered to be systemically important should apply on an individual basis to each investment firm. **A derogation is provided for small and non-interconnected firms** within banking groups subject to consolidated application and supervision under the CRR/CRD IV.

Own funds: the capital instruments which qualify as own funds for investment firms to meet their capital requirements under this Regulation consist of the same items as under CRR/CRD IV. For this purpose, Common Equity Tier 1 (CET1) capital should constitute at least 56 % of regulatory capital, with Additional Tier 1 (AT1) capital eligible for up to 44 % and Tier 2 capital eligible for up to 25 % of regulatory capital.

Capital requirements: all investment firms must maintain an amount equal to the initial capital required for their authorisation as permanent minimum capital at all times.

For the smaller ones, the capital requirements would be set more simply. The latter should have a capital equal to the highest of the following requirements: their requirement of permanent minimum capital, or a quarter of their fixed overheads measured on the basis of their activity of the previous year.

Concentration risk: investment firms should monitor and control their concentration risk, including in respect of their customers. Only firms that are not considered small and non-interconnected should report to competent authorities on their concentration risks. For investment firms specialised in commodity derivatives or emission allowances, which can have large concentrated exposures to the non-financial groups they belong to, these limits may be exceeded without additional capital as long as they serve group-wide liquidity or risk management purposes.

Liquidity: investment firms should have internal procedures to monitor and manage their liquidity needs and be required to hold a minimum of one third of their fixed overheads requirements in liquid assets.

Supervisory reporting and public disclosure: investment firms shall publicly disclose their levels of capital, their capital requirements, remuneration policies and practices, and their governance arrangements. However, small and non-interconnected firms shall not be subject to public disclosure requirements.

Systemic investment firms: the proposal amends the definition of credit institutions in CRR.

The status of credit institutions will be granted to large investment firms that have assets above EUR 30 billion. Large investment firms of systemic importance **will continue applying CRR/CRD IV** and will be fully subject to the prudential and supervisory requirements applicable to credit institutions. The European Central Bank (ECB), in the exercise of its supervisory function (single supervisory mechanism), will monitor these systemically important investment firms within the banking union.

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.