IFD/IFR in summary

The EU's Investment Firms Directive (**IFD**) and Investment Firms Regulation (**IFR**) puts in place a new prudential framework for MiFID-authorised investment firms (**Investment Firms**).

The new framework aims to ensure the safe functioning of Investment Firms and to ensure that they properly manage customer and market risk. The new framework allows for differentiated regulation of Investment Firms depending on their classification, with higher impact Investment Firms being subjected to more intensive regulation. The degree of regulation will depend on the firm's particular business activity, risk profile and structure which in turn dictates their new prudential class. A relatively small number of Investment Firms will be subject to the same prudential requirements that are applied to banks. The remaining Investment Firms are subject to a harmonised, and for some an enhanced, set of prudential requirements.

Classifications of Investment Firms

Investment Firms are categorised into one of the following four classes:

"Class 1" Investment Firms

Systemically important Investment Firms dealing on own account and/or who underwrite or place financial instruments on a firm commitment basis and who have average of monthly total assets, calculated over a period of twelve consecutive months exceeds €30bn; or (if below €30bn) where the undertaking is part of a group in which the total value of the consolidated assets of all undertakings in the group exceeds €30bn

Key impacts

- Must re-authorise as Credit Institutions
- Supervised under the SSM if located in the Eurozone
- Regulated under the CRR and CRD IV
- Initial capital requirement €5m, but could be subject to higher ongoing capital requirements depending on nature of activities carried out

"Class 1 minus" Investment Firms

Systemic Investment Firms dealing on own account and/or who underwrite or place financial instruments on a firm commitment basis and where the average of monthly total assets, calculated over a period of twelve consecutive months, exceeds €15bn; or (if below €15bn) where part of group in which the total value of the consolidated assets exceeds €15bn.

Investment Firms may be designated as "Class 1 minus" at the option of competent authorities where they have consolidated assets of €5bn or more and meet other criteria relating to their significance and the risks posed in the event of their failure.

Investment Firms may also elect to be subject to CRR if they are part of a group which includes a credit institution which is supervised under CRR and obtain competent authority approval.

Key impacts

- Do not require re-authorisation as Credit Institutions
- Will be regulated under the CRR and CRD IV
- Initial capital requirement equal to the initial capital requirement for authorisation to conduct the relevant investment services set by IFD

"Class 2" Investment Firms

Large Investment Firms that are not systemically important which hold own funds at certain thresholds based on the higher of their permanent minimum requirement, fixed overhead requirement, or k-factor calculation.

This is the default categorisation for Investment Firms, unless national competent authorities assess some Investment Firms as being systemically important and therefore falling into class 1 minus. Such Investment Firms may be able to benefit from a lighter regime if falling within the parameters for class 3 Investment Firms. The ultimate assessment will be determined by the firm's daily trading flow, assets under management, client money, and net position risk.

Key impacts

- Subject to IFD supervisory requirements
- Subject to IFD/IFR remuneration requirements
- Publish reports on environmental, social or governance risks, physical risks and transition risks related to the transition into a more sustainable economy, subject to a three year phase in period
- Establish internal capital assessment process
- Establish liquidity adequacy assessment process
- Subject to new "K-factor" requirements which are a means to calculating a directly proportional capital requirement for each firm's risk profile
- Hold liquid assets equal to at least one third of the firm's fixed overhead requirement
- Initial capital requirement of €750,000, €150,000 or €75,000 depending on nature of activities

"Class 3" Investment Firms

Small Investment Firms that are not interconnected with other Investment Firms and do not undertake any higher risk activities and fall below a range of size-related thresholds and criteria. Class 3 Investment Firms will be subject to a relatively lighter prudential framework under the new regime, but will still need to assess the changes they need to make to prepare for the new regime.

Key impacts

- Must not hold client money or client securities
- Subject to the current MiFID II remuneration framework and not the remuneration framework in IFD/IFR
- Subject to new "K-factor" requirements which are a means to calculating a directly proportional capital requirement for each firm's risk profile
- Hold own funds equal to permanent minimum capital requirement or a quarter of their fixed overheads (whichever is higher) measured on the basis of their activity in the preceding year.
- Initial capital requirement of €750,000, €150,000 or €75,000 depending on nature of activities carried out

EBA workplan and consultations

The EBA has published a Roadmap on Investment Firms which sets out its workplan for implementing the new framework. The EBA mandates cover six main thematic areas:

- Thresholds and criteria
- Capital requirements and composition
- Reporting and disclosure
- Remuneration and governance
- Supervisory convergence and SREP
- Environmental, Sustainable and Governance factors and risks (**ESG**)

The EBA has launched a number of public consultations on its regulatory deliverables under the roadmap. Summaries of all open consultations under IFD/IFR are available here.

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