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Proposed New Regulatory Framework for Investment Firms

On 7 January 2019, it was announced via a press release by the Council of the European Union (the "**Council**") that it's Permanent Representatives Committee ("**COREPER**") had endorsed its position on a package of measures, composed of the proposed Investment Firms Regulation ("**IFR**") and the proposed Investment Firms Directive ("**IFD**"), which will set out a new regulatory framework for investment firms designed to make "the rules applicable to investment firms more proportionate and more appropriate to the level of risk which they take".

The IFR and the IFD will, for most existing investment firms, replace the existing prudential requirements for investment firms set out in the Capital Requirements Regulation (575/2013) ("**CRR**") and the CRD IV Directive (2013/36/EU) ("**CRD IV Directive**") and will also amend the Markets in Financial Instruments Directive (2014/65/EU) ("**MiFID II Directive**") and the Markets in Financial Instruments Regulation (600/2014) ("**MiFIR**").

The Council has published notes setting out the Council Presidency's compromise proposals on the IFR and the IFD, which are set out below:

- A note (5021/19) setting out the Presidency compromise proposal on the IFR.

- A note (5022/19) setting out the Presidency compromise

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proposal on the IFD.

Bespoke Requirements for Investment Firms

Investment firms and credit institutions in the European Economic Area ("**EEA**") are currently subject to similar prudential rules set out in the CRD IV Directive and the CRR which include capital, liquidity and risk management requirements.

The European Commission, which has proposed the new framework, holds the view that the provisions contained in the CRD IV Directive and CRR do not take sufficient account of the business models and risks of investment firms. This point is reiterated by the Council which has indicated that the risks faced and posed by most investment firms are substantially different to the risks faced and posed by credit institutions and that such differences should be clearly reflected in the prudential framework.

Under the proposed new framework, many investment firms would no longer be subject to rules that were originally designed for credit institutions. However, the largest and most systemic investment firms would remain subject to the existing prudential framework under the CRD IV Directive and the CRR.

Three Classes of Investment Firm

Under the proposed new framework, investment firms will be divided into three classes.

- **Class 1** – covers the largest and systemically relevant investment firms which engage in "bank-like" activities and services, which would include proprietary trading or underwriting of financial instruments. Such firms whose consolidated assets exceed EUR 15 billion would automatically be subject to the CRD IV Directive and CRR.

- **Class 2** – covers a category of investment firms that are not categorised as systemic. Such firms would be subject to a tailored prudential regime under the proposed new framework.

- **Class 3 –** covers non-systemically relevant investment firms that do not fall into Class 2 and are defined as "small and non-interconnected investment firms".

In summary the largest firms (Class 1) would be subject to the full banking prudential regime and would be supervised as credit institutions, whereas smaller firms which are not considered systemic (Classes 2 & 3) would face a new tailored regime with bespoke and lighter prudential requirements.

Equivalence Regime

The new proposed framework also seeks to strengthen the equivalence regime, as set out in MIFID II Directive and MIFIR, which would apply to third country investment firms. As the text contained in the IFR and the IFD sets out in greater detail in relation to the requirements providing such firms access to the single market. Furthermore, the proposed requirements also seeks to grant additional powers to the European Commission in order to monitor foreign financial firms which operate in the EEA.

For instance, where the proposed activities to be performed by third country firms are likely to categorised as systemic, the proposed new framework will allow the European Commission to apply certain specific operational conditions to an equivalence decision to ensure that the European Securities and Markets Authority and national competent authorities have the necessary tools to prevent regulatory arbitrage and to monitor the activities of third country firms.

Next Steps

The agreement reached on 7 January 2019 will require the approval of the European Parliament before being finalised. The Council and the European Parliament will now begin trialogue negotiations. It is intended that the new regime would start to apply 18 months after the IFR and the IFD are finalised and formally adopted.

Please find a copy of the press release published by the Council here.

Contact Information

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