

EBA publishes IFR/IFD Roadmap to 2021 implementation

July 13, 2020



The EU's new IFR/IFD framework¹ reshapes how investment firms and others with MiFID top-up permissions calculate their regulatory capital requirements and at what level these need to be maintained from June 2021. All firms in scope of the IFR/IFD need to fall within a specific class, based on their regulated activity but also within certain quantitative metrics in the form of “**K-Factors**”.

Systemically important and larger risky investment firms (i.e. Class 1) will be treated either as credit institutions or be held to the same rules under the CRR 2/CRD V² framework. Those in the Eurozone and its Banking Union will become subject to SSM and SRM supervision. All other investment firms (Class 2 and 3) in the EU-27³ will become subject to the IFR/IFD framework, which includes a consolidated set of regulatory capital and liquidity requirements with limited waivers along with rules on internal models, governance, remuneration and disclosure. In-scope firms, in particular those in groups, will want to take prompt action well ahead of the June 2021 start date.

To neatly summarize and further develop certain concepts, the European Banking Authority (**EBA**) published⁴ on June 4, a roadmap for the implementation of the new prudential regulatory framework for investment firms (the **Roadmap**)⁵ and launched a public consultation on its first set of regulatory deliverables on prudential, reporting, disclosures and remuneration requirements. The EBA also published a template⁶ and instructions⁷ for the 2020 EBA data collection exercise for investment

1 Consisting of Regulation (EU) 2019/2033 - the Investment Firms Regulation (**IFR**) available [here](#) and Directive (EU) 2019/2034 - the Investment Firms Directive (**IFD**) available [here](#).

2 Regulation (EU) 2019/876 amending the Capital Markets Regulation (**CRR 2**) available [here](#) and Directive (EU) 2019/878 amending the Capital Requirements Directive IV (**CRD V**) available [here](#).

3 Given that the UK has not requested nor received, at the time of writing, an extension to the Brexit transitional period, when ends on December 31, 2020, the UK will not be following the IFR/IFD framework but the UK's Financial Conduct Authority had indicated and then released Discussion Paper (**DP/02**), which is open for responses until September 25, 2020, assessing comparable reforms to the UK's prudential regime for investment firms. Even if the UK will likely diverge from the EU's new framework, it is conceivable that the UK legislative policymakers may, to the extent relevant, appropriate and desirable, use the EBA Roadmap as a base starting point and may also, given the longer period, look to see how the EBA responds to its consultation to take stock of how this might impact the UK's own regime.

4 Available [here](#).

5 Available [here](#).

6 Available [here](#).

7 Available [here](#).

firms. This exercise, for which submissions to national competent authorities is required by August 19, 2020 with revisions due by September 16, 2020, aims to assess the impact⁸ of the proposed rules in the Consultation Papers published alongside the Roadmap comprised of:

- draft Regulatory Technical Standards (**RTS**) on prudential requirements for investment firms;⁹
- draft Implementing Technical Standards (**ITS**) on reporting and disclosures for investment firms;¹⁰
- draft RTS on instruments for investment firms remuneration;¹¹ and
- draft RTS on pay out in instruments for variable remuneration under IFD.¹²

The Roadmap outlines the EBA's plan (working together with the European Securities and Markets Authority – **ESMA** and relevant national competent authorities and the ECB-SSM) for each of the rulemaking mandates conferred upon it through provisions set out in the IFR/IFD framework and clarifies its order of priorities.

The consultation will run until (at least) September 4, 2020 i.e. prior to the deadline to resubmit revised data under the data collection exercise. In its own words, the EBA is committed to delivering on its IFR/IFD mandates following a four-phased approach running from 2020 to 2025¹³ with the biggest push of 15 Phase 1 items out of a total of 31 deliverables to be completed by December 2020.

With current disruptions affecting authorities and the fact that the consultation itself only closes September 2020, some of this work may spill over into Phase 2 that runs to the IFR/IFD go live day in June 2021. Unlike COVID-19 driven deferrals to start dates of the amended Capital Requirements Regulation (**CRR**)



and corresponding Directive (**CRD IV**) through CRR 2/CRD V, no indication has been made as to whether IFR/IFD mandates might be postponed. Clarity on this point may hopefully be communicated during the current consultation phase. Regardless of any delay, if approved then the draft RTS and ITS would be submitted to the European Commission for endorsement and then scrutinized by the European Parliament and Council prior to being adopted and published in the Official Journal of the EU. The aim is for the RTS and ITS to be adopted and for these to apply from June 2021 i.e., the start date of the IFR/IFD Framework.

This Client Alert provides an analysis and overview of the documents outlined in the consultation and should be read in conjunction with the first¹⁴, second¹⁵, and third¹⁶ part of our Eurozone Hub's coverage on this development.

⁸ The EBA is collecting data on, among other things:

- Firms' group structure and business, current and revised prudential requirements and balance sheet information.
- The criteria for authorizing an investment firm as a credit institution.
- The number of identified staff whose professional activities have a material impact on a firm's risk profile or assets it manages.

⁹ Available [here](#).

¹⁰ Available [here](#).

¹¹ Available [here](#).

¹² Available [here](#).

¹³ The mandates allocated to the EBA include 18 draft RTS, 3 draft ITS, 6 sets of guidelines, 2 reports, the requirement for the EBA to maintain a list of capital instruments and a database of administrative sanctions, and a number of notifications in various areas.

¹⁴ See the first part of our dedicated coverage on the original proposal in this development from our Eurozone Hub available [here](#).

¹⁵ See the second part of our dedicated coverage on the original proposal in this development from our Eurozone Hub available [here](#).

¹⁶ Read our Eurozone Hub's coverage on the Consilium's position on IFR and IFD as of April 2020 [here](#).

Short summary of the consultation papers

The first and longest consultation paper on prudential requirements includes:

- three draft RTS on the reclassification of certain investment firms to credit institutions;
- five draft RTS on capital requirements for investment firms at solo level; and
- one draft RTS on the scope and methods of prudential consolidation for investment firms at group level.

The second paper on reporting and disclosures includes:

- draft ITS on the levels of capital, concentration risk, liquidity, the level of activities as well as disclosure of own funds;
- draft RTS specifying the information that investment firms have to provide in order to enable the monitoring of the thresholds that determine whether an investment firm has to apply for authorization as credit institution; and
- a set of templates has also been developed to assist competent authorities in the verification on the mentioned information. After a consultation period of three months, the EBA would deliver the final draft RTS and ITS to the European Commission, to be aligned with the application of the IFR requirements. The EBA submission of the final updated standards to the European Commission is (currently) expected to take place in December 2020. EBA plans to develop a data-point model (DPM), XBRL taxonomy, and validation rules based on the final draft RTS and ITS.

The third and fourth consultation papers focus on remuneration requirements and include:

- draft RTS on the criteria to identify all categories of staff whose professional activities have a material impact on the firm's risk profile or assets it manages (i.e. **risk takers**). The identification criteria are a combination of qualitative and appropriate quantitative criteria, which aim to ensure that a sufficient level of scrutiny by investment firms and competent authorities is applied when identifying staff whose professional activities have a material impact on the risk profile of an investment firm or the assets it manages. Following the conclusion of the consultation process, the EBA will subsequently finalize the draft standards and submit them to the European Commission; and
- draft RTS specifying the classes of instruments that adequately reflect the credit quality of the investment firm as a going concern and possible alternative arrangements that are appropriate to be used for the purposes of variable remuneration of risk takers. The link to credit quality as a going concern is established by introducing uniform minimum trigger events for write-down and conversion of Additional Tier 1, Tier 2, and other Instruments. To ensure that different classes of financial instruments are appropriate for the purposes of variable remuneration, these should provide appropriate incentives for staff to be prudent and long-term oriented in their risk-taking. The EBA aims to submit the draft standards to the European Commission in November 2020 and it is assumed that in-scope firms will have to comply with these standards on remuneration packages awarded for the performance year 2021.



The Roadmap – a review of the thematic areas

The Roadmap sets out the timing for the EBA to produce final versions of the above-listed RTS, ITS, Guidelines and Reports and reiterates that the EBA should also establish a list of capital instruments and a database of administrative sanctions. The Roadmap has grouped the EBA's work in terms of, first, the deadlines set in the IFR/IFD and, second, the area of the mandate. The mandates' thematic areas will thus cover:

1. Thresholds and criteria for investment firms to be subject to the CRR;
2. Capital requirements and composition;
3. Reporting and disclosure;
4. Remuneration and governance;
5. Supervisory convergence and supervisory review and Pillar 2; and
6. Environmental, social and governance (**ESG**) exposures to track the on-going work under the revised CRR 2/CRD V package and the EBA's action plan on sustainable finance.

In relation to thematic area (1), the EBA is looking at leveraging on the existing RTS on the authorization of credit institutions, as well as other existing work (which in the Banking Union, will also need to be read in conjunction with the ECB-SSM's Authorization Guidelines i.e., rules¹⁷ relevant for bank license applicants in the Banking Union), while also ensuring that these take into account the existing requirements of investment firms. This mandate also includes requirements to lay down a framework for subjecting the large investment firms to the CRR and to provide clear guidance to competent authorities (including in the Banking Union, the ECB-SSM) on assessing the information to be provided in an application to become a credit institution.

On thematic area (2), the EBA is tasked with refining a assessment methodology for each of the K-Factors¹⁸, supplementary clarification concerning some of the associated notions as well as details of the scope and methods for prudential consolidation of an investment firm group amongst others.

On thematic area (3), the EBA is to develop the reporting requirements for investment firms, and

to specifically set out requirements in terms of own funds, levels of minimum capital, concentration risk, liquidity requirements, level of activity in respect of small and non-interconnected investment firms and the reporting requirements for the purposes of the thresholds that apply to certain investment firms. The Roadmap states that the EBA's key objectives are "to develop the reporting and disclosure requirements for investment firms focused on developing proportionate and fit-for-purpose reporting", where the information reported reflects the underlying regulation and captures all necessary information according to the nature, scale and level of risk of the activities of the investment firm.

The EBA has two objectives as far as thematic area (4) is concerned: (i) to ensure a comprehensive framework for investment firms within the EU, taking into account their specificities and in light of the application of proportionality for remuneration and governance under the IFD, and (ii) to ensure cross-sectoral consistency between the governance and remuneration framework under the IFD and the CRD.

The EBA's key deliverables on thematic area (5) have been aligned with those contained within the IFR and the IFD in order to deliver on the mandates regarding supervisory cooperation, convergence and the supervisory review and evaluation process (**SREP**). The EBA's policy also includes objectives related to (i) providing policy products that are fit for purpose for the day-to-day work of CAs; (ii) ensuring a consistent and proportionate application of methodologies across the Union; and (iii) ensuring cross-sectoral consistency between supervisory cooperation, the SREP and the Pillar 2 framework under the CRD and the IFD.

On thematic area (6), the EBA plans to deliver the ESG-related mandates applicable to investment firms by exploring the synergies with ongoing work under the revised CRR/CRD IV regime as amended by CRR 2/CRD V, including on how to incorporate ESG into risk management and supervision as part of the supervisory review process, risk management and stress testing.

¹⁷ See coverage from our Eurozone Hub [here](#).

¹⁸ K-Factors are defined in coverage from our Eurozone Hub [here](#).

Detailed breakdown of the RTS and ITS

The first consultation paper includes RTS under:

- Article 8a(6)(a) of the CRD IV, specifying the information to be provided to competent authorities for the authorization of an investment firm as credit institution in accordance with the new definition in the CRR;
- Article 8a(6)(b) of the CRD IV on the calculation of the EUR 30 billion thresholds for an investment firm to be required to apply for a credit institution authorization;
- Article 55(5) of the IFR on the monitoring of information related to the thresholds for credit institutions, although this RTS is addressed together with ITS on reporting requirements under Article 54 of the IFR and included in the consultation paper on the reporting and disclosure requirements;
- Article 13(4) of the IFR, specifying the deductions to be applied for the calculation of the fixed costs, that are the basis for the calculation of the fixed overheads requirement;
- Point (a) of Article 15(5) of the IFR, specifying the methods for measuring the K-factors to the extent these are not already fully detailed in the IFR;
- Point (b) of Article 15(5) of the IFR providing clarification on the notion of segregated accounts by setting the criteria for their identification for the purpose of calculating the capital requirement related to holding client money (**K-CMH**);
- Point (c) of Article 15(5) of the IFR, specifying the adjustments for the K-DTF coefficients in correspondence of stressed market conditions when markets experience a period of extreme volatility;
- Article 23(3) of the IFR, specifying the calculation of the amount of the total margin for the calculation of the clearing margin given (**K-CMG**) and the criteria to avoid regulatory arbitrage in case that approach is used; and
- Article 7(5) of the IFR elaborating on the scope and methods of prudential consolidation for investment firm groups.

The second consultation paper includes:

- Draft ITS on reporting requirements for investment firms under Article 54(3) and on disclosures requirements under Article 49(2) IFR; and
- Draft RTS on the monitoring of information related to the thresholds for credit institutions reporting requirements for investment firms under Article 55(5) IFR.

In relation to the ITS, the EBA introduces with it a different set of templates and instructions for class 2 investment firms (Annexes I and II of the Draft ITS) and a set of templates and instructions for class 3 firms (Annexes III and IV of the Draft ITS) where the supervisory reporting framework also incorporates different and tailored reporting templates with different frequencies. There is also one template included to define the size and level of activity thresholds that will trigger the reporting requirements into one or the other classification of investment firms (class 2 and class 3).

As to the RTS, monthly values of the total assets both for an individual firm, as well as for a group should be reported to the competent authorities on a quarterly basis. Additionally, two data points should be included to enable the reporting of the average amount over the past 12 months of individual assets of any subsidiaries established outside the Union that carry out any of the activities referred to in points (3) and (6) of Section A of Annex I MiFID II. The templates for the verification of total assets are provided in Annex I of the Draft ITS on Article 55(5) IFR and consist of a set of three templates:



- IF 10.01 - Verification of total assets at individual level and group test;
- IF 10.02 - Total assets for group test; and
- IF 10.03 - Total assets for group test broken down by entity.

The third and fourth consultation paper outline two additional draft RTSs, namely:

- Under Article 32(8) IFD, draft RTS to specify the instruments under point (j)(iii) of paragraph (1) of Article 32 IFD and possible alternative arrangements for the pay out of variable remuneration. It should be remembered that Article 32(1)(j) IFD provides that at least 50% of the variable remuneration consists of certain instruments, including (iii) Additional Tier 1 instruments or Tier 2 instruments or Other Instruments which can be fully converted to Common Equity Tier 1 instruments or written down and that adequately reflect the credit quality of the investment firm as a going concern; and
- Under Article 30(4) IFD, draft RTS to specify appropriate criteria to identify the categories of individuals whose professional activities have a material impact on the investment firm's risk profile as referred to in Article 30(1) IFD.

The EBA is currently envisaging to deliver according to the following timelines:

- phase 1: by December 2020;
- phase 2: by June 2021;
- phase 3: by December 2021; and
- phase 4: between December 2021 and June 2025.

In general, these consultation papers present a much bigger change than anyone anticipated. In addition, the period for preparation investment firms are left with is extremely short and in-scope firms will also now be under pressure to also review their Three Lines of Defense (**3LoD**) model¹⁹, which may need to be reassessed during a time of continued crisis and remote working as well as ESMA's new 2020 Guidelines on the MiFID II compliance function.²⁰

Outlook

Affected financial services firms, regardless of which Class they fall into, will need to act now in order to be best placed for these changes to capital requirements, and have compliance systems to capture new metrics on an on-going basis including how these flow into the Internal Capital Adequacy Assessment Process (**ICAAP**), the Individual Liquidity Adequacy Assessment Process (**ILAAP**) and the Supervisory Review and Evaluation Process (**SREP**), new rules on remuneration and ultimately a more regulatory invasive, possibly more centralized style of supervision for certain larger firms. The issues raised herein are likely to be relevant to all business and control functions (legal, risk, compliance, governance and audit) in optimizing both the regulatory capital requirement impact, the on-going cost of compliance but will likely also influence how some firms structure, execute, book and custody various transactions.

Our Dentons Financial Institutions Regulatory and Eurozone Hub lawyers comprise multi-jurisdictionally qualified regulatory specialists, including with significant experience gained in-house working for EU regulatory and supervisory policymakers, banks, broker-dealers and fund managers. We have detailed experience in constructing tactical and strategic solutions for clients in understanding changes to the prudential regulatory, related conduct of business, risk and governance arrangements as well as supervisory engagement planning across all levels of a 3LoD framework.

We equally provide on-going support to business units and control functions of all types of MiFID investment firms, banks and asset managers advising on the technical and practical implementation of EU prudential and conduct of business rules (including Banking Union specifics) and provide tailored training. We equally support firms working on their regulatory reporting and ICAAP/ILAAP and also assist with firms' preparations of their regulatory and supervisory engagement in both non-contentious on-going interaction, including SREP (as well as how it operates in the Banking Union), but also contentious engagement including in the context of thematic reviews, on-site inspections, special audits and dawn raids.

¹⁹ See coverage from our Eurozone Hub available [here](#).

²⁰ See coverage from our Eurozone Hub available [here](#).

If you would like to discuss any of the items mentioned above, in particular how to forward plan compliance with the IFR/IFD framework including how it fits into the wider supervisory priorities of the ECB-SSM, EBA and other ESAs or how they may affect your business more generally, please contact our **Eurozone Hub** key contacts.

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