



Investment Firms: Central Bank of Ireland Consultation on Competent Authority Discretions in the IFD/IFR

January 2021

On 14 January 2021, the Central Bank of Ireland (**Central Bank**) published a [consultation paper](#) outlining its proposed approach to national competent authority discretions in the Investment Firms Directive ((EU) 2019/2034) and Investment Firms Regulation ((EU) 2019/2033) (**IFD/IFR**) (**Consultation Paper**). The Central Bank is inviting feedback to its proposals by 26 March 2021, following which it intends to issue an 'Implementation of NCA Discretions in IFD/IFR' Regulatory Notice by end June 2021.

The Consultation Paper does not offer an exhaustive account of all NCA discretions under IFD/IFR. The application of remuneration-related discretions is not included. These were dealt with in a separate Department of Finance consultation which concluded in July 2020, and guidance is still awaited.

Certain IFD/IFR discretions mirror or are materially the same as those under the Directive 2013/36/EU and Regulation (EU) No. 575/2013 on capital requirements for credit institutions and investment firms (**CRDIV/CRR**). The intention is to apply a consistent or equivalent treatment in terms of how the Central Bank approached its NCA discretions under CRDIV/CRR.

In general, the Central Bank relies on a case by case approach for individual firms (e.g. large exposure waivers) and this is also evident in its proposed approach to the NCA discretions in IFD/IFR. As detailed below, Class 3 firms in particular should be alert to the need to specifically apply for waivers in areas of IFD/IFR where it may have been anticipated that a general disapplication of certain requirements would have been applied (e.g. around minimum liquidity and the ICAAP).

SCOPE OF APPLICATION

Most existing Irish investment firms are likely to fall into either Class 2 or Class 3 for the purposes of IFD/IFR. The dividing line between being a Class 2 or Class 3 firm is important within the IFD/IFR. Class 3 firms are small and non-interconnected investment firms which do not hold client assets and do not engage in trading against proprietary capital (see conditions below). Under IFD/IFR, Class 3 firms are meant to be subject to a lighter and more proportionate prudential regime given the lower risk profile. Class 3 firms will be required to hold minimum own funds based on the higher of their permanent minimum capital requirement (**PMR**) or their fixed overhead requirement (**FOR**).

For Class 2 firms, minimum own funds to be held are the higher of PMR, FOR and, importantly, a new k-factor requirement which is tailored to the risks of the particular investment services and activities of the firm. The largest investment firms, being those that have similar risk profiles to credit institutions and that meet certain minimum balance sheet sizes and engage in dealing on own account or placing without a firm commitment, continue to be subject to the CRD IV/CRR regime (Class 1/Class 1 Minus firms).

WHAT CRITERIA NEED TO BE MET TO BE CLASSIFIED AS A CLASS 3 INVESTMENT FIRM?

In order to be classified as a Class 3 firm, all of the following criteria must be met:

- Balance sheet total of less than €100m
- Total annual gross revenue from investment services/ activities of the firm are less than €30m
- Assets Under Management are less than €1.2bn.
- Client Orders Handled are less than €100m a day for cash trades or €1bn a day for derivatives.
- The firm must not hold any clients' financial instruments or client money.
- The firm must not have any daily trading flow (i.e. own account trades).
- No trading book, no net position risk, clearing risk and no risk of trading counterparty default.

HOW IS THE CENTRAL BANK APPROACHING THE EXERCISE OF ITS NCA DISCRETIONS?

The guiding principles for the Central Bank in relation to the IFD /IFR discretions are:

- To adopt a prudent approach to the steady-state provisions (i.e. where there is a similar discretion under CRDIV/CRR).
- To choose the more risk sensitive option, where one is identified.
- To be consistent and transparent in the intended approach, and the reasoning behind it.

The onus is on an investment firm to apply for exercise by the Central Bank of a discretion. It is important to note that existing CRDIV/CRR waivers do not automatically carry over to firms now regulated under IFD/IFR. Therefore, investment firms currently benefiting from such waivers will need to re-apply for the equivalent IFD/IFR waiver (to the extent available).

Sections I to IV of the Consultation Paper set out the Central Bank's proposed approach towards the key competent authority discretions. A key takeaway in the Consultation Paper is that the Central Bank is adopting a cautious approach for Class 3 firms as can be seen below.

SECTION I: APPLICATION OF THE CRDIV/CRR REGIME TO INVESTMENT FIRMS

- The Central Bank is reserving its discretion to apply the CRR regime on a case by case basis to (and thereby classify as Class 1 firms), those investment firms with consolidated assets of between €5-15bn and where justified in light of the size, nature, scale and complexity of the activities of the investment firm concerned.
- The Central Bank may allow investment firms which are part of a banking group and consolidated under CRDIV/CRR not to apply IFD/IFR on a solo basis on receipt of a notification from the firm, subject to being satisfied as to a range of matters.

SECTION II: LIQUIDITY REQUIREMENTS

- MiFID investment firms, unless regarded as systemic, are currently not subject to the liquidity requirements under the CRDIV/CRR regime. IFD/IFR introduces a minimum liquidity requirement for investment firms: to hold at least one third of their FOR in liquid assets at all times (the **Liquidity Requirements**).
- While IFR allows NCAs to exempt Class 3 firms from the Liquidity Requirements, the Central Bank is proposing not to exercise this discretion on a general basis. Instead, Class 3 firms would need to apply to the Central Bank for a waiver on an individual basis and it is indicated that such a waiver would only be granted in exceptional circumstances.

SECTION III: ASSESSMENT OF INTERNAL CAPITAL AND LIQUID ASSETS

- The Central Bank will not be exercising the available discretion to exempt Class 3 firms from the requirement to undertake the IFD's version of the ICAAP in order to determine additional Pillar 2 style capital add-ons. Class 3 firms may seek a waiver from this on an individual basis.

SECTION IV: K-FACTOR ADJUSTMENT

- In certain circumstances Class 2 Firms may use projections rather than historical data for the purpose of k-factor calculations. This will only apply where there has been a material change in the firm's business model.

SECTION V: AMENDMENTS TO THE CENTRAL BANK INVESTMENT FIRMS REGULATIONS

- The Central Bank is also proposing updates to Regulation 8 of the Central Bank Investment Firms Regulations to align reporting requirements with the classification of investment firms under the IFD/IFR.

NEXT STEPS

The IFD (once transposed into Irish law) and the IFR apply from 26 June 2021 so the clock is running for firms to ready themselves for compliance with the IFD/IFR requirements and to prepare to apply for relevant waivers under the new regime. The Central Bank expects investment firms to have begun their gap analysis/impact assessment on IFD/IFR and to be progressing with their compliance and change projects to achieve compliance with the new regime from 26 June 2021.

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