Investment Firm Regulation and Directive (IFR and IFD) Review
By the Dutch ministry of Finance, Autoriteit Financiële Markten and De Nederlandsche Bank

0. Need for IFR/IFD review

- The IFR/IFD framework has generally functioned well. It provides a framework for sound and stable prudential regulation and supervision of investment firms. However, targeted changes are necessary to improve the risk-based nature of the framework, ensure a level playing field for investment firms active inside and outside the EU, and increase the proportionality of governance requirements. We call on the European Commission to perform a review of the IFR/IFD and take these proposed changes into account.
- The targeted changes are proposed in light of a key objective of the IFR/IFD since they seek to further strengthen the IFR/IFD capability to provide an appropriate and proportionate prudential regulatory framework tailored specifically to investment firms and their characteristics. The goal of these changes is to ensure that the vulnerabilities inherent to investment firms and the risks they may pose to clients, the market, themselves, and their liquidity risk can be adequately supervised and addressed.[1]
- The proposed changes also enhance the role of investment firms in the development of European capital markets. Investment firms play a crucial role by providing sound asset management services, facilitating the activities on trading platforms and contributing to the liquidity of European and global financial markets. This benefits the resilience and functioning of EU financial markets, making it cheaper for EU small and medium enterprises to raise funds on the financial markets and provide investment opportunities for consumers.

1. Suggested improvements

a. Improve risk-based nature of the framework

- The main goal of the IFR/IFD is to manage the specific prudential risks associated with investment firms. These prudential risks differ from those of banks because of the different business models of the two types of organisations. The IFR/IFD should therefore be the default prudential framework for investment firms. We call on the European Commission to critically review in general the appropriateness of the IFR/IFD framework for investment firms, in particular when it comes to the bank authorisation requirement. Applying the CRR/CRD should only be an exception.
- To better tailor the IFR/IFD framework to the risk profile of investment firms, we propose a mix of actions:
    - Simplify the categorisation of investment firms:
        - Harmonise the different categorisation thresholds for all but class 1 firms in terms of terminology, scope and calculation, and ensure the alignment of the class 1 firms thresholds with the thresholds for significant banks, given the interlinkage with ECB and SSM supervision.
        - Evaluate the necessity of the class 1-minus category by evaluating if and which financial stability risks these investment firms have posed since the introduction of the IFR/IFD framework.
    - Improve the risks-based nature and predictability of capital requirements:
        - Review the criteria under which investment firms are classified as class 1 firm by considering thresholds which better encompass the risks taken and posed by these firms. In order to better encompass risk reducing measures of investment firms and the activities performed by investment firms, balance sheet size should not be the exclusive criterium for the threshold between class 1 and 2. These criteria could be combined with criteria on the complexity of the business model, central clearing, continuous hedging, or risk strategy.
        - Recalibrate certain K-factors such as the K-DTF (Daily Trading Flow) and K-COH (Client Orders Handled) to better align them with the actual risks these capital requirements are intended to address.

[1] In this regard we refer to recital 2 of the IFR.

- Investigate the possibility to introduce a K-factor that is specifically focused on capturing operational risk of investment firms in general.
- Set consistent and clear criteria for the unencumbrance of liquid assets[2] and investigate whether a liquidity requirement that reflects the different liquidity profiles of investment firms could be calibrated.
- Introduce the application of the (Fundamental Review of the Trading Book, related to market risk) for capital requirement purposes and the CVA (Credit Valuation Adjustment, related to counterparty risk) CRR3 methodologies as an optionality for class 2 investment firms.[3]
- Review the functioning of the K-CMG factor (Clearing Member Given). In practice, we notice that the capital requirement for market risk calculated via the K-NPR (Net Position Risk) is generally lower than the clearing margin imposed by the clearer. This discourages firms from using the K-CMG factor, while it can be a prudent way of calculating market risks. One way to encourage the use of the K-CMG factor is by adjusting the multiplier used in the calibration of the K-CMG.[4]

b. Ensure a level playing field for investment firms active inside and outside the EU, and prevent regulatory arbitrage

- Several (large) EU investment firm groups do not only operate within the EU, but are active globally. Whilst these groups, on the one hand, benefit from their access to the EU internal market, on the other hand, they also compete with their international competitors that do not have an EU holding company. In this regard, we believe that it is crucial to provide a level playing field between the EU and global markets for internationally active investment firm groups. This would further facilitate the development of the EU capital markets and improve the competitiveness of the EU financial sector, including fintech companies.
- We observe that the current framework could be improved to make it more contributive to the aforementioned level playing field. For example, certain internationally active EU investment firm groups currently have to compete with their international competitors whilst having to apply EU governance, remuneration, transparency and risk management requirements to their third country subsidiaries. This will reduce the attractiveness of the EU capital markets, both for innovative investment firm startups and EU investment firm groups already present in the EU.
- We also notice that the current framework allows for regulatory arbitrage since it leaves open the possibility for entities to choose between regulatory regimes that are most favourable to them. The following two examples exemplify this:
  - In the Netherlands we have observed in practice several methods to evade consolidated supervision under the IFR/IFD, such as via the restructuring of the group or the relocation of a holding company. However, the fact that consolidated supervision does not apply, does not mean that risks and vulnerabilities of the investment firm group in the EU have simultaneously disappeared. On the contrary, it means that the lack of consolidated supervision may leave them unaddressed.
  - Entities licensed under MiFID or CRD are explicitly mentioned in the scoping of IFR/IFD. However, entities licensed under AIFMD or UCITS that have permission to perform certain MiFID activities or services, are now not in scope of IFR/IFD. This goes against the concept of 'same risks, same rules'.
- Considering the above-mentioned considerations, we call on the European Commission to:
  - Maintain the current scope of the group capital test or provide a supervisory discretion for supervisors to waive investment firms that are subject to the prudential consolidation as

---

[2] With unencumbrance we mean an asset which is not subject to any legal, contractual, regulatory or other restriction preventing the investment firm from liquidating, selling, transferring, assigning or, generally, disposing of the asset via an outright sale or a repurchase agreement within the following 30 calendar days.
[3] Under CRR2, the use of the FRTB is for reporting purposes only. Regarding CVA, this is currently capitalised according to Article 32 of the IFR, by applying a multiplier of 1.5 in the calibration to the K-TCD (Trading Counterparty Default) requirement.
[4] In practice, we observe that the clearing margin required is on average 20% higher than the K-NPR requirement.

referred to in Article 7 of the IFR[5] from applying governance, remuneration, transparency and risk management requirements as referred to in section 2 of the IFD on a consolidated basis, in order to maintain current operating procedures.
    - Improve the risk-based nature of consolidated supervision by clearly defining 'satisfactory level of prudence' in the group capital test in the level 1 text.
    - Make explicit whether certain supervisory powers can be applied on a consolidated basis, such as the SREP, supervisory measures and powers, the additional own funds requirement, and specific liquidity requirements.
    - Establish an explicit requirement for investment holding companies and investment firms to report on a consolidated and solo level financial information (FINREP).
    - Examine the scoping of the IFR/IFD, MiFID, AIFMD and UCITS and determine whether further harmonisation of the prudential aspects of these directives can contribute to a level playing field.

c. Increase proportionality and clarity of governance requirements

- We believe that good governance is a key principle in risk-based regulatory regimes and efficient markets. We nevertheless see opportunities to increase proportionality of the governance requirements, while maintaining this key principle. This would contribute to the EU's mission of reducing the administrative burden for companies.
- We see opportunities to:
    - Create a threshold for risk and remuneration committees that better reflects the different risk profiles of investment firms. Different thresholds could be based on the activities that an investment firm performs, for example those of asset managers and propriety traders, possibly in line with the specific thresholds included in the Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) under the IFD. Additionally, it could be explored whether it is warranted to require that a risk committee only has to be established at the consolidated level, so that the level of application of the requirement to establish this kind of committee is aligned with the level of application of the requirement to establish a remuneration committee.
- The IFD currently contains an indirect obligation to establish a Supervisory Board or one-tier board with non-executives. We suggest that this obligation should preferably be made explicit, so that legal uncertainty for market participants and supervisors is removed.

[5] Union parent investment firms, Union parent investment holding companies, and Union parent mixed financial holding companies.