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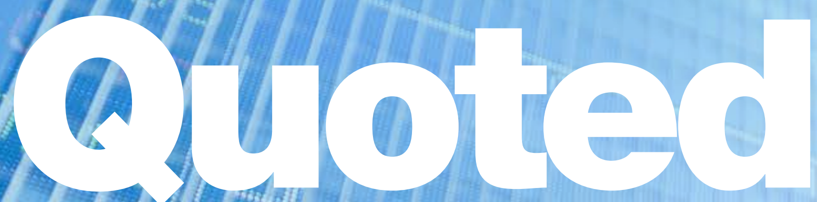

The IFR and IFD: the new prudential regime for investment firms

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The IFR and IFD: the new prudential regime for investment firms

On 26 June 2021 a new prudential regime will enter into force for investment firms. The new regime consists of a Regulation (hereinafter: IFR)[1] and a Directive (hereinafter: IFD)[2]. The reason for introducing this new regime is that the current CRR/CRD IV regime, which applies to both credit institutions and investment firms, focuses on typical banking risks and therefore is not adapted to the risks run by investment firms. In this Quoted we will discuss the changes that this new regime will bring for investment firms, such as those in the area of capital requirements, a limitation of concentration risks, liquidity requirements, reporting and disclosure requirements and the remuneration policy. The discussion of the changes is also based on the draft bill submitted for consultation for the IFD Implementation Act, and the consultation report drawn up on it. You will find a number of practical recommendations in the last paragraph of this Quoted.

1. Background

At present, most investment firms with a MiFID II licence fall under the prudential regime of the CRR/CRD IV, as do credit institutions.[3][4] The provisions contained in CRD IV and CRR are however designed for credit institutions and typical banking risks, and are therefore less suited to investment firms. Credit institutions provide loans and hold deposits. Given these activities, credit institutions run a credit risk on their borrowers. There is also a liquidity risk, because account holders may withdraw their bank balances or savings very quickly, which can cause a bank run. These risks do not exist in this form with investment firms as they are not banking investment firms.

Also, the insolvency of an investment firm that provides investment advice or receives and transmits orders in financial instruments will have fewer negative consequences for the stability of the financial sector as a whole than the insolvency of a credit institution. With such a (non-systemically relevant) investment firm, the importance of maintaining the business as a going concern and avoiding insolvency is not as great as with a credit institution. In practice, the current prudential framework for investment firms is also considered to be highly complex, partly due to the use of a range of exceptions for certain types of investment firms. Because of this complexity, and since the rules are less well adapted to investment firms, there is also the risk that the Member States will apply the rules in widely differing ways. The aim of the new framework is to make the prudential requirements more risk-sensitive and proportional for investment firms.

2. Scope and categorisation of investment firms

The new prudential regime applies to licensed investment firms which are regulated under MiFID II.[5] Under the new regime, a distinction is made between three categories of investment firms.[6] The applicable prudential rules vary, depending on the category to which the investment firm belongs.

Category 1 investment firms

Category 1 investment firms comprise large, systemically relevant investment firms that in many respects show similarities with systemically relevant credit institutions, except that these investment firms do not meet the criteria to qualify as a credit institution (they cannot hold deposits or other repayable funds). As ‘quasi-banks’, these systemically relevant investment firms are requalified as *credit institutions*[7] and as such will continue to fall under the prudential regime of the CRR/CRD.

1 Regulation 2019/2033/EU.

2 Directive 2019/2034/EU.

3 Directive (EU) no. 2013/36 and Regulation (EU) no. 2013/575.

4 These are only the CRR investment firms, as specified in Article 4(1)(2) CRR. This definition of investment firm is not the same as that in MiFID II.

5 This is laid down in Article 2 par. 1 IFD and Article 1 par. 1 IFR.

6 For the sake of completeness, it is noted that the designation of the various categories of investment firms as dealt with below do not appear as such in the text of the IFR/IFD. The category designations used in this Quoted are the most common names as can be found in the literature.

7 See amended Art. 4 par. 1 CRR on the grounds of Art. 62 par. 3 IFR.

In order to qualify as a Category 1 investment firm, an investment firm must, in short: (i) be active in dealing on own account, underwriting financial instruments or placing financing instruments on a firm commitment basis (so-called 'high-risk activities') and in addition (ii) have consolidated assets of at least EUR 30 billion.[8]

From now on, this category of investment firms will qualify as 'credit institution' within the meaning of Article 1:1 of the Dutch Financial Supervision Act (*Wet op het financieel toezicht*, hereinafter **Wft**), and so the licensing requirement under Article 2:11 Wft will apply to them. According to the draft explanatory memorandum to the consultation bill to implement the IFD, there are two investment firms with their registered offices in the Netherlands that would qualify as a credit institution.[9]

If these Category 1 firms are already licensed as an investment firm, they do not immediately need to have a banking licence as a transitional regime will apply. The prohibition on operating a business as a credit institution without a licence does not apply as long as the requalified investment firm has applied for a banking licence in time. If an application for a banking licence has been submitted in time, the investment firm that qualifies as a credit institution can continue its activities without a banking licence, as long as the European Central Bank (**ECB**) has not yet taken a decision on the licence application.[10]

The starting point is that the banking licence must have been applied for no later than when the average of the total monthly total assets equals or is higher than the EUR 30 billion threshold for twelve successive months.[11] Investment firms that already possessed a licence as an investment firm before the IFD entered into force, and qualified as a credit institution from the moment the IFD entered into force (namely 25 December 2019), must have submitted a licence application to the Dutch Central Bank (*De Nederlandsche Bank N.V.*, **DNB**) by 27 December 2020. The ECB will decide on the licence application. These firms must calculate the average of their total monthly assets based on the twelve successive months *prior* to that moment. Thus, if the average of the total assets equals or is higher than EUR 30 billion for a period of twelve successive months prior to the IFD entering into force, the banking licence must have been applied for before 27 December 2020.[12]

Category 1a investment firms

Investment firms engaged in 'high-risk activities' (namely dealing on own account, underwriting financial instruments or placing financing instruments on a firm commitment basis), but do not reach the EUR 30 billion threshold of consolidated assets and therefore do not meet the requirements to qualify as a Category 1 investment firm, can still be subject to the prudential regime of the CRR/CRD. Such investment firms qualify as Category 1a investment firms[13] if they meet a lower threshold of consolidated assets.

There are two possibilities:

(i) If the total value of the consolidated assets of the investment firm is less than EUR 30 billion, but more than EUR 15 billion, the investment firm is automatically subject to the prudential regime of the CRR via a mutatis mutandis clause in the IFR[14]; and
(ii) If the total value of the consolidated assets is less than EUR 15 billion, but more than EUR 5 billion, the national regulator has the discretionary power to subject such an investment firm to the CRR regime, if

8 The threshold of EUR 30 billion can also be achieved if the investment firm has total individual assets of less than EUR 30 billion, but forms part of a group in which the total value of the consolidated assets of all investment firms within that group that are active in the high-risk activities is equal to or greater than EUR 30 billion.

9 See paragraph 6.1 of the draft explanatory memorandum to the consultation bill to implement the IFD.

10 New Article 8 bis CRD, as amended by the IFD and its intended implementation in Art. 2:13a and Article III of the consultation bill to implement the IFD.

11 New Article 8 bis par. 1 CRD, as amended by the IFD. See also Art. 2:13a of the consultation bill to implement the IFD.

12 New Article 8 bis par. 3 CRD, as amended by the IFD. See also Art. III of the consultation bill to implement the IFD.

13 As already noted in footnote 6, the designation of the various categories of investment firms does not appear as such in the text of the IFR/IFD. The category designations used in this Genoteerd are the most common names as can be found in the literature.

14 Article 1 par. 2 (a) IFR

– in short – the regulator deems the investment firm to be systemically relevant.[15]

This category of investment firms is therefore not requalified as a credit institution under the CRR, but through a mutatis mutandis clause in the IFD/IFR[16] is subject to the full rules of the CRR. Only a few rules of the IFR/IFD regime continue to apply to this category.[17]

Category 1b investment firm

In addition, there is also the Category 1b investment firm: these investment firms also perform high-risk activities, but choose to be subject to the prudential regime of the CRR/CRD instead of the new IFR/IFD regime.[18] In short, this option exists if the investment firm is a subsidiary and is already included in the supervision of a credit institution, financial holding or mixed financial holding on a consolidated basis. If an investment firm wishes to make use of this option, it must submit an application to DNB. This category of investment firms will not be requalified as a credit institution under the CRR either, but with the consent of DNB will be subject to the prudential regime of the CRR via a mutatis mutandis clause in the IFR. More information on applications for consent to apply the CRR can be found on DNB's website.[19]

Category 2 investment firm

In the IFD/IFR methodology, Category 2 is more or less the main category of investment firms: all investment firms that do not fall in Category 1 (or 1a or 1b) and do not fall in Category 3 either, qualify as a Category 2 investment firm. In order to qualify as a Category 2 investment firm, the investment firm must therefore establish that (i) it is not a Category 1 (or 1a or 1b) investment firm, and (ii) it exceeds one of the threshold values to qualify as a Category 3 investment firm (see *figure 1*).

Regarding the threshold values as shown in *figure 1*, it is worth mentioning the following. Where under the current CRR prudential regime the (capital) requirements for an investment firm depend on the activities and services of that investment firm, the IFD/IFR introduces a risk-weighted, quantitative system, using so-called 'K-factors': quantitative indicators that are taken into account to determine the prudential requirements of an investment firm on the basis of the risks that an investment firm forms for clients (*Risk to Clients*, 'RtC'), markets (*Risk to Market*, 'RtM') and itself (*Risk to Firm*, 'RtF') (which are then subdivided, more on this later in paragraph 3). The K-factors/quantitative indicators, however, are also important in determining whether an investment firm falls in Category 2 or Category 3.

Although the use of the K-factors leads in principle to categorising investment firms on the basis of risk-sensitive methodology instead of based on services provided or activities carried out by an investment firm, there is still a link with these activities and services. For example, the large group of proprietary traders in the Netherlands will by definition fall in Category 2 because certain K-factors for this group (such as Net Position Risk, Clearing Margin Given and Daily Trading Flow) will always be greater than the threshold values used (namely: zero).

15 This option for national regulators exists on the grounds of Article 5(1) IFD if at least one of the following criteria applies: (a) de investment firm carries out the activities concerned on such a large scale that if the investment firm becomes insolvent or otherwise finds itself in an emergency situation, this would lead to a systemic risk; (b) the investment firm is a clearing member (in the sense of Art. 4(1) point 3 IFR); (c) the competent authority deems it justified given the scope, nature, scale and complexity of the investment firm's activities, taking account of the principle of proportionality and in connection with one or more of the following factors: i) the importance of the investment firm for the economy of the EU or the Member State concerned; ii) the importance of the cross-border activities of the investment firm; iii) the interconnectedness of the investment firm and the financial system. In the consultation bill to implement the IFD, this option is embedded in Article 3:4a Wft.

16 Article 1 par. 2 IFR and Article 5 IFD.

17 Following the provisions of Articles 55 (reporting requirements) and 59 (transitional arrangement) IFR (see Art. 1 par. 4 IFR).

18 Article 1 par. 5 IFR.

19 https://www.toezicht.dnb.nl/3/50-238393.jsp.

Figure 1:

Class	Covered firms	
2	Other investment firms than those belonging to category 1 or 3	
3	Investment firms that meet the following criteria (Art. 12 IFR):	
	K-AUM (assets under management, under both discretionary portfolio management and non-discretionary (advisory) arrangements)	< €1.2 billion
	K-COH (the value of the total client orders handled daily)	< €100 billion (cash transactions) or €1 billion (derivatives)
	K-ASA (the total daily assets safeguarded and administered)	Zero
	K-CMH (total daily client funds)	Zero
	K-NPR (positions in the trading portfolio of an investment firm dealing on own account, either for itself or on behalf of a client) or K-CMG (all positions coming under clearing, or on a portfolio basis if the full portfolio comes under clearing or a margin deposit)	Zero
	K-DTF (the value of the total daily trading flow, with carrying weightings for cash transactions and derivatives, carried out in its own name, either for itself or on behalf of a client)	Zero
	K-TCD (exposure to trading counterparty default)	Zero
	The total of the items in and outside the balance sheet total of the investment firm	< €100 million
	The total annual gross income from investment services and activities (average of the last two years)	< €30 million

Category 3 investment firm

Each investment firm that does not fall in Category 1 (or 1a or 1b), will therefore have to calculate the K-factors to assess whether it falls in Category 2 or Category 3. Category 3 investment firms are small, non-interconnected investment firms. A simplified prudential regime applies to Category 3 investment firms and the provisions on governance, remuneration, transparency, risk management and prudential reports are not, or to a lesser extent, applicable.

If an investment firm does not exceed the threshold values for the quantitative indicators as contained in *figure 1*, it is considered a Category 3 investment firm. However, if one of the threshold values is exceeded, it will qualify as a Category 2 investment firm. If an investment firm no longer meets all conditions, in principle it will no longer be classified as a Category 3 investment firm with immediate effect.[20]

For investment firms that form part of a group, the threshold values K-AUM, K-COH, the balance sheet total and the total annual gross income will be examined at group level. This means, for example, that two investment firms that form part of a group and each have a K-COH of EUR 55 million in cash transactions will each qualify as a Category 2 investment firm, because the total COH exceeds EUR 100 million. The other threshold values referred to will be applied only at individual level.[21]

20 See Article 12 par. 2 IFR and also the exceptions referred to therein.

21 Article 12 par. 2 IFR.

3. The new prudential regime for category 2 and 3 investment firms

Three pillars

Just as the current CRR/CRD IV regime, the new prudential regime for investment firms is also based on the Three-Pillar regulatory model of Basel II. The first Pillar covers minimum capital and liquidity requirements. The second Pillar regulates the investment firm's accountability to the regulator for capital and liquidity adequacy. If the regulator deems the capital to be insufficient, a corrective requirement can be imposed on the company in the form of what is known as a 'SREP decision'. On the basis of the third Pillar, the investment firm is required to publish information about the prudential requirements, risk management and principles of the remuneration policy. In particular, the new regime modifies the implementation of the Pillar I capital requirements with the introduction of a simpler applicable framework, focused on the nature of the investment firm's busines and the resulting risks.

Own funds requirement

For investment firms belonging to Category 2, a capital requirement applies which is the highest of[22]:

(i) The permanent minimum capital requirement;
(ii) The capital in accordance with the overheads requirement; or
(iii) The K-factor requirement.

For Category 3 investment firms, part (iii) does not apply and the own funds requirement is the highest of the permanent minimum capital requirement and the overheads requirement.[23]

The permanent minimum capital requirement is equal to the applicable initial capital (*see figure 2*).[24] The initial capital is slightly higher than that on the basis of the current prudential regime.

Figure 2:

Investment service or activity	Initial capital
(3) Dealing on own account, (6) underwriting financial instruments and/or placing financial instruments on a firm commitment basis, or (9) operating an OTF if also dealing on own account.	EUR 750.000
Investment firms that provide the following investment services and are not authorised to hold funds or financial instruments: (1) receiving and transmitting orders, (2) carrying out orders on behalf of clients, (4) individual portfolio management, (5) investment advice and (7) placing financial instruments without a firm commitment basis.	EUR 75.000
All other investment firms, therefore operating an MTF and OTF (without dealing on own account) or investment firms that provide the following investment services and are permitted to hold funds or financial instruments: (1), (2), (4), (5) and (7).	EUR 150.000

The overheads requirement is an amount of at least one quarter of the overheads of the investment firm in the previous year (based on financial reporting), minus items such as profit-related bonuses, profit-sharing among employees, directors and partners and one-off extraordinary expenses. Under the current regime the overheads requirement already exists as an alternative for calculating the operational costs requirement for credit institutions.[25] Further details on calculating the overheads requirement will be set out in a delegated regulation.[26]

22 Article 11 par. 1 IFR.
23 Article 11 par. 2 IFR.
24 Article 9 IFD.
25 Article 13 IFR.
26 Article 13 par. 4 IFR.

Entirely new compared to the current framework is the K-factor requirement.[27] The purpose of the K-factor requirement is to ensure the investment firm holds enough capital appropriate to the risks that the investment firm runs, and the extent of the risks. The K-factors provide for three types of risks[28]:

Figure 3:

K-factor requirement
Risk-to-Client (RtC):
- K-AUM: assets under management;
- K-CMH: client money held;
- K-ASA: assets safeguarded and administered; and
- K-COH: customer orders handled.
Risk-to-Market (RtM):
- K-NPR: net position risk; or
- K-CMG: if permitted by the competent regulator on the basis of the conditions in Article 23 IFR, a K-factor based on all positions or portfolio under clearing.
Risk-to-Investment Firm (RtF):
- K-TCD: trading counterparty default;
- K-CON: concentration risk in excess of certain threshold values;
- K-DTF: daily value of transactions on own account.

The K-factor requirement is the sum of the RtC, RtM and RtF K-factors calculated with due regard for the applicable rules under the IFR.[29] The CMH, ASA, COH and DTF K-factors, for example, are calculated based on the weighted average amount over the past three months. With K-AUM that is the average amount over the past twelve months. The capital requirement is then calculated by multiplying the amount by a coefficient laid down in Article 15 IFR, such as 0.04% for K-ASA. The K-factors for market risks (K-NPR) and risks at the level of the investment firm (K-CON and K-TCD) are in fact a simplified version of the current CRR capital requirements for market risk, large exposures/ concentration risk and the credit risk of the counterparty.

We will outline below a calculation example for the K-factor K-AUM[30], the amount of assets under management for third parties. Let's say that an asset manager in the period from 1 October 2020 to 1 January 2022 manages each year an average of EUR 2 billion in client assets on the basis of an asset management mandate that is performed by the investment firm itself (so there is no delegation to a third-party asset manager). The capital requirement for the month of January 2021 as far as this K-factor is concerned must be calculated on the basis of the average assets managed at the end of the month in the period from 1 October 2020 to 30 September 2021. The capital requirement is calculated by multiplying the amount of the average assets managed by 0.02%. This means that the capital requirement for this K-factor is EUR 400,000. This amount is the minimum capital that the investment firm must hold, and this requirement must be calculated anew each month. In practice, the capital requirement on the basis of the K-factors can therefore vary from month to month.[31]

Regarding the own funds composition, it is stipulated that investment firms hold own fundsthat comprise the sum of their tier-1 core capital, additional tier-1 capital, and tier-2 capital, with due regard for certain conditions. At least 56% of the own funds must be made up of tier-1 capital.[32] For the definition of tier-1 capital and potential deviations from the main rule, reference is made to the applicable provisions in the CRR.[33]

Liquidity requirement

Investment firms have the obligation to hold liquid assets for an amount at least equal to one third of the overheads requirement.[34] For most investment firms this is a new requirement compared to the current prudential regime under CRR/CRD IV. It is a light requirement, though, namely the requirement to hold cash or ready-to-liquidate

27 Title II IFR.
28 Article 15 par. 1 and 2 IFR.
29 Article 15 IFR.
30 Article 17 IFR.
31 Article 17 par. 1 IFR.
32 Article 9 par. 1 IFR.
33 Article 17 par. 1 and 2 IFR.
34 Article 43 IFR.

assets such as government bonds and covered bonds for one month.[35]

The IFR explicitly provides that cash, short-term deposits and financial instruments belonging to clients, even if held by the investment firm in its own name, are not considered as liquid assets.[36] Category 2 investment firms that do not deal on own account and do not provide placement services on a firm commitment basis and Category 3 investment firms may also include in their liquid assets trade receivables and commissions or fees receivable within thirty days, up to one-third of the minimum liquidity requirements and at a discount rate of 50%.[37]

Concentration risk

A Category 2 investment firm is required to continuously monitor and manage its concentration risk.[38] This means that the investment firm must calculate the exposure value. In short, the exposure value is the sum of (i) the net position (difference between long and short positions) in the investment firm's trading portfolio in financial instruments issued by one client or group of connected clients and (ii) the exposure value of derivative contracts and transactions entered into with that client. An investment firm's limit for concentration risk of an exposure value with respect to an individual client or group of connected clients is 25% of its own funds.[39]

The requirement to monitor and manage their concentration risk also applies to Category 3 investment firms. However, given the activities of a Category 3 investment firm, this will not be so relevant.

Consolidated supervision

The IFR and IFD provide for consolidated supervision, as a result of which the capital requirements apply not only to the licensed investment firm, but also to any holding company and financial subsidiaries.[40]

Contrary to the standard method of prudential consolidation in accordance with Article 7 IFR, DNB may also allow investment firms to calculate their capital requirements at group level on the basis of the 'group capital test' in accordance with Article 8 IFR. This group capital test may be allowed for group structures that are considered sufficiently simple, provided that the investment firm's group as a whole does not pose significant risks to clients or the market that would otherwise require supervision on a consolidated basis. More information on the application to apply the group capital test can be found on DNB's website.[41]

On the basis of the group capital test, the holding company must ensure sufficient own funds to hedge the total book value of its participations in, amongst others, its subsidiaries (investment firms and other types of financial institutions).[42] DNB may allow a lower amount of own funds to be held than based on this calculation, provided that this amount is not lower than the sum of the own funds requirements that apply to the investment firm and other financial institutions in the group on an individual basis.

It is possible that a Dutch investment firm is itself a subsidiary of a bank and is included in the consolidated supervision of that bank under the CRR. In that case, an exemption can be requested from DNB from the obligation to comply individually with the prudential regime based on IFR/IFD.[43]

Supervisory review and evaluation process (SREP)

The investment firm must carry out an annual assessment of the risks to which it is exposed, the extent to which these are mitigated and the amount of capital required to hedge the residual risk. This is the Internal Capital Adequacy Assessment Process (ICAAP).[44] The periodic evaluation of this report by DNB is the Supervisory Review and Evaluation Process (SREP). If the evaluation shows

35 On the question which assets qualify as liquid assets, one may refer to the Delegated Regulation with the CRR: this concerns unencumbered cash and certain weighted assets, such as government bonds and covered bonds.

36 Article 43 par. 2 IFR.

37 Article 43 par. 3 IFR

38 Article 37 IFR.

39 Article 37 par. 1 IFR.

40 Chapter 2 IFR.

41 https://www.toezicht.dnb.nl/3/50-238389.jsp.

42 Article 8 IFR.

43 Article 6 IFR.

44 Article 24 IFD.

that the investment firm does not comply or is in danger of not complying with the rules or holds insufficient capital, given the risks it runs, DNB may impose special measures, including an additional capital requirement. The procedure involved is described in Articles 3:18aa, 3:74a 3:111a.0 and 3:111aa.0 of the consultation bill to implement the IFD.

Disclosure and reporting requirements

Under the new regime, Category 3 investment firms are required to report to DNB each quarter on the amount and composition of their own funds, the calculation of the own funds requirement and prudential ratios.[45] Category 3 investment firms must report the same information to DNB as Category 2 investment firms, with the exception of the information on concentration risk and – if exempted by DNB – the liquidity requirements. Category 3 investment firms report annually instead of monthly.[46] An important easing measure compared to the current regime is that specific reporting templates for investment firms will be developed, while investment firms so far have reported based on the templates developed for credit institutions under the CRR.

Alongside the reports to DNB, certain disclosure requirements also apply to Category 2 investment firms, in addition to the publication of the financial statements. These disclosure requirements concern information on risk management, capital requirements, governance, investment policy and ESG criteria.[47] The disclosure requirements will apply to a broader group of investment firms than is currently the case, namely all Category 2 investment firms. The obligations will not apply to Category 3 investment firms. Unlike the rules for credit institutions, the IFR does not provide for an exemption from the obligation to disclose certain (business-sensitive) information.

4. Applicability of the regime to managers

The IFD and IFR apply to investment firms licensed under MiFID II.[48] The term 'investment firm' is therefore not materially interpreted for the purposes of IFD and IFR; it is not a question of whether an investment service is provided, but whether a licence has been granted under MiFID II. However, in the consultation bill to implement the IFD the scope of certain rules has been extended to managers of investment funds and undertakings for collective investments in transferable securities (UCITS) that provide investment services (i.e.: managers with a MiFID top-up).[49] The solvency requirement, liquidity requirement and organisational requirements have similarly been declared applicable to managers with a MiFID top-up.[50] It follows from the consultation report that the bill will clarify that the prudential requirements of the Regulation and Directive only apply to the extent that the relevant manager of an investment fund or UCITS also provides investment services.[51] The intention is that managers with a MiFID top-up will be subject to the capital requirement that represents the highest capital requirement: either the capital requirement under the UCITS Directive or AIFM Directive, or the capital requirement under the IFR/IFD.[52] DNB estimates that the pillar 1 capital requirements for the largest managers of investment funds and UCITS would increase on average by about 7% as a result of the requirements under the IFR.[53]

5. Remuneration

The introduction of the IFR and IFD not only changes the prudential regime for investment firms, but also sets rules on other topics relevant to investment firms, such as remuneration policies.

45 Article 54 IFR.
46 Article 54 par. 2 IFR.
47 Part 6 IFR.
48 Article 2 par. 1 IFD and Article 1 par. 1 IFR.
49 The proposed Article 1:19 par. 3 Wft.
50 The proposed Articles 3:18aa, 3:111a.0 and 3:111aa.0 b.
51 Consultation report, p. 3.
52 Consultation report, p. 4.
53 Consultation report, p. 4.

Remuneration policy

For Category 2 investment firms, the IFD and IFR contain a comprehensive set of remuneration rules. Category 3 (small and non-interconnected) investment firms are in principle excluded from the IFR/IFD remuneration rules.[54] This is only different if they are under group supervision.[55] However, Category 3 investment firms remain subject to the MiFID II rules on remuneration and corporate governance. These MiFID II provisions, which apply to all investment firms, are considered sufficient for such small and non-interconnected investment firms. Category 1 (or 1a or 1b) investment firms are subject to the CRD remuneration rules. For the sake of completeness, it should be noted that in the draft explanatory memorandum to the consultation bill to implement the IFD, it was announced that the provisions on remuneration in Chapter 1.7 of the Wft that already apply in principle to all investment firms will continue to apply in full (and will therefore also apply to Category 3 investment firms).[56]

As part of their internal governance, Category 2 investment firms should have remuneration policies and practices in place that are consistent with and contribute to sound and effective risk management.[57] The adoption and application of the remuneration policy should be based on a large number of principles as laid down in Article 30 IFD. Investment firms should adopt and apply these principles in a manner that is appropriate to the size and internal organisation of the investment firm and to the nature, scope and complexity of its activities.[58]

The IFR/IFD remuneration rules are largely based on the rules of the CRD/CRR. One of the new features of the IFD is the explicit requirement that the remuneration policy must be gender-neutral. This follows from Article 26(1)(d) and last paragraph of the IFD and is also one of the principles that must underlie the adoption and application of the remuneration policy.[59] Gender-neutral means: equal pay for male and female employees for equal work or work of equal value.[60] The European Banking Authority (**EBA**), together with the European Securities and Markets Authority, will develop guidelines on gender-neutral remuneration policies.

Variable remuneration

The IFD also has a large number of requirements for variable remuneration. Remarkably, unlike the CRD, the IFD does not stipulate a bonus cap. Instead, Article 30(2) IFD requires investment firms to set an appropriate ratio between the fixed and the variable component of the total remuneration in their remuneration policy. Given that the IFD provides for maximum harmonisation and does not include a possibility for Member States to deviate, the end of the Dutch bonus cap for non-systemically relevant investment firms seemed imminent. However, in the final version of the IFD, a recital has been added in the preamble from which it follows that the IFD should not prevent Member States from imposing maximum ratios on the basis of national law. This seems to open the way for the Dutch legislator to maintain the existing Dutch remuneration policy, including the 20% bonus cap, for non-systemically relevant investment firms.

6. ESG

As of December 26, 2022, Category 2 investment firms (with a few exceptions) must publish a report containing information on environmental, social or governance (ESG) related risks. This information must be published once in the first year and half-yearly in subsequent years.

54 See Article 25 par. 1 IFD. Under Article 29 par. 3 IFD a Category 3 investment firm must however comply with certain rules to manage certain risks (as laid down in Article 29 par. 1 (a)(c)(d) IFD. This article will be implemented via Article 3:17 of the Wft and the Prudential Supervision of Financial Undertakings (Wft) Decree (*Besluit prudentiele regels Wft*), as follows from the draft explanatory memorandum to the consultation bill to implement the IFD. In principle, the periodic evaluation by the national regulator linked to this obligation (see Article 36 IFD) does not apply to Category 2, unless it is deemed necessary due to the extent, nature, scale and complexity of the activities of the Category 3 investment firm (see Article 36 par. 2 IFD and the consultation bill to implement the IFD in the new proposed Article 3:18aa par. 2)

55 See Article 7 IFR.

56 It will therefore concern requirements on the remuneration policy, publication obligations, the bonus ceiling, the retention fee, the prohibition on guaranteed variable remuneration, the maximum severance payment, adjustments to the variable remuneration and the prohibition on variable remuneration in the case of state aid, according to the draft explanatory memorandum to the consultation bill to implement the IFD.

57 Article 26 IFD.

58 Article 30 par. 3 IFD.

59 Article 30 par. 1 (b) IFD.

60 The principle of equal pay for male and female employees for equal work or work of equal value is laid down in Article 157 of the EU Treaty on the functioning of the European Union.

No later than December 2021, EBA will prepare a report on the introduction of technical criteria for exposures to activities primarily related to ESG objectives. This in order to assess the potential causes and effects of risks for investment firms. EBA's report will cover areas such as: (i) a definition of ESG risks, (ii) an assessment of the potential for significant concentrations of specific assets to increase an investment firm's ESG risks, (iii) a description of the processes by which an investment firm can identify, assess and manage ESG risks, and (iv) the criteria, parameters and measures by which regulators and investment firms can assess the short, medium and long-term impact of ESG risks. Following the report, EBA can develop guidelines on ESG risks for investment firms.

7. Third-country groups and the EU intermediate holding company

In the situation where two or more MiFID II investment firms have a parent company established in a third country, in principle there will be no supervision at group level under the IFR/IFD. After all, the parent company is located in a third country. However, Article 55 IFD provides in that case that the competent regulator must assess whether the investment firms are subject to supervision in the third country that is considered equivalent to the supervision under the IFD/IFR.

In the absence of such equivalent supervision, appropriate supervisory techniques will have to be determined in order to achieve the prudential consolidation objectives of the IFR. This must be done by the regulator that would be the group supervisor if the parent company were established in the EU. One of the measures that can be taken is that the relevant regulator may require the establishment of an intermediate holding company in the EU (investment holding company or mixed financial holding company). The rules on prudential consolidation will then be applied at the level of this EU intermediate holding company.

8. Practical recommendations

This Quoted has discussed a number of changes brought by the new prudential regime and what these mean for the business activities of investment firms (and managers with a MiFID top-up).

1. Determine whether your organisation falls within the scope of the new regime, namely by qualification as a Category 2 or 3 investment firm or as manager with a MiFID top-up.
2. Identify which obligations apply to you and what you need to change in your procedures compared to the current CRR/CRD IV regime.
3. Establish a procedure to continue to determine whether your firms qualify as a Category 2 or 3 investment firm, given the applicable thresholds.
4. Establish a procedure or modify the existing procedure to meet the requirements under the new prudential regime, such as the minimum capital requirement (including the K-factor requirement), the concentration risk, and the reporting and disclosure requirements.

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Quoted

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