2 May 2019

New EU prudential regime for investment firms

The new Regulation on prudential requirements for MiFID investment firms (**IFR**) and the accompanying Directive (**IFD**) have now been passed by the European Parliament and, subject to adoption by the European Council (which is expected shortly), will become law.

IFR/IFD will introduce a bespoke prudential regime for most MiFID investment firms to replace the one that currently applies under the fourth Capital Requirements Directive (**CRD IV**) and the Capital Requirements Regulation (**CRR**). This will mean higher regulatory capital requirements for firms, subject to some transitional phasing-in. It will also mean new, more onerous remuneration rules based on those applicable to banks, as well as a raft of internal governance and disclosure and reporting requirements.

The rules are likely to be a significant step up for many firms, but the biggest impact is likely to be for adviser/arranger firms. These changes may result in a significant increase in their capital requirements and the application to them for the first time of both prudential consolidation and detailed remuneration rules.

The new regime will also introduce a stricter framework for third-country firms seeking to rely on the equivalence provisions in the Markets in Financial Instruments Regulation (**MiFIR**).

This briefing focuses on the key elements of the new regime as it will impact upon firms.

THE HEADLINES

- The new regime will come into force **in late 2020/early 2021**
- It will directly impact MiFID investment firms only (not banks, insurers and other financial services firms) – but there are some implications for AIFMs and UCITS managers
- Most MiFID investment firms, including portfolio managers and, for the first time, adviser/arrangers, will be subject to the new prudential regime
- A handful of very large firms will only be subject to limited elements of the new regime and will continue to be subject to CRR/CRD IV
- Some small firms which satisfy stringent conditions will not have to comply with all of the requirements
- Firms will be required to set aside more capital (some a great deal more) – impact may be softened by a 5-year phase-in transitional period
- Most firms will be subject to onerous remuneration rules: no bonus cap, but other "bankers" rules will apply (e.g. malus and clawback) although some small and medium sized firms will be exempt from pay rules regarding deferral and payment in securities
- Liquidity requirements will apply
- Some rules will apply on a group-wide (consolidated) basis
- In a Brexit-inspired change, requirements for third country equivalence assessments under MiFIR will be beefed up

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This briefing comprises the following sections:

IMPLEMENTATION AND BREXIT

The new regime is likely to apply in EU Member States in late 2020/early 2021.

Although the Level 1 legislation is now near-final, further details will continue to emerge by way of technical standards and guidance which the European Banking Authority is mandated to provide.

Whatever happens in the coming months as regards Brexit, and whether or not the UK is still in the EU when the IFR/IFD comes into effect, the regime will apply to UK investment firms.

NEXT STEPS FOR FIRMS

Firms should now:

- consider the relevance that prudential consolidation may have to the application and scope of the requirements;
- consider the impact of the new remuneration rules and whether an exemption of some of the requirements may be available; and
- calculate the quantum of their capital requirements under the new rules and plan to meet any higher requirements.

APPLICATION OF THE REGIME: NEW CATEGORISATION OF FIRMS

The application of the requirements under the IFR/IFD depends on the size, complexity and activities of the relevant MiFID investment firm.

FULL APPLICATION OF IFR/IFD (FULL IFD/IFR FIRMS)

Any firm that does not satisfy the criteria in either of the next two sub-sections (i.e. it is not a large firm subject to CRD IV/CRR nor a small and non-interconnected investment firm) will be subject to the full application of the IFR/IFD. The majority of MiFID investment firms, including portfolio managers and, in all likelihood, many adviser/arrangers, will fall into this category because they will not be able to satisfy all of the criteria required to be a small and non-connected investment firm (see below). Accordingly, this briefing focuses on the requirements of the regime as they will impact on the majority of firms which are neither very large nor small and non-interconnected.

PARTIAL APPLICATION OF IFR/IFD (SNIFS)

Where a MiFID investment firm meets the requirements to be a "small and non-interconnected investment firm" (**SNIF**) then the IFR/IFD regime applies, but on a limited basis.

The SNIF threshold conditions

For a firm to qualify as a SNIF it must satisfy **all** of the following conditions:

- its AUM (assets under management and some assets under ongoing advice – see K-factor section below) **must be less than EUR 1.2 billion***;
- its COH (client orders handled– see K-factor section below) must be **less than** either **EUR 100 million** per day for cash trades or **EUR 1 billion** per day for derivatives*;
- the calculation of its ASA (assets safeguarded and administered), CMH (client money held), DTF (daily trading flow), NPR (net position risk) or CMG (clearing margin given) and TCD (trading counterparty default) **must *all* be zero**;
- it must have an on- and off-**balance sheet total of less than EUR 100 million***; and
- it must have **an average total gross revenue** from investment services and activities of **less than EUR 30 million*.**

Combination of group investment firms

As will be seen from the above, for the purposes of the divide between full application the regime and being a SNIF a number of calculations will be relevant. Some of these (as denoted by an asterisk) – AUM, COH, on- and off-balance sheet total and total annual gross revenue - apply on "***a combined basis for all investment firms that are part of a group***". (However, in respect of the total annual gross revenue firms may exclude any double-counting that may arise in respect of gross revenues generated in the group.) It is unclear whether this "combination" in each case applies on a worldwide basis, taking into account firms in the group which meet the MiFID II definition of "investment firm" even if they are not authorised in the EU, rather than specifically on a consolidation group analysis: the legislation is not explicit on this point.

For the purposes of AUM (assets under management), firms may disregard assets under management that have been formally delegated to them by another financial entity. However, AUM must include assets of which the firm has delegated management to another firm. As noted above, it also includes some assets where these relate to investment advice of an ongoing nature which may preclude some adviser/arrangers from eligibility as SNIFs particularly given that the requirement will be applied on a combined group basis.

As regards CMH (client money held), the European Commission had originally proposed that a firm which does not hold client money but nonetheless *controls* it (which, in the UK at least, is true for the vast majority of firms who are able to direct the movement of cash pursuant to a mandate) would also be precluded from being a SNIF (regardless of whether it satisfied the other conditions). This no longer the case under the final text, which defines CMH by way of the *holding* of client money only.

Any firm which originally satisfies the SNIF criteria but then no longer meets one or more of them will immediately move into the full application of IFR/IFD (subject to a three month transitional where it no longer satisfies one of the asterisked criteria above, but its ASA, CMH, DTF, NPR, CMG and TCD all remain zero).

See below as to how the application of the IFR/IFD regime is calibrated for SNIFs.

LARGE/SYSTEMICALLY-IMPORTANT FIRMS (CRD IV/CRR FIRMS)

Certain MiFID investment firms which deal on own account and/or carry out the activities of underwriting or placing on a firm commitment basis and which by virtue of their size and/or interconnectedness in the financial system are considered to be of systemic importance, will *not* be subject to the prudential requirements of IFR/IFD.

Instead, they will be treated as credit institutions and continue to be prudentially regulated under CRD IV and the CRR (and, in due course, under the fifth Capital Requirements Directive (**CRD V**) and the second Capital Requirements Regulation). They will, however, be subject to certain ongoing reporting requirements under the regime (in terms of verifying the size of their total assets on a monthly basis to determine whether they should remain outside the IFR/IFD prudential regime). On the face of the legislation at least they will also be subject to the IFD's initial capital requirements although that may be a mistake.

In practice, this category is most likely to be relevant to a very small number of firms that are large investment banks or are part of groups that contain such banks.

APPLICATION OF THE QUANTITATIVE REGULATORY CAPITAL AND REPORTING/DISCLOSURE ELEMENTS OF THE REGIME: PRUDENTIAL GROUPS AND CONSOLIDATION

Application of requirements on an individual basis

All investment firms subject to the IFR must comply with the regime's requirements relating to own funds composition, the calculation of capital requirements, concentration risk, liquidity requirements, disclosure and reporting on a solo (individual firm) basis.

Prudential consolidation: application of quantitative and reporting/disclosure requirements on an individual and consolidated basis

A **parent investment firm, parent investment holding company or parent mixed financial holding company *in the EU*** shall also apply all of the above requirements on a consolidated basis. The consolidation group (a **prudentially consolidated situation**) will include the relevant parent and its direct and indirect subsidiaries worldwide which fall within the EU definitions of investment firm, financial institution, ancillary services undertaking and tied agent. For most firms, this does not represent a change to existing consolidation requirements, but it will be new for some, e.g. adviser/arrangers.

When applying the IFR's own funds requirements on a consolidated basis, there will be some read-across to the CRR (as amended by IFR) in relation to determining the minority interests and qualifying capital of subsidiaries in the consolidation.

The group capital test: the alternative application of requirements

By way of derogation to the full prudential consolidation requirement described above, supervisors will have the discretion to apply a simpler and lighter-touch group capital test in the case of group structures which they deem to be "sufficiently simple" and in respect of which no significant risks to clients or to the market will arise from not applying consolidated supervision.

If this is relevant, the top EU parent will be subject to a requirement to hold at least enough own funds to cover the full book value of all its holdings in subsidiary investment firms, financial institutions, ancillary services undertakings and tied agents in the group, together with the total amount of all its contingent liabilities in favour of such firms.

APPLICATION OF THE GOVERNANCE, TRANSPARENCY, TREATMENT OF RISKS AND REMUNERATION REQUIREMENTS

If full prudential consolidation under the IFR applies (see above), then the IFD's requirements relating to internal governance, transparency, treatment of risks *and remuneration* will *also* be applied to firms which are subject to the full application of the regime on a solo *and* consolidated basis (except in relation to certain third-country subsidiaries where it would be unlawful to do this). It will therefore only be possible to apply these requirements exclusively on a solo basis where the regulator has applied the "sufficiently simple" derogation in IFR outlined above.

REMUNERATION

PROPORTIONATE REMUNERATION POLICIES

An investment firm should have a remuneration policy that is proportionate to the size, internal organisation and nature of the firm and the scope and complexity of its activities. The policy must comply with a number of principles, including that it is gender neutral (i.e. based on equal pay for male and female workers for equal work or work of equal value), it promotes sound and effective risk management, it contains measures to avoid conflicts of interest, it encourages responsible business conduct and it promotes risk awareness and prudent risk taking.

REMUNERATION STAFF

The remuneration requirements apply in respect of staff, such as senior management and employees with comparable remuneration, whose professional activities have a material impact on the risk profile of the firm or the assets that it manages. The EBA, in consultation with ESMA, will develop draft regulatory technical standards which will specify the criteria firms should use in identifying their "material impact" staff. In doing so, the ESAs will take account of the existing remuneration guidelines which exist under MiFID II, AIFMD and UCITS.

VARIABLE TO FIXED RATIOS

The remuneration requirements of IFR/IFD are modelled on those in the CRR/CRD IV, although they fall short of making investment firms subject to that regime's so-called "bankers' bonus cap" – i.e. the mandatory limit on the ratio of variable remuneration to fixed remuneration that may be paid to relevant staff.

However, firms will be required to set - and publish - appropriate ratios themselves, ensuring that the fixed component represents a "sufficiently high proportion" of the total remuneration to enable the operation of a fully flexible policy on variable remuneration components – including the right not to pay any variable remuneration at all. In setting these ratios, the firm must take into account the business activities of the firm and the associated risks as well as the impact that different categories of staff have on the risk profile of the firm.

VARIABLE REMUNERATION

Allocation

Any variable remuneration must comply with a number of requirements, including when assessing the performance of the individual, taking into account both financial and non-financial criteria.

In terms of allocation, at least 50% of such remuneration must consist of one or more of the following instruments:

- shares (or equivalent ownership interests);
- share linked instruments (or equivalent non-cash instruments);
- additional Tier 1 instruments (e.g. preferred shares, contingent convertible securities (CoCos));
- Tier 2 instruments (e.g. subordinated debt) or other instruments fully convertible into Common Equity Tier 1 instruments; and
- non-cash instruments which "reflect the instruments of the portfolios managed" by the firm.

It appears that, except in the case of those instruments reflecting instruments in managed portfolios, such instruments must be linked to the employer group (as opposed to, for example, awarding units in a fund product).

Mandatory deferral

At least 40% of the variable remuneration must be deferred over a three to five year period. In the case of particularly high variable remuneration (not defined, but could be EUR 500,000 or more) this deferral percentage rises to at least 60%.

Where an employee leaves the firm before retirement age, the firm must also hold any discretionary pension benefits for a period of five years in the form of the instruments listed above and, once paid out, these benefits will be subject to a five-year retention period by the employee.

Exemption from the allocation and mandatory deferral requirements

The requirements for variable remuneration to be deferred and to be payable in non-cash assets do not apply:

- to firms with on- and off- balance sheets assets equal to or less than EUR 100 million averaged over the four year period preceding the relevant financial year; or
- to an individual member of staff for whose annual variable remuneration component is no more than EUR 50,000 and which does not represent more than 25% of their total annual remuneration.

Member States have the discretion to increase the EUR 100 million threshold to up to EUR 300 million in certain cases (e.g. where the investment firm is not one of the three largest firms in the relevant jurisdiction, it is subject to simplified (or no) recovery and resolution requirements and its on- and off-balance sheet trading book business is EUR 150 million or less). They also have the right to remove the individual member of staff exemption in relation to particular individuals based on the specificities of national remuneration practices in the relevant market or based on the nature of an individual's job profile or responsibilities.

The exemption will not therefore be available to certain entities with higher asset levels, such as some CLO collateral managers and some other fund managers which make investments from the balance sheet of the regulated entity.

Malus and clawback

Significantly, up to 100% of the variable remuneration should be reduced or withheld in times of financial stress for the firm, including by way of malus (reducing or cancelling deferred remuneration that has not yet vested) or clawback arrangements, taking account of an individual's complicity in the firm's losses and/or issues going to fitness and properness.

REMUNERATION COMMITTEE

Firms with on- and off- balance sheet assets of over EUR 100 million (subject to the discretion to raise that threshold to EUR 300 million (see above)) must establish an independent and gender balanced remuneration committee to consider the remuneration policies and incentives. This may be established at group level and, where employee representation is required in management bodies under national law, shall include employee representatives.

REMUNERATION DISCLOSURES AND REGULATORY REPORTING

Firms will be required to make public specified information regarding their remuneration policy and practices. This will include aspects related to gender neutrality and the gender pay gap. While the remuneration-related disclosures will not require individuals to be named, it will involve more granular disclosures than those with which MiFID firms are currently familiar. This will include, in addition to disclosure of the important characteristics of the policy and the ratios between fixed and variable remuneration, aggregate quantitative remuneration information, broken down by senior management and "material impact" staff, indicating things such as: the split between fixed and variable remuneration, the amounts of variable remuneration broken down into the allowable types, the amounts of deferred remuneration awarded and due to vest and details regarding severance payments.

In addition, firms will be required to provide their supervisors with information on the number of natural persons who are remunerated EUR 1 million or more per financial year, presented in pay brackets of EUR 1 million. The disclosure will need to include information broken down in relation to job responsibilities, business area and the elements of salary, bonus, long-term award and pension contribution.

QUANTITATIVE CAPITAL REQUIREMENTS

OWN FUNDS REQUIREMENT

Subject to transitional phasing-in (see below), a firm will be required to have own funds at all times at least equal *to the highest of its*:

- *fixed overheads requirement*;
- *permanent minimum requirement*; and
- *K-factor requirement*.

The fixed overheads requirement

The *fixed overheads requirement* is at least one quarter of the firm's fixed overheads (such as salaries and rent) for the preceding year. It is essentially three months' worth of normal operating expenses. The EBA, in consultation with ESMA, will be developing draft regulatory technical standards to specify the precise calculation, including items that must be deducted from the calculation (because they are deemed to be optional or because they would cease to be relevant if the firm were winding down its activities, such as staff bonuses and other remuneration and profit-shares). These are likely to follow the equivalent standards under the CRR.

The permanent minimum requirement

The permanent minimum requirement is a fixed sum (subject to transitional phase-in) which varies depending on the activities carried on by the firm and will essentially operate as a "floor" so that a firm must always hold regulatory capital of at least that amount on an ongoing basis. For:

- an investment firm authorised to carry on reception and transmission of orders, execution of orders on behalf of clients, portfolio management, investment advice and/or placing without a firm commitment and which does not hold client money or securities - *this will include the majority of portfolio managers and adviser/arrangers* - this will be **EUR 75,000** after transitional phase-in (compared to the current initial capital requirement of EUR 50,000);

- an investment firm which is authorised to deal on own account and/or underwrite and/or place instruments on a firm commitment basis, the sum will be **EUR 750,000** after transitional phase-in (compared to the current initial capital requirement of EUR 730,000); and
- any other investment firm (including those which do hold client money or securities) this will be **EUR 150,000** after transitional phase-in (compared to the current initial requirement of EUR 125,000).

The K-factor requirement

This is a new, activities-based capital requirement. The overall "K-factor" requirement is an aggregate sum derived from three risk factors applicable to the firm. Those three risk factors are:

- *Risk-to-Client (RtC) K-factor requirement* – this comprises the following components, each of which must be calculated on a rolling average basis in accordance with the new rules and multiplied by a prescribed coefficient:

K-factor	Factor	Coefficient	Notes
K-AUM	AUM = "assets under management"	0.02%	Covers both discretionary portfolio management and non-discretionary arrangements involving "investment advice of an ongoing nature". This definition may mean that, in addition to more traditional portfolio management arrangements, some of the assets under advice of a number of adviser/arrangers could be caught. *Includes* where the firm has delegated management of the assets to another entity. *Excludes* those assets which the firm is managing under a delegated authority from another entity.
K-CHM	CMH = "client money held"	0.4% 0.5%	- for segregated accounts. - for non-segregated accounts.
K-ASA	ASA = "assets safeguarded and administered"	0.04%	
K-COH	COH = "client orders handled"	0.1% 0.01%	- for cash trades. - for derivatives trades. This covers, for example, client orders handled through the reception and transmission of orders and by way of execution on behalf of clients. N.B. Expressly *includes* transactions executed by portfolio managers and as a result of investment advice from the firm – but excludes transactions where the firm already calculates K-AUM in respect of the client's investments. This should avoid double-counting. It also excludes circumstances in which the firm is managing under a delegated authority from another entity.

- *Risk-to-Market (RtM) K-factor requirement* – for the trading book positions of an investment firm which *deals on own account* (whether for itself or on behalf of clients) is either one or the other of the following two K-factors (no coefficients are applied):

K-factor	Factor	Coefficient	Notes
K-NPR	NPR = "net position risk"	-	This is the value of transactions recorded in the trading book.

K-CMG	CMG = "clearing margin given"	-	This is the amount of total margin as required by a clearing member or qualifying CCP.

- *Risk-to-Firm (RtF) K-factor requirement* – this is calculated by aggregating together all of the following components calculated in accordance with the new rules and multiplied (if relevant) by the applicable coefficient:

K-factor	Factor	Coefficient	Notes
K-TCD	TCD = "trading counterparty default"	-	This represents the exposures in the trading book in instruments and transactions giving rise to the risk of counterparty default. No coefficient is applied.
K-DTF	DTF = "daily trading flow"	0.1% 0.01%	- for cash trades. - for derivatives. This component represents the daily flow of transactions entered into through own account dealing or execution of orders on behalf of clients in the firm's name (i.e. as principal). It excludes the value of order handled on a reception and transmission basis or through the execution of orders on behalf of clients (as agent) – these transactions should already be included in K-COH (see above)). It also expressly excludes transactions executed by a firm providing portfolio management services on behalf of investment funds.
K-CON	CON = "concentration risk"	-	This components represents the exposures which exceed the concentration limits specified by IFR. Firms are subject to a limit on exposure to an individual client or group of connected clients of 25% of own funds or, in the case of exposures to certain financial sector clients, the higher of 25% of own funds and EUR 150 million (or, if lower, 100% of own funds).

Transitional arrangements relating to the own funds requirement

The IFR contains some transitional provisions intended to smooth the impact on investment firms by allowing them to build up the new required amounts of capital over a longer period. However, it is not clear whether the transitional arrangements will also apply to consolidated capital requirements.

Fixed overheads requirement and/or K-factors requirement

Instead of the fixed overheads requirement and/or the K-factors requirement components of the own funds requirement under the new regime, firms can choose to use the following for a period of *five years*:

- where the firm was subject to the CRR prior to the entry into force of the new regime, twice the capital requirement that would have applied had it continued to be subject to the CRR; or

- for firms that were not in existence prior to the new regime entering into force, twice their fixed overheads requirement under the *new* regime.

Permanent minimum requirement

Instead of the permanent minimum requirement component of the own funds requirement under the new regime, firms may use the following for a period of *five years*:

- where a firm was only subject to an initial capital requirement prior to the entry into force of the new regime, twice the applicable initial requirement under CRD IV;

- for certain firms which were in existence prior to the new regime entering into force, a modified version of their existing initial capital requirements under CRR, subject to an increase of at least EUR 5,000 for each year of the five year transitional period; or

- for firms which provide only the MiFID services of reception and transmission of orders, execution of orders on behalf of clients, portfolio management and/or investment advice and which are not permitted to safeguard and administer financial instruments, a "floor" of at least EUR 50,000, subject to an increase of at least EUR 5,000 for each year of the five year transitional. This is likely to be relevant for many exempt CAD firms including adviser-arrangers as well as portfolio managers.

LIQUIDITY REQUIREMENTS

In addition to the own funds requirements, firms will be required to hold an amount of liquid assets equal to at least one third of their fixed overheads requirement, which, in practice, will equate to one month's fixed overheads.

Liquid assets for these purposes are tightly defined but include:

- claims on national governments, exposures to central banks, high quality covered bonds, corporate debt, securitisations and unencumbered short term bank deposits, but subject in some cases to specific eligibility criteria and haircuts. It also includes shares or units in collective investment schemes, subject to strict eligibility criteria and a cap of EUR 50 million; and

- other assets not covered above, but which are traded on a trading venue for which there is a liquid market as defined in MiFIR and the MiFIR delegated regulation, subject to a haircut of 55%.

Firms (other than those which deal on own account and/or underwrite or place on a firm commitment basis) will also be able to include receivables from trade debts and fees or commissions receivable within 30 days, but not to satisfy any specific liquidity requirements imposed by their regulator, and only to satisfy one third of their liquidity requirement and subject to a 50% haircut.

Client money and assets will not count as liquid assets.

ADDITIONAL SUPERVISORY POWERS

Supervisors can also require firms to hold additional capital in certain circumstances such as where they consider that the firm is exposed to risks which are not adequately covered by the standard capital requirements.

Where two or more MiFID investment firms are subsidiaries of a third-country parent then the relevant supervisor may, if it considers that the group is not subject to consolidation on an equivalent basis to that which would have applied had the parent been an EU entity, require appropriate supervisory techniques to be applied. In particular, this could include a requirement for the third-country group to establish an intermediate EU holding company. This echoes, in part, the requirement for there to be an intermediate EU holding company for certain third-country credit institution groups as set out in the forthcoming CRD V.

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESSES (ICAAPS)

Firms will be required to conduct an internal capital adequacy assessment process (ICAAP), which may result in a firm needing to hold a higher level of capital than that prescribed by the quantitative requirements alone. This is already the case under the existing rules for most – but not all – MiFID investment firms. The nature of the arrangements, strategies and process that it will be required to have should be appropriate and proportionate to the nature, scale and complexity of the activities carried out by the relevant firm.

DISCLOSURES AND PUBLIC REPORTING

Firms will also be subject to a wide range of disclosure and reporting requirements under the IFR/IFD. These include (but are not limited to) the requirements set out below.

Firms will be obliged to make *public* disclosures about their capital, capital requirements, risk management objectives and policies, internal governance arrangements and (as outlined above) remuneration policies and practices.

Public country-by-country reporting rules currently applicable to firms caught by the CRR will be extended to all Full IFD/IFR Firms and this will require them to disclose the following information annually in relation to *each* EU Member State and non-EU jurisdiction in which they have a branch or a subsidiary that meets the definition of a "financial institution":

- the name, nature of activities and location of any subsidiaries and branches;
- the turnover;
- the number of employees on a full-time equivalent basis;
- the profit or loss before tax;
- the tax on profit or loss; and
- any public subsidies received.

This information must be audited (in accordance with the accounts directive) and, where possible, annexed to the firm's individual or consolidated financial statements.

Firms will also be required to disclose to supervisors on a quarterly basis certain regulatory capital information including the level and composition of own funds, capital requirements, capital requirement calculations, concentration risk and liquidity requirements.

Firms with on- and off- balance sheets assets over EUR 100 million and which exercise holdings of voting rights over 5% in the shares of an issuer traded on a regulated market on behalf of their clients are also required to disclose certain voting information, including voting rights held and a description of the firm's voting behaviour.

APPLICATION OF IFR/IFD REGIME TO SNIFS

As discussed above, the IFR/IFD regime applies on a more limited or modified basis for those firms which can be categorised as SNIFs.

The main modifications to the IFR/IFD provisions discussed in this briefing for SNIFs are set out below.

Requirement	Application to SNIF
Application of IFR/IFD requirements on an individual basis	Competent authorities may waive the requirement for a SNIF to comply with the IFR's requirements relating to own funds composition, the calculation of capital requirements, concentration risk, liquidity requirements, disclosure and reporting on a solo basis where the firm is, broadly speaking, within a consolidation group, subject to the satisfaction of a number of detailed conditions.
Remuneration	The remuneration provisions do not apply to SNIFs.

Own funds requirement	A SNIF will be required to have own funds at all times at least equal to the highest of its: - fixed overheads requirement; and - permanent minimum requirement. SNIFs will therefore not be subject to the K-factor requirements, although some elements of the K-factor calculations will nevertheless be relevant to such firms in determining whether they continue to qualify as a SNIF.
Liquidity requirements	SNIFs will be subject to the liquidity requirements, although they will also be able to include trade receivables and fees or commissions receivable within 30 days and, in addition, supervisors will have the discretion to exempt them from having to comply at all.
Internal capital adequacy assessment process	The requirement to carry out an internal capital adequacy assessment process does not apply to SNIFs but supervisors have the discretion to require SNIFs to do so if they deem it appropriate.
Public disclosures	SNIFs are only required to make public disclosures where they issue Additional Tier 1 instruments and these are limited to disclosures about their capital, capital requirements and risk management objectives and policies. The public country-by-country reporting rules will also not apply.
Disclosures to supervisors	SNIFs will only be required to disclose to supervisors regulatory capital information on an annual basis rather than quarterly.

DISCLOSURE OF ENVIRONMENTAL, SOCIAL OR GOVERNANCE (ESG) RISKS

In keeping with the EU's wider initiatives on environmental, social or governance issues, the EBA will be required to compile a report on ESG-related risks and deliver it to the European Parliament, the Council and the Commission within two years of the IFD entering into force. Amongst other things that report will set out a definition of ESG-related risks, physical risks and the risks related to the transition to a more sustainable economy, an assessment of whether significant concentrations of specific assets might increase such risks and a description of the process an investment firm might use to identify, assess and manage such risks. Following that report the EBA may decide to adopt guidelines on ESG-related risks.

Following on from that, three years after the IFR enters into force, all investment firms (other than, broadly, those with on- and off- balance sheets assets below EUR 100 million) will be required to disclose information on ESG-related risks, physical risks and transition risks, as defined in the EBA's report. After the first disclosure, the second disclosure will have to be made a year later. After that, further disclosures will have to be made biannually.

THIRD COUNTRY FIRMS AND EQUIVALENCE ASSESSMENTS

The Commission's proposed legislation addresses a number of issues relating to third country (i.e. non-EU) investment firms.

The most striking change is the proposed revision of the rules on assessing third countries for equivalence in relation to the provision of cross-border services by third country firms under MiFIR. The relevant provision in MiFIR is being amended to state that when carrying out any equivalence assessment in relation to a third country for those purposes, the Commission must take into account (amongst other factors):

- whether firms in that jurisdiction are subject to prudential, organisational and business conduct requirements which are equivalent to those which apply in MiFIR, CRD IV, CRR and the IFR/IFD regime and their relevant implementing measures; and

- whether firms in that third country are subject to effective supervision and enforcement to ensure compliance with those requirements.

The revised provision also states that, where the activities to be performed are likely to be of systemic importance for the EU (e.g. in the case of the UK post Brexit), the Commission may only conclude that a third country has the necessary equivalent measures after a "detailed and granular assessment" of whether the requirements set out under EU prudential legislation are met. In doing this, the Commission will take into account the degree of supervisory convergence between the relevant third country and the EU. It will be a significant challenge for some jurisdictions – such as the United States – to demonstrate that they have equivalent prudential rules at a detailed and granular level.

Third-country firms which make use of the equivalence provisions when they become available will need to report annually to ESMA on the scale and scope of the activities provided and carried out in the EEA as well as other financial governance information.

APPLICATION TO AIFM AND UCITS

The IFR/IFD regime applies to MiFID investment firms. IFD also makes direct amendments to the Alternative Investment Fund Managers Directive (**AIFMD**) and the UCITS Directive to provide that own funds of an AIFM or UCITS management company can never be less than the IFR's fixed overheads requirement – i.e. one quarter of the firm's fixed overheads for the previous year.

It is not clear how the IFR/IFD regime will apply to AIFMs or UCITS managers with "top-up" MiFID permissions (under Article 6(4) AIFMD and Article 6(3) of the UCITS Directive respectively). This is likely to depend on different Member State interpretations.

Subject to the above, the new regime will not directly impact upon AIFMs or UCITS management companies, although it is likely to be a source of inspiration for future prudential rules directed at those firms. In this regard, it should be noted that the scope of the Commission's review of IFR/IFD (referred to in the section below) will not be restricted to investment firms subject to IFR and IFD. It will also extend to the provisions on remuneration in AIFMD and the UCITS Directive "with the aim of achieving a level playing field for all investment firms active in the Union".

REVIEW OF THE OPERATION OF THE NEW REGIME

Some of the new rules are quite radical and untested. The Commission will be required to review and assess the operation of the new rules and report back to the European Parliament and the Council, particularly in relation to the calibration of the new regime, within 3 years of the new regime taking effect. This is somewhat odd since the five year transitional period will still be in operation and firms will likely not be applying the full set of prescribed metrics by the date of the review.

For background on how the proposal for the IFR/IFD regime developed, please refer to our briefing notes of 6 October 2017 and 21 December 2017 .

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