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## Change in the Prudential Regulation of Investment Firms – The Investment Firm Regulation and Directive

### Introduction

The current EU prudential legislation for investment firms is regulated by the Capital Requirements Regulation (“CRR”) and the Capital Requirements Directive (“CRD”), collectively referred to as the “CRR package”.

On the 05 December 2019, a new Investment Firms [Regulation](#) (“IFR”) and Investment Firms [Directive](#) (“IFD”), called the “IFS package”, were published in the Official Journal of the European Union with an effective date of 25 December 2019. On 26 December 2019, an 18-month transition period has started to elapse, during which Investment Firms must effect the necessary changes to become fully compliant with the IFS package.

The aim of the IFS package is to introduce more proportionate and risk-sensitive laws for investment firms, through which, for example, reporting and disclosure requirements will be lessened. Capital requirements, own funds requirements<sup>1</sup>, and liquidity requirements are re-evaluated to better capture the risks investment firms are exposed to.

The IFS package will eventually replace the existing prudential framework for investment firms as set out in the CRR package. However, a small number of firms, as described below, will still be required to apply the CRR package. It is important to note that MIFIR and MIFID will continue to apply in their entirety to all investment firms irrespective of their classification.

### IFS Package Firm Classification

The principle change of this framework is the reclassification of investment firms and its ramifications as outlined above. According to the IFS Package, firms will have to be classified into three classes and 1 sub class:

- i. Class 1 and the sub-class, Class 1 Minus;
- ii. Class 2; and
- iii. Class 3 firms.

During the course of 2020 and 2021, the Authority will issue self-assessment tests to all licensed Investment Firms, for the latter to determine under which Class they will fall. These tests will be based upon Regulatory Technical Standards as issued by the European Authorities and further details will be communicated under separate cover.

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<sup>1</sup> Own Funds Requirements will be calculated using the newly introduced K-Factors. The details regarding these calculations are still being concluded by the European Commission and will be published through Regulatory Technical Standards

### Class 1 Firms and Class 1 Minus Firms

These are defined in Article 1 of the Investment Firms Regulation (“IFR”), however, there are two main principle rules which determine whether an Investment Firm falls under Class 1. These requirements entail that an investment firm, *inter alia*:

- i. deals on own account and/or underwrites financial instruments and/or places financial instruments on a firm commitment basis; and
- ii. has total consolidated assets<sup>2</sup> equal to or in excess of EUR 15 billion.

A Class 1 Minus Firm’s total value of the consolidated assets is equal to or exceeds EUR 5 billion but is less than EUR 15 billion. Similarly to Class 1 Firms, Class 1 Minus firms must also deal on own account and/or underwrite financial instruments and/or place financial instruments on a firm commitment basis. Unlike the Class 1 status, this does not come into force automatically, but is up to the MFSA’s discretion.

Both Class 1 and the sub-class Class 1 Minus Firms must apply the CRR Package in full.

### Class 2 and Class 3 Firms

Class 2 and Class 3 Firms, governed by the new IFS package, are neither systemic, nor bank like, nor of a significant size. Class 2 Firms may be referred to as small *and interconnected* firms, whilst Class 3 Firms as small and *non-interconnected* firms.

Class 3 Firms are defined in Article 12 of the IFR. The determination on whether an Investment Firm is defined as Class 2 or Class 3 is based on various factors. Class 3 Firms must, at all times, satisfy all the following conditions:

- i. Assets under management are less than EUR 1.2 billion;
- ii. Client orders handled are less than either:
  - a. EUR 100 million/day for cash trades or
  - b. EUR 1 billion/day for derivatives.
- iii. Assets safeguarded and administered are zero;
- iv. Clients’ money held are zero;
- v. Daily trading flow is zero;
- vi. Net Position Risk or Clearing Margin Given is zero;
- vii. Trading Counterparty Default is zero;
- viii. The on- and off-balance sheet total of the investment firm is less than EUR 100 million;
- ix. The total annual gross revenue from investment services and activities of the investment firm is less than EUR 30 million calculated as an average on the basis of the annual figures from the two-year period immediately preceding the given financial year.

The calculations in relation to each factor are still being discussed on a European level. The MFSA will keep the industry informed during the course of 2020 and 2021.

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<sup>2</sup> The term “Consolidated assets” has not been defined yet. A Regulatory Technical Standard is going to be published in due course to address this.

Class 2 Firms are the residual class and, unlike Class 1 Firms, Class 1 Minus Firms, and Class 3 Firms there is no specific list within the IFS package which they have to adhere to. They are firms which satisfy neither the requirements for Class 1, nor Class 1 Minus, nor Class 3.

### Conclusion

The MFSA therefore advises all relevant stakeholders to review the IFS Package and consider its impact on the investment firm. The MFSA will keep Licence Holders updated as developments arise.

Should you have any queries do not hesitate to contact the Investment Firms Team within the Securities and Markets Supervision Function on [investmentfirms@mfsa.mt](mailto:investmentfirms@mfsa.mt).