

Investment Firms Regulation and Directive: Overview

Friday 7 May 2021

INVESTMENT FIRMS REGULATION AND DIRECTIVE

OVERVIEW

07 MAY 2021

SECURITIES & MARKETS SUPERVISION



AGENDA

0905hrs	Introduction – An overview of the salient changes	Page 3
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INTRODUCTION – AN OVERVIEW OF THE SALIENT CHANGES



Mr Ian Meli
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A BRIEF HISTORY

Banks & Investment Firms subject to the Capital Requirements Directive (CRD) regime since 1993

Investment Firms required a tailor-made regime for simplicity and consistency – operational model is distinct from that of banks

Applicability: a) All EU Investment Firms licensed under MiFID; b) AIFMs and UCITS Mancos offering ancillary MiFID services

Proportionality – Small and non-interconnected firms subject to a lighter treatment



TIMELINE



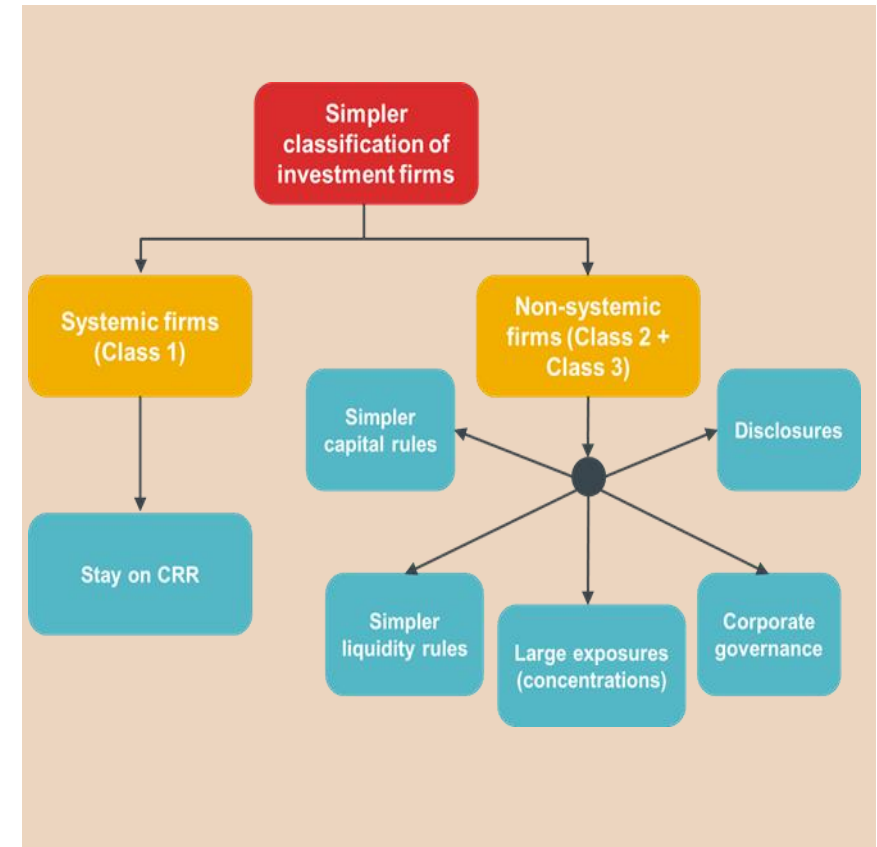
CONTENT OF THE IFD

- Initial capital of Investment Firms (IFs) – some IFs will be required to hold higher capital
- Internal Capital Adequacy Risk Assessment
- Supervisory Review Evaluation Process and Environmental, Social and Governance
- Supervisory powers and tools for the prudential supervision of Ifs

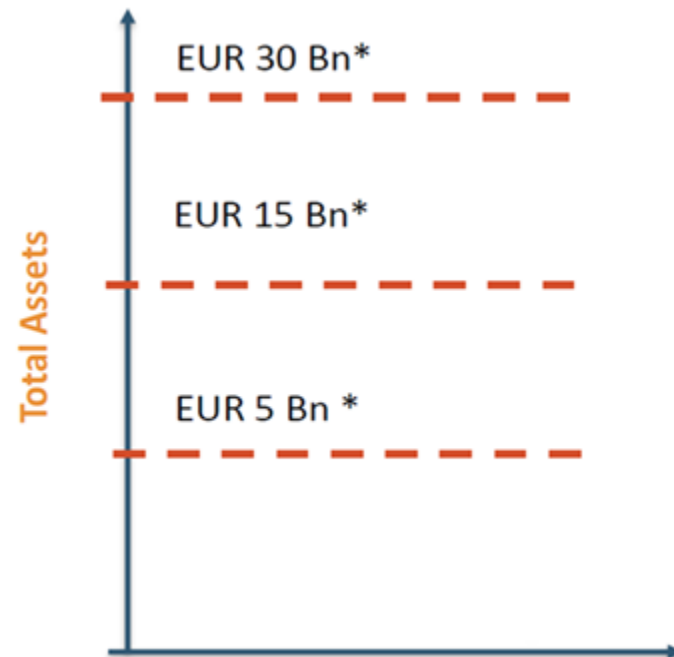


CONTENT OF THE IFR

- Own funds requirements
- Requirements limiting concentration risk
- Liquidity requirements
- Reporting requirements related to own funds, concentration
- Public disclosure requirements
- New regulatory reporting
- Reporting on a group-wide basis



MAIN CHANGES - CATEGORISATION (1)



IFs* whose total value of consolidated assets is equal or exceeds EUR 30bn shall obtain a credit institution licence

Class 1 - IFs* whose total value of consolidated assets is equal or exceeds EUR 15bn shall apply the requirements of CRR/D

Class 1 minus - IFs* whose total value of consolidated assets is equal or exceeds EUR 5bn may be subjected to the requirements of CRR/D upon the NCA discretion

*provided that the IF is dealing on own account or is providing underwriting on a firm commitment basis services

MAIN CHANGES - CATEGORISATION (2)

- Class 1 and 1 minus as defined in slide 8
 - In Malta we do not have LHs licensed solely as falling under this category as they have a Credit Institution license – hence they would still fall under CRD/CRR
- Class 2
 - Residual Class, IFs which are not class 1, class 1 minus nor class 3
 - Covering the current Category 2 and Category 3 IFs
- Class 3 – small and non-interconnected Investment Firms
 - **Can't hold client money and assets**
 - Similar to the current Category 1 IFs

CONSOLIDATION

Capital, remuneration, transparency and regulatory reporting of EU group entities: applies to parent on the basis of consolidation

Parent companies of low risk groups are allowed to use own funds to cover the full book value of subsidiaries and any contingent liabilities



MAIN PRUDENTIAL CHANGES - K-FACTORS

Risk-To-Client: assets under management + client monies + assets safeguarded + client orders handled

Risk-To-Market: net position risk or clearing margin given

Risk-To-Firm: exposure to default of trading counterparties + daily trading flow + concentration risk



CAPITAL REQUIREMENTS

The highest of:

- a) Minimum amount (EUR 75K, EUR 150K or EUR 750k as applicable); *or*
- b) Fixed overheads requirement; *or*
- c) Newly introduced K-factor requirement

Top-ups required:

- Individual Capital Adequacy Risk Assessment Process (ICARA)
- **Regulator's discretion based on identified risks**

NEW CAPITAL REQUIREMENTS (1)

Initial Capital	€750,000	€150,000	€75,000
MIFID Activity	<ul style="list-style-type: none"> - Dealing - Underwriting 	<ul style="list-style-type: none"> - Reception & Transmission of Orders - Execution - Portfolio Management - Investment Advice - Placing w/o commitment - <i>Can hold or control clients' money/assets</i> 	<ul style="list-style-type: none"> - Reception & Transmission of Orders - Execution - Portfolio Management - Investment Advice - Placing w/o commitment - <i>Cannot hold or control clients' money/assets</i>
Class	Class 2	Class 2	Class 3 – given they respect Article 12 IFR thresholds, if not, class 2

NEW CAPITAL REQUIREMENTS (2)

	Capital Ratios	
	Under CRR	Under IFR*
CET 1 Ratio	$\frac{CET\ 1}{Total\ Risk\ Exposure} \geq 4.5\%$	$\frac{CET\ 1}{D} \geq 56\%$
Tier 1 Ratio	$\frac{CET\ 1 + Additional\ T1}{Total\ Risk\ Exposure} \geq 6\%$	$\frac{CET\ 1 + Additional\ T1}{D} \geq 75\%$
Total Capital Ratio	$\frac{CET\ 1 + Additional\ T1 + T2}{Total\ Risk\ Exposure} \geq 8\%$	$\frac{CET\ 1 + Additional\ T1 + T2}{D} \geq 100\%$

*whereby D is the highest of (a) the fixed overheads requirement; (b) initial capital requirement; or (c) the k-factor requirement.

LIQUID ASSETS REQUIREMENT

Minimum of one month's fixed overheads in liquid assets

Liquid assets include:

- Cash
- Treasury securities
- Other debt subject to specific eligibility criteria and haircuts
- Shares or units in certain money market funds
- Other assets traded on a trading venue for which there is a liquid market (per MiFIR) subject to haircut of 55%

May also include: Receivables from trade debts and fees or commissions receivable within 30 days: a) to satisfy 1/3 of the liquidity requirement and; b) subject to a 50% haircut

REMUNERATION AND INTERNAL GOVERNANCE (1)

Class 2 investment firm's remuneration policies and practices have to be:

- a) consistent and promote sound and effective risk management;
- b) gender neutral – EBA and ESMA to issue guidelines on gender neutral remuneration policies;
- c) clearly documented and proportionate to the size, nature and complexity of activities of the IF;
- d) in line with the business strategy;
- e) avoids conflicts of interests and promotes risk awareness and prudent risk taking;
- f) reviewed periodically by senior management; and
- g) fixed component must represents a high proportion of total remuneration.

The remuneration policy to cover senior management, risk takers, staff involved with control functions and employees receiving similar overall remuneration.

REMUNERATION AND INTERNAL GOVERNANCE (2)

Class 2 IFs shall publicly disclose the remuneration policies and practices: namely;

- a) The gender neutrality and pay aspects;
- b) The characteristics of the remuneration system;
- c) The ratio between fixed and variable remuneration;
- d) Aggregated quantitative information on remuneration broken down by senior management and risk takers;
and
- e) Information on whether in benefits from a derogation under Article 32(4) of the IFD.

Exemptions:

- a) Class 3 IFs are not subject to remuneration requirements under the IFD but the MiFID II requirements shall continue to apply
- b) IFs having on and off-balance sheet assets less than **€100m** are exempt from establishing a risk committee

IMPLEMENTATION INTO LOCAL FRAMEWORK

- i. Amendments to the Investment Services Act
- ii. Amendments to 4 Subsidiary Legislations and the enactment of 2 new Subsidiary Legislations
- iii. Revisions of Part A and Part BI of the Investment Services Rules for Investment Services Providers

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LEGISLATIVE CHANGES



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LEGISLATIVE CHANGES - INTRODUCTION

- Christmas Day 2019 IFR and IFD came into force
- Applicability is 26 June 2021
- IFD requires transposition

LEGISLATIVE CHANGES - CRD V vs IFD

- Original CRD V application was 28 December 2020
- 26 June 2021 CRD V applies to Class 1 and Class 1 Minus
- IFD applies to Class 2 and Class 3

LEGISLATIVE CHANGES - IFD TRANSPOSITION

- The Investment Services Act (Cap. 370)
- **Subsidiary Legislations (“SLs”)**
- The Part B1 MiFID Rulebook

LEGISLATIVE CHANGES - CHANGES TO THE ISA

- Mostly amendments to existing laws
- 3 brand new Articles:
 - Inclusion of Holding Companies in Supervision of Compliance with the Group Compliance test
 - Mixed activity holding companies
 - Assessment of third-country supervision and their supervisory techniques

LEGISLATIVE CHANGES - CHANGES TO SL 370.03 - FEES

- Removal of Categories
- Restructuring of the Fees
- Applicability of the Fees

LEGISLATIVE CHANGES - CHANGES TO SL 370.09 - ICS

- Licence Holders will still be required to contribute
- Resolution Function is driving these changes
- Removal of the Categories

LEGISLATIVE CHANGES - CHANGES TO SL 370.43 – THIRD COUNTRY FIRMS

- Transposes Articles of MiFID II
- IFD Article 64 amends MiFID II
- Imposes reporting on branches of third country firms
- Clarifies Reverse Solicitation

LEGISLATIVE CHANGES - CHANGES TO SL 371.15 – SUPERVISORY CONSOLIDATION

- Transposes Articles of the CRD IV
- Contains provisions for Credit Institutions and Investment Firms
- Deletion of all Regulations relating to Investment Firms

LEGISLATIVE CHANGES - TWO NEW SLs SIMILAR TO SL 371.15

- 1 SL transposes CRD to Investment Firms
- 1 SL Transposes IFD
- Powers are practically the same
- Will ensure clarity for the industry

LEGISLATIVE CHANGES - NEW SL SIMILAR TO SL 370.15 – SUPERVISORY REVIEW

- Current SL transposes CRD IV
- IFD gives the MFSA similar powers
- A creation of a similar SL is necessary

LEGISLATIVE CHANGES - NEW SL SIMILAR TO SL 370.25 – CRD PENALTIES

- Current SL transposes CRD
- MFSA may apply administrative penalties

LEGISLATIVE CHANGES - THE RULEBOOK – PART B1 MiFID

- Reorganisation
- Different approach to the implementation of Regulations
- New Rules because of IFD

LEGISLATIVE CHANGES - WAY FORWARD



- ISA will be tabled to Parliament for consideration
- SLs will pass through Cabinet
- Rulebook will be issued shortly for comments

LEGISLATIVE CHANGES - TRANSITIONAL PROVISIONS – LOCAL FIRMS

- Local Firms established before Christmas 2019 have five years to increase own funds to **€750,000**:
 - **€250,000** as of 26 June 2021
 - At least **€100,000** yearly after that
- Local Firms established after Christmas 2019 have to increase own funds to **€750,000 immediately**

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IFRD APPLICABILITY AND INVESTMENT FIRMS' CLASSIFICATION



Jesmar Ciappara
Senior Manager
Securities and Markets Supervision

PRUDENTIAL CLASSIFICATION



- Class 1: **Investment firms which provide 'bank-like' services, including (3) and/ or (6) of Section A** of Annex I to MiFID II and whose total value of the consolidated assets is equal to or exceeds EUR 15 billion.
- Class 1 Minus: Investment firms which provide services, including (3) and/ or (6) of Section A of Annex I to MiFID II, whose consolidated assets is larger than EUR 5 billion but less than EUR 15 billion and is subject to a decision with respect to its classification by the MFSA.
- Class 2: The residual class of investment firms that do not fall under Class 1, Class 1 minus nor Class 3.

PRUDENTIAL CLASSIFICATION

Class 3: Small and non-interconnected investment firms whereby they meet all of the following conditions at all times:

- (a) Assets Under Management is less than EUR 1,2 billion;
- (b) Clients orders handled is less than either:
 - i. EUR 100 million/day for cash trades; or
 - ii. EUR 1 billion/day for derivatives;
- (c) Assets safeguarded and administered is zero;
- (d) Client money held is zero;
- (e) Daily trading flow is zero;
- (f) Net position risk or clearing margin given is zero;
- (g) Trading counterparty default is zero;
- (h) The on- and off-balance sheet total is less than EUR 100 million
- (i) The total annual gross revenue from investment services and activities of the investment firm is less than EUR 30 million.

PRUDENTIAL CLASSIFICATION – ONGOING MONITORING

- Class 1: **Where an investment firm no longer meets any of the 'Class 1' thresholds, calculated over a period of 12 consecutive months, it shall cease to be considered as a Class 1 investment firm.**
- Class 1 Minus: Any decision taken by the MFSA in this regard, shall cease to apply where the investment firm no longer meets **the 'Class 1 Minus' thresholds, calculated over a period of 12 consecutive months.**
- Class 3:
 - i) **Where an investment firm no longer meets any the 'Class 3' conditions, it shall cease to be considered so.**
 - ii) Where an investment firm no longer meets the conditions set out in points (a), (b), (h) or (i) but continues to meet the conditions set out in points (c) to (g) above, it shall cease to be considered so, after a period of 3 months.
 - iii) **Where an investment firm which has not met all of the 'Class 3' conditions subsequently meets them, it shall be considered so only after a period of 6 months.**

SCOPE AND APPLICABILITY



- Class 1: CRR/D and articles 55 and 59 of IFR shall apply.
- Class 1 Minus: CRR/D and articles 55 and 59 of IFR shall apply, subject to MFSA decision.
- Dealing firms which are subsidiaries and are included in the supervision on a consolidated basis of a Credit Institution, financial holding company or mixed financial holding company: CRR/D shall apply, subject to MFSA decision.
- Classes 2 & 3: IFR/D shall apply.
- Credit Institutions: IFR/D is not applicable.
- Fund Managers (full scope AIFMs and UCITS management companies): IFR/D is not applicable.
- De minimis AIFMs: Subject to IFR/D, where they provide MiFID services.

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BREAK

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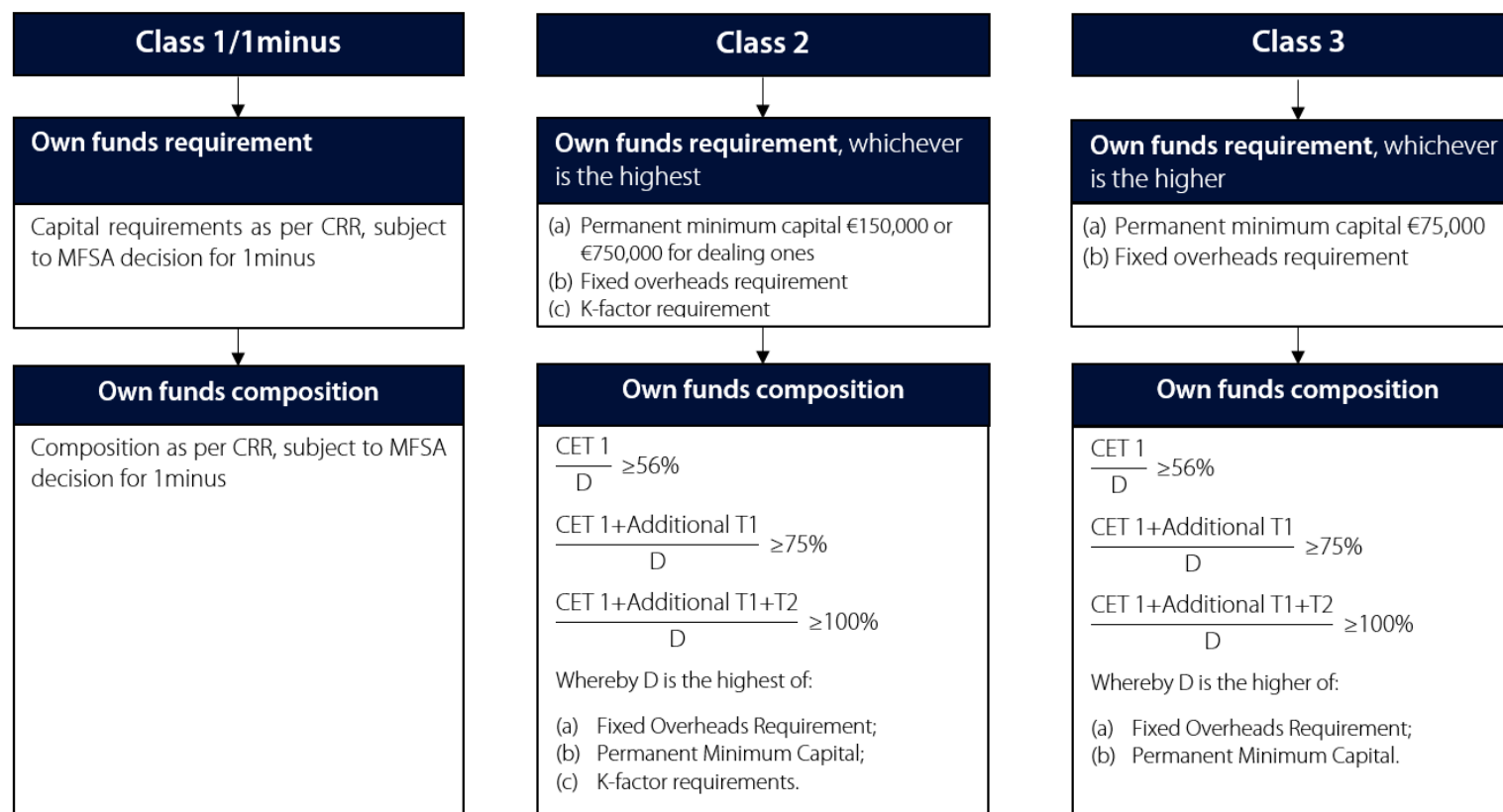
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CAPITAL REQUIREMENTS

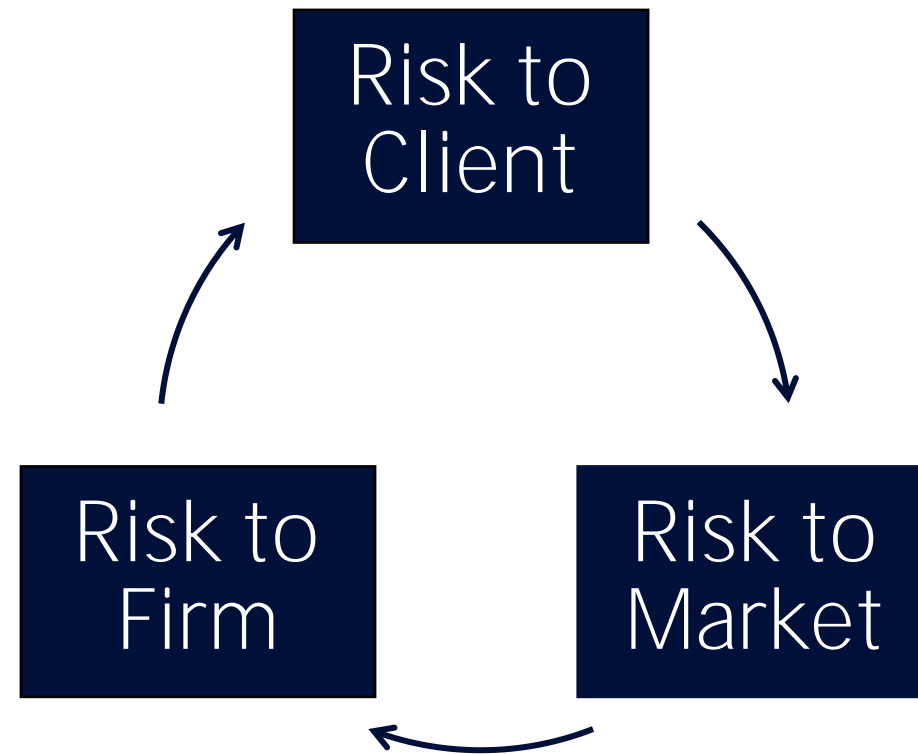


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CAPITAL REQUIREMENTS



CAPITAL REQUIREMENTS (2) – K-FACTORS



CAPITAL REQUIREMENTS (3) – RISK TO CLIENT

K-AUM	K-CMH	K-ASA	K-COH
<ul style="list-style-type: none">• K-AUM is equal to 0.02% of AUM• AUM include assets under advice of “ongoing nature”• AUM include assets the management of which has been delegated	<ul style="list-style-type: none">• K-CMH is equal to 0.4% (on segregated accounts) and 0.5% (on non-segregated accounts) of CMH	<ul style="list-style-type: none">• K-ASA is equal to 0.04% of ASA• For the purpose of calculating K-ASA, depositary and custodianship services offered to CISs are not to be included	<ul style="list-style-type: none">• K-COH is equal to 0.1% (for cash trades) and 0.01% (for derivatives) of COH

CAPITAL REQUIREMENTS (4) – RISK TO FIRM

K-TCD	K-DTF	K-CON
<ul style="list-style-type: none">K-TCD shall be equal to: $\alpha * EV * RF * CVA$	<ul style="list-style-type: none">K-DTF is equal to 0.1% (for cash trades) and 0.01% (for derivatives) of DTF	<ul style="list-style-type: none">K-CON shall be calculated by those firms which hold exposure values in excess to the 'soft limits' identified under the IFR in relation to clients

CAPITAL REQUIREMENTS (4) – RISK TO MARKET

K-NPR

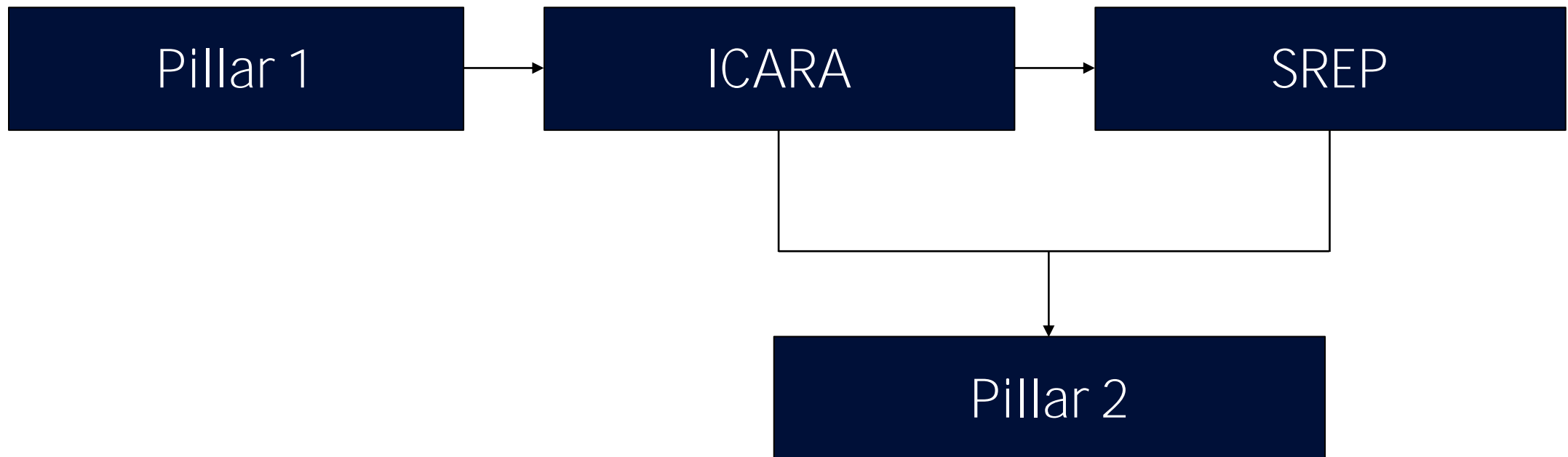
- Same concept of standardised market risk under CRR. Must be calculated in line with Title IV of Part Three of CRR

EITHER OF

K-CMG

- Where permissible, investment firms may calculate K-CMG for all positions that are subject to clearing
- K-CMG shall be the third highest amount of total margin required multiplied by 1.3 over a three months period

CAPITAL REQUIREMENTS – PILLAR 2



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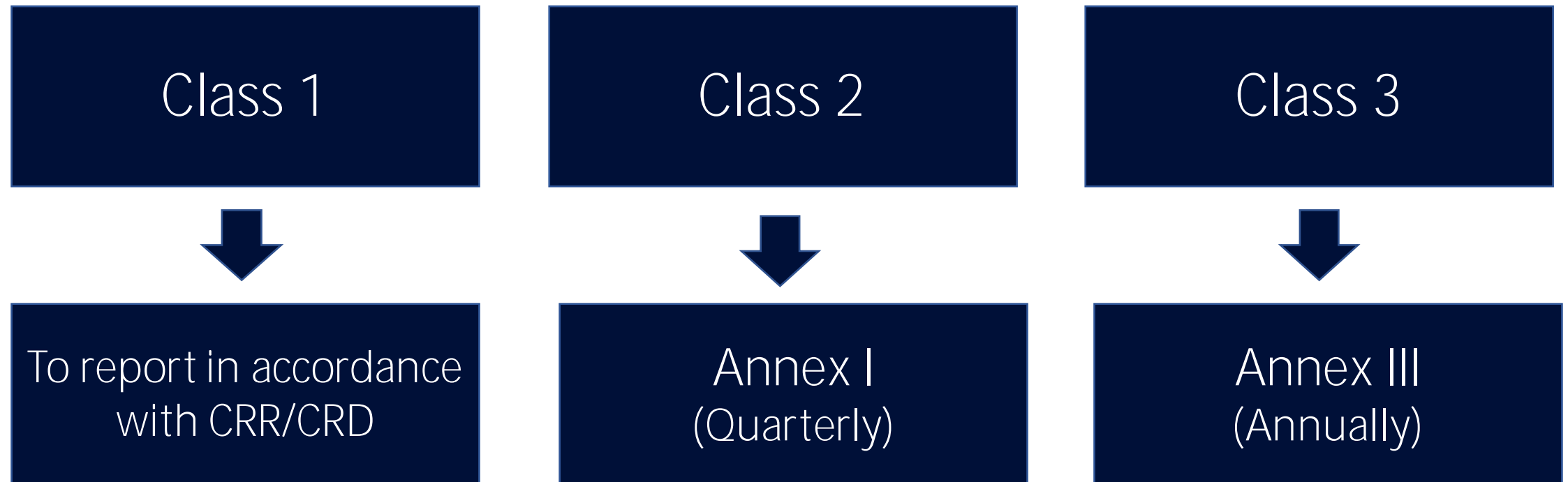
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REPORTING AND DISCLOSURE REQUIREMENTS



Daniel Cassar
Technical Expert
Securities and Markets Supervision

INVESTMENT FIRMS REPORTING



PUBLIC DISCLOSURES



Risk management objectives & policies

Internal governance

Own funds

Own funds requirements

PUBLIC DISCLOSURES (2)



Remuneration policy & practices

Investment Policy

Environmental, social & governance risk

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Q&A SESSION

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Thank you

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