IFPR
New Classifications of Investment Firms and Key Changes

New Classifications of Investment Firms

The current prudential classifications of MiFID investment firms will cease to exist and will be replaced with three new categories.

- **Class 1**—Systemic and Large Investment Firms with a balance sheet of over €30 billion carrying out bank-like activities will be classified as credit institutions and remain subject to the current Capital Requirements Regulation and Directive (CRR/CRD).
- **Class 2**—Non-Systemic Investment Firms that exceed specific quantitative thresholds will be in scope of all new IFR rules.
- **Class 3**—Non-Systemic firms defined as Small and Non-Interconnected (SNIs) with a simplified business model and reduced scope of activities will be subject to IFR with limited scope.

Thresholds for Class 2 and Class 3 Firms:

Class 2: Firms meeting any of the following tests	
Balance sheet total	≥ €100m
Total annual gross revenue from investment activities	≥ €30m
Assets under management	≥ €1.2bn
Daily client orders handled: • For cash trades (amount paid/received) • For derivatives trades (notional value)	≥ €100m ≥ €1bn
Assets safeguarded and administrated	> 0
Client money held	> 0
Daily trading flow	> 0
Net position risk/clearing member guarantee	> 0
Trading counterparty default	> 0

Any firm below these thresholds will be classifies as Class 3.

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Key Changes

The key areas of impact relate to own funds, concentration risk, liquidity, reporting and public disclosure:

Class 2: Firms meeting <u>any</u> of the following tests	
Capital Requirements	**The most significant change introduced by the Investment Firm Directive and Investment Firm Regulation (IFD/IFR) consists of a new risk-based methodology for calculation known as a K-factor (KFR) which is a quantitative metrics to calculate ongoing capital requirements.** Initial capital requirements will remain as the minimum of capital required, however it will be referred to a Permanent Minimum Capital Requirement (PMR). **All firms will need to hold sufficient capital to meet the greater of their PMR and Fixed Overhead Requirement (FOR).** Class 2 firms will have to compare their PMR and FOR with KFR.
Liquidity Requirements	All investment firms will have to maintain a minimum liquid asset requirement equivalent to at least 1/3 of their fixed overhead requirement (FOR). All investment firms should have internal procedures to monitor and manage their liquidity requirements.
Reporting Requirements	Reporting requirements are expected be more appropriate and proportionate for investment firms i.e. simpler forms. It will be on a quarterly basis for all firms but on an annual basis for Class 3 firms in the Ireland and the rest of the EU.
Remuneration Policies	The Prudential Sourcebook for Investment Firms (IFPRU) and Prudential Sourcebook for Banks (BIPRU) remuneration codes will be replaced with a single remuneration code for investment firms.
Prudential Consolidation	The Group Capital Test (GCT) can be adopted as an alternative to full prudential consolidation but this requires permission from the regulator. Consequently, the existing consolidation waiver (IFCW) will be removed.

Own Funds Requirements	All firms will need to hold sufficient capital to meet the greater of their permanent minimum requirement (PMR) and their fixed overhead requirement (FOR). Class 2 firms will also have to compare their PMR and FOR with a K-factor capital requirement (KFR). There will be transitional provisions that will allow firms to meet any increase in capital over a period of 5 years. This includes a potential capping of FOR to twice the current level.
Concentration Risk	All investment firms should monitor and control their concentration risk, such as location of client money, location of client assets, location of own cash deposits, and sources of earnings. Class 3 firms will not need to report it to the regulators.
ICARA	All MiFID firms will now need to undertake an Internal Capital Adequacy and Risk Assessment (ICARA), with exemption for some Class 3 firms if the regulators deem it appropriate. This is similar to the current Internal Capital Assessment Process (ICAAP), but does include key differences such as the need to consider wind-down planning. For the UK regime, more details will be provided in subsequent consultation papers.
Public Disclosure	All investment firms will be required to publicly disclose their levels of own funds, own funds requirements, governance arrangements, and remuneration policies and practices, to provide transparency to their clients and the wider markets.