THE INVESTMENT FIRM PRUDENTIAL REGIME

BACKGROUND

The existing Capital requirement regimes are rooted in the original 1993 Investment Services Directive (ISD) and the Capital Adequacy Directive (CAD) and are largely based on successive iterations of the international regulatory standards set for large banking groups which only partially address the specific risks inherent to the diverse activities of investment firms.

The requirements emanating from the Capital Requirements Directive (CRD) / Capital Requirements Regime (CRR) are largely calibrated to preserve the lending capacity of credit institutions through economic cycles and to protect depositors and taxpayers from possible failure. The European Banking Authority ("EBA") highlighted deficiencies in the present regime by particularly criticising its disproportionate complexity and non-risk-responsiveness.

In December 2019, the European Parliament and Commission approved the Investment Firm Regulation and Investment Firm Directive (collectively the "**IFR Package**") which capture requirements for the prudential supervision of investment firms.

This represents a significant reform in the EU regulatory framework and will have a material impact on most investment firms.

The IFR Package will eventually replace the existing prudential framework for investment firms as set out in the CRD/CRR package. A small number of firms will still be required to apply the CRR package. It is important to note that MiFID and MiFIR will continue to apply in their entirety to all investment firms irrespective of their classification under the IFR package.

SCOPE & APPLICABILITY

The new IFR Package will apply to MiFID firms licensed in Malta. The prudential requirements that apply to investment firms under the IFR prudential regime will depend on what the type of MiFID II services offered and activities performed by the investment firm. Riskier activities will require more onerous prudential obligations.

TIMELINE

The new requirements will be enforced as from **26 June 2021.**

ZASMalta
REGULATORY COMPLIANCE SOLUTIONS

info@zasmalta.com

+356 2015 6707

+356 2015 6704

CHANGES

- Introduction of new classes of firms which depend on the activities undertaken, systemic importance, size and interconnectedness;
- New permanent minimum capital and liquidity requirements;
- The introduction of liquidity monitoring and management requirements;
- The introduction of new risk-based measures reflecting the business undertaken – referred to as 'K-factors' which will focus on Risk to Customers, Risk to Market and Risk to Firm;
- Developments in group consolidation requirements;
- Enhanced governance standards and more extensive disclosures;
- Updates to the financial information reported to the regulator and changes in the frequency of such reporting;
- Changes to the approach in risk assessment with the introduction of the ICARA process; and
- New remuneration provisions and developments in clawback rules.

INITIAL ACTION

- Plan, implement and ensure adequate financial resources, personnel and systems. As applicable, this includes evaluating the impact of the proposed increases to initial capital requirements and changes in the Fixed Overheads Requirement on capital requirements;
- Assessment of 'Risk to Market', 'Risk to Firm' and predominantly the 'Risk to Customer' aspect and identify impact on capital and ascertain impacts from other K-Factor calculations;
- Understand how the changes could influence business strategy decisions by implementing a thorough and documented assessment; and
- Review the remuneration policy and practices.

OUR ASSISTANCE

ZASMalta has collaborated with Wheelhouse Advisors, a market-leading UK provider of prudential advisory, accounting and tax services, to assist you with a range of solutions designed to meet your needs. They have been providing practical support within the market and their experience covers:

- **IFPR Impact Assessment:** Understand how the new regime impacts your firm. This includes categorisation, capital requirements and resources, liquidity requirement and resources, group consolidation rules, regulatory reporting, ICARA process and public disclosure.

- **ICARA Process Review and Preparation:** Transitioning from RMICAAP to ICARA, which requires all firms to annually conduct and document their ICARA process to ascertain the level of capital required to adequately address future and current risks in the business.

- **Board and Senior Management Training:** Provision of education and learning packages designed to ensure those responsible for governance are in a position to adequately oversee and challenge the IFPR package.

- **Prudential Monitoring and Regulatory Reporting:** Ongoing monitoring of thresholds, liquidity and capital adequacy. Preparation and submission of regulatory reports allowing you to focus on the core business.

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