

Introducing IFD / IFR: A New Prudential Regime for Investment Firms

From 26 June 2021, a new prudential regime applies to investment firms authorised under the Markets in Financial Instruments Directive¹ ("MiFID II").

This new framework, set out in the Investment Firm Regulation² ("IFR") and the Investment Firm Directive³ ("IFD"), significantly revises the prudential rulebook for investment firms by introducing a bespoke regime.

Underpinned by the principles of risk relevance and proportionality, the new regime applies a range of rules relating to capital requirements, financial and regulatory reporting, internal governance and remuneration to investment firms, depending on their classification across a risk spectrum.

Classification of Investment Firms

Depending on size, scale and activities, investment firms fall into one of three categories under the IFD / IFR regime: Class 1; Class 2 and Class 3.

Class 1 firms are systemically important firms that are authorised to deal on their own account or underwrite or place financial instruments on a firm commitment basis and whose total assets exceed €30 billion (individually or on a group basis).

These firms are subject to European Central Bank supervision and must now apply for authorisation as a credit institution. Until the new licence is issued, they remain subject to the Capital Requirements Directive⁴ ("CRD") and the Capital Requirements Regulation⁵ ("CRR") capital and remuneration requirements that applied prior to 26 June 2021.

Class 1 minus firms are investment firms authorised to deal on their own account or underwrite or place financial instruments on a firm commitment basis and whose total value of consolidated assets exceeds €15 billion but does not meet the €30 billion Class 1 threshold.

These firms continue to be regulated under CRD / CRR and remain subject to CRD / CRR capital and remuneration requirements.

Class 2 firms are investment firms that are not systemically important and which exceed certain size and risk thresholds.

This is expected to be the default category for many investment firms.

Class 2 firms are subject to IFD / IFR supervisory and remuneration requirements (unless part of a group that is subject to consolidated supervision under the CRD / CRR).

¹ <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32014L0065>

² <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019R2033>

³ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32019L2034R%2802%29>

⁴ <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0338:0436:En:PDF>

⁵ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32013R0575>

Class 2 firms are required to hold minimum own funds based on the higher of their fixed overhead requirement ("FOR"), their permanent minimum capital ("PMC") requirement or a new 'K-factor' own funds requirement.

The K-factors are a set of metrics used to determine the capital requirements for a firm, depending on the range and extent of services the firm provides.

Class 3 firms are small and non-interconnected firms which do not meet certain thresholds. These are subject to reduced and modified IFD / IFR requirements (unless part of a group that is subject to consolidated supervision under CRD / CRR requirements). Class 3 firms are required to hold minimum own funds based on the higher of their FOR requirement or their PMC.

They are not required to calculate their capital based on the K-factor methodology but still need to calculate K-factors for categorisation purposes.

Class 3 firms continue to be subject to the MiFID remuneration requirements and not the IFD / IFR remuneration framework.

Remuneration

The IFD / IFR introduce remuneration requirements including deferral, payment in instruments and remuneration committees for many investment firms. Consistent with the principle of proportionality, the governance and remuneration requirements will depend on a firm's classification and balance sheet size. The Central Bank of Ireland ("Central Bank") intends to issue an 'Implementation of NCA Discretions in IFD / IFR Regulatory Notice' in due course to set out how it will exercise the Member State remuneration related discretions to be granted to it by the Irish Minister of Finance.

Disclosure Requirements and Regulatory Reporting

Investment firms subject to IFD / IFR are required to publish certain disclosures on the same date as the publication of annual financial statements in a medium and location determined appropriate by the firm. Where possible, all disclosures should be provided in one medium or location.

Disclosure requirements depend on classification under IFD / IFR classification.

Class 2 firms are required to disclose risk management objectives and policies including a summary of the strategies and processes to manage those risks and a concise risk statement describing their overall risk profile. In addition, Class 2 firms must disclose information regarding the main features of own instruments issued by firms, internal governance arrangements and remuneration policy and practices.

Class 3 firms are not required to make public disclosure requirements unless they issue Additional Tier 1 instruments. Where Additional Tier 1 instruments are issued, these firms are required to disclose risk management objectives and policies and make own funds disclosures.

Level 2 firms are required to submit quarterly reports to NCAs on level, composition, requirements and calculation of own funds, concentration risk, liquidity requirements and the level of activity in respect of determining whether the firm is a Level 2 or Level 3 firm. Level 3 firms shall submit such reports on an annual basis. Firms carrying out the activities of dealing on own account or underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis, or both, are required to submit additional reports if the total value of their consolidated assets exceeds €5 billion, calculated as an average of the previous 12 months.

National Implementation: Ireland

IFR and IFD entered into force on 25 December 2019. IFR is directly effective from 26 June 2021 and EU Member States are expected to apply domestic legislation implementing IFD from 26 June 2021.

The Irish Department of Finance issued a Feedback Statement⁶ on 24 May 2021 on the outcome of its public consultation on the national discretions under IFD in May 2020. For further details see our client update Ireland Exercises National Discretions under IFD / IFR⁷.

The European Union (Investment Firms) Regulations 2021 (S.I. 355 of 2021⁸) and European Union (Investment Firms) (No. 2) Regulations 2021 (S.I. 356 of 2021⁹) were signed and came into effect on 21 September 2021 to complete the partial transposition of IFD and IFR into Irish law.

Article 62(6) of IFD, which requires Member States to impose an obligation on Class 1 Firms to re-authorise as credit institutions, remains to be transposed into Irish law. The Irish Department of Finance intends to conclude work, as soon as possible, to establish in legislation a re-authorisation process for those investment firms required to re-authorise as credit institutions.

On 23 June 2021, the Central Bank issued a Feedback Statement¹⁰ providing further guidance on how it will exercise competent authority discretions in the IFR and IFD.

⁶ <https://assets.gov.ie/135676/61353679-13aa-49cb-a3e3-dfde5af72fa1.pdf>

⁷ <https://maples.com/en/knowledge-centre/2021/5/ireland-exercises-national-discretions-under-ifd-and-ifr>

⁸ https://opac.oireachtas.ie/Data/Library3/Documents%20Laid/2021/pdf/DOFdocslaid230921_230921_102336.pdf

Noting that the transposition into Irish law of IFD Articles 60 and 61 amends own funds requirements for AIFMs and UCITS management companies with MiFID II top-up permissions, the Central Bank has clarified that such entities should continue to comply with the current prudential regime specified in their conditions of authorisation pending further Central Bank engagement.

What should investment firms do?

To ensure compliance with the IFD / IFR regime, investment firms should familiarise themselves with the IFD / IFR requirements and the potential impact on their business.

This may involve the following initial considerations:

- Assessment of the firm in the context of Class 1 / 2 / 3 categorisation
- Review of the applicable minimum capital requirements
- Revision of the firm's remuneration policies and procedures / framework
- Preparing for the new public disclosure requirements and the regulatory reporting regime that the firm is subject to

Any gaps identified in the current business model should be remediated and policies and procedures should be updated to ensure compliance.

In January 2021, the Central Bank indicated¹¹ that investment firms' preparation for the IFD / IFR should be discussed at board level.

⁹ https://opac.oireachtas.ie/Data/Library3/Documents%20Laid/2021/pdf/DOFdocslaid230921a_230921_111142.pdf

¹⁰ <https://www.centralbank.ie/docs/default-source/publications/consultation-papers/cp135/feedback-statement-to-cp135.pdf?sfvrsn=4>

¹¹ <https://www.centralbank.ie/news/article/speech-ready-for-change-gerry-cross-29-jan-2021>

A Central Bank statement¹² on 14 July 2021 reminded relevant firms to engage with the European Banking Authority data collection exercise (as part of its second consultation¹³ on the draft RTS on the calculation of the threshold in Article 8a(1) of CRD) as communicated to them by their supervisory team and to confirm their IFD / IFR classification to that team by the end of August 2021.

How Maples Can Help

Our dedicated Irish Financial Services Regulatory Group is currently working with a number of firms implementing the new regime, including: reviewing remuneration framework and employment terms; engaging with the Central Bank; assessing re-categorisation of firms and relevant thresholds (particularly within group contexts) and advising clients on interpreting key provisions.

Further Information

Further information on our Irish Financial Services Regulatory Group, and the services we provide is available on our website page¹⁴ and in our brochure¹⁵.

If you would like further information, please liaise with your usual Maples Group contact or:

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¹² [https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/investment-firms/mifid-firms/regulatory-requirements-and-guidance/central-bank-statement-for-mifid-investment-firms-authorized-for-mifid-activities-\(3\)-or-\(6\).pdf?sfvrsn=2](https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/investment-firms/mifid-firms/regulatory-requirements-and-guidance/central-bank-statement-for-mifid-investment-firms-authorized-for-mifid-activities-(3)-or-(6).pdf?sfvrsn=2)

¹³ <https://www.eba.europa.eu/eba-launches-second-consultation-its-technical-standards-calculation-eur-30bn-threshold-investment>

¹⁴ <https://maples.com/en/services/specialty-services/irish-financial-services-regulatory>

¹⁵ <https://maples.com/-/media/files/pdfs/articles-and-chapters/financial-services-regulatory-group---core-services.pdf>