Overview

ESMA and the EBA released a joint report on investment firms on 14 December 2015, in response to the European Commission's call for advice regarding the prudential regime applied to investment firms.

The report provides a detailed and constructive analysis of the issues with the current investment firm prudential regime, key aspects of which are summarized below. The report concludes with the recommendations that a **new prudential regime should be devised and rolled out to non-systemic and non-interconnected investment firms.**

Issues highlighted

Complexity level

As the majority of investment firms are not considered by the supranational or domestic regulators to pose a material risk to financial stability, the link to banking requirements in the capital adequacy of these firms is being reviewed for the first time in 20 years.

The proposal is for the development of a new prudential regime for the majority of investment firms considered to be not undertaking 'bank-like' activities.

The aim of the proposal would be to reduce the complexity of capital adequacy assessments currently under CRDIV, which applies assessments relevant to deposit taking to smaller investment firms where it is not relevant to the business model, thereby generating irrelevant data for regulators.

Reporting requirements

The prospect of reduced and simplified reporting requirements for non-systemic investment firms has been raised, which could potentially over time see the current COREP template reduced and made more applicable to the investment firm business model.

Capital

The report highlights the role that regulators expect capital to play for investment firms, namely:

- Financial Stability
- Investor protection
- Firm wind-down

As the authorities have concluded that the majority of investment firms will not have an impact on financial stability in the event of firm failure, and as the majority act solely on an agency basis whereby legal protection and segregation of client money and assets is already in place, **the principal role of capital is to ensure an orderly wind-down of the firm** and migration of funds under management to an alternative provider.

Consequently, while largely exempt from the Banking Recovery and Resolution Directive, **investment firms can potentially expect to be asked for much more detailed wind-down analyses than were previously required;** more akin to a 'living will' which could be used to migrate assets under management in the event of a firm failure.

In return for potentially lower reporting and capital obligations this seems a rational approach that is likely to be welcomed by the industry.

However, the report is simply the first step in scoping out a new prudential regime and firms can expect to see further publications and potentially requests for industry wide data as the options are assessed in detail.

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