Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014 (Text with EEA relevance)

REGULATION (EU) 2019/2033 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

of 27 November 2019

on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Central Bank[(1)],

Having regard to the opinion of the European Economic and Social Committee[(2)],

Acting in accordance with the ordinary legislative procedure[(3)],

Whereas:

(1) Robust prudential requirements are an integral part of the regulatory conditions under which financial institutions provide services within the Union. Investment firms are, together with credit institutions, subject to Regulation (EU) No 575/2013 of the European Parliament and of the Council[(4)] and to Directive 2013/36/EU of the European Parliament and of the Council[(5)] as regards their prudential treatment and supervision, while their authorisation and other organisational and conduct requirements are set out in Directive 2014/65/EU of the European Parliament and of the Council[(6)].

(2) The existing prudential regimes under Regulation (EU) No 575/2013 and Directive 2013/36/EU are largely based on successive iterations of the international regulatory standards set for large banking groups by the Basel Committee on Banking Supervision and only partially address the specific risks inherent to the diverse activities of a large number of investment firms. The specific vulnerabilities and risks inherent to those investment firms should therefore be specifically addressed by means of appropriate and proportionate prudential arrangements at Union level.

(3) The risks which investment firms themselves incur and pose for their clients and the wider markets in which they operate depend on the nature and volume of their activities,

including whether investment firms act as agents for their clients and are not party to the resulting transactions themselves, or whether they act as principals to the trades.

(4) Sound prudential requirements should ensure that investment firms are managed in an orderly way and in the best interests of their clients. They should take into account the potential for investment firms and their clients to engage in excessive risk#taking and the different degrees of risk assumed and posed by investment firms. Equally, such prudential requirements should aim to avoid imposing an undue administrative burden on investment firms.

(5) Many of the prudential requirements that stem from the framework of Regulation (EU) No 575/2013 and Directive 2013/36/EU are designed to address common risks faced by credit institutions. Accordingly, the existing requirements are largely calibrated to preserve the lending capacity of credit institutions through economic cycles and to protect depositors and taxpayers from possible failure, and are not designed to address all of the different risk profiles of investment firms. Investment firms do not have large portfolios of retail and corporate loans and do not take deposits. The likelihood that their failure can have a detrimental impact on overall financial stability is lower than in the case of credit institutions. The risks faced and posed by most investment firms are thus substantially different to the risks faced and posed by credit institutions and such differences should be clearly reflected in the prudential framework of the Union.

(6) The prudential requirements to which investment firms are subject under Regulation (EU) No 575/2013 and Directive 2013/36/EU are based on those of credit institutions. Investment firms the scope of whose authorisation is limited to specific investment services which are not targeted by the current prudential framework are subject to numerous exemptions from those requirements. Those exemptions recognise that those investment firms do not incur risks of the same nature as credit institutions. Investment firms which carry out activities that are targeted by the current prudential framework and that involve trading in financial instruments on a limited basis are subject to corresponding requirements of the framework in terms of capital but are eligible for exemptions in other areas, such as liquidity, large exposures and leverage. Investment firms the scope of whose authorisation is not subject to those limitations are subject to the same prudential requirements as credit institutions.

(7) The trading of financial instruments, whether for the purposes of risk management, hedging or liquidity management or for taking directional positions on the value of the instruments over time, is an activity in which both credit institutions and investment firms authorised for dealing on own account may engage and which is already addressed by the prudential framework under Regulation (EU) No 575/2013 and Directive 2013/36/EU. In order to avoid an unlevel playing field which could lead to regulatory arbitrage between credit institutions and investment firms in this area, the own funds requirements resulting from those rules that address the risk should therefore also continue to apply to those investment firms. The exposures of those investment firms to their trading counterparties in specific transactions and corresponding own funds requirements are also covered by the rules and should therefore also continue to apply to investment firms in a simplified way. Finally, the rules on large exposures in

the current prudential framework are also relevant when the trading exposures of those investment firms to specific counterparties are particularly large and thereby generate an excessively concentrated source of risk for an investment firm from the default of the counterparty. Those rules should therefore also continue to apply to investment firms in a simplified way.

(8) Differences in the application of the existing prudential framework in different Member States threaten the level playing field for investment firms within the Union. Those differences stem from the overall complexity of the application of the framework to different investment firms based on the services that they provide, where some national authorities adjust or streamline such application in national law or practice. Given that the existing prudential framework does not address all the risks faced and posed by some types of investment firms, large capital add#ons have been applied to certain investment firms in some Member States. Uniform provisions addressing those risks should be established in order to ensure harmonised prudential supervision of investment firms across the Union.

(9) A specific prudential regime is therefore required for investment firms which are not systemic by virtue of their size and interconnectedness with other financial and economic actors. Systemic investment firms should, however, remain subject to the existing prudential framework under Regulation (EU) No 575/2013 and Directive 2013/36/EU. Those investment firms are a subset of investment firms to which the framework laid down in Regulation (EU) No 575/2013 and Directive 2013/36/EU currently applies and which do not benefit from dedicated exemptions from any of their principle requirements. The largest and most interconnected investment firms have business models and risk profiles that are similar to those of significant credit institutions. They provide ‘bank#like’ services and underwrite risks on a significant scale. Furthermore, systemic investment firms are large enough to, and have business models and risk profiles which, represent a threat for the stable and orderly functioning of financial markets on a par with large credit institutions. Therefore it is appropriate that those investment firms remain subject to the rules set out in Regulation (EU) No 575/2013 and Directive 2013/36/EU.

(10) The specific prudential regime for investment firms which, by virtue of their size and interconnectedness with other financial and economic actors, are not considered to be systemic should address the specific business practices of different types of investment firms. Investment firms with the highest possibility of generating risks to clients, markets or the orderly functioning of the investment firms themselves should, in particular, be subject to clear and effective prudential requirements tailored to those specific risks. Those prudential requirements should be calibrated in a manner proportionate to the type of investment firm, the best interests of the clients of that type of investment firm and the promotion of the smooth and orderly functioning of the markets in which that type of investment firm operates. They should mitigate identified areas of risk and help ensure that, if an investment firm fails, it can be wound down in an orderly manner with minimal disruption to the stability of financial markets.

(11) The regime provided for in this Regulation should not affect the obligations of designated market makers at trading venues pursuant to Directive 2014/65/EU to provide quotes and be present in the market on a continuous basis.

(12) The prudential regime for investment firms which, by virtue of their size and interconnectedness with other financial and economic actors, are not considered to be systemic should apply to each investment firm on an individual basis. However, in order to facilitate the application of prudential requirements for investment firms in the Union which are part of banking groups, to avoid disrupting certain business models the risks of which are already covered by the application of prudential rules, investment firms should be allowed to apply the requirements of Regulation (EU) No 575/2013 and Directive 2013/36/EU where appropriate, subject to approval by the competent authorities, provided that their decision to do so is not driven by regulatory arbitrage purposes. Further, since the risks incurred by small and non#interconnected investment firms are limited for the most part, they should be allowed to avail themselves of an exemption from the specific prudential requirements for investment firms where they are part of a banking group or investment firm group headquartered and subject to consolidated supervision under Regulation (EU) No 575/2013 and Directive 2013/36/EU or under this Regulation and Directive (EU) 2019/2034 of the European Parliament and of the Council[7], as applicable, in the same Member State, as those prudential frameworks should adequately cover those risks in such cases. In order to mirror the existing treatment of investment firm groups under Regulation (EU) No 575/2013 and Directive 2013/36/EU, for groups consisting only of investment firms, or where consolidation under Regulation (EU) No 575/2013 does not apply, the parent undertaking in such groups should be required to comply with the requirements of this Regulation based on the consolidated situation of the group. Alternatively, instead of prudential consolidation, where such investment firm groups reflect simpler structures and risk profiles, competent authorities may allow the parent undertaking in the group to have sufficient capital to support the book value of its holdings in the subsidiaries. Where they are part of an insurance group, small and non#interconnected investment firms should also be allowed to avail themselves of an exemption from disclosure requirements.

(13) In order to allow investment firms to continue to rely on their existing own funds to meet their own funds requirements under the prudential framework specific to investment firms, the definition and composition of own funds should be aligned with Regulation (EU) No 575/2013. This includes full deductions of balance#sheet items from own funds in accordance with Regulation (EU) No 575/2013, such as deferred tax assets and holdings of capital instruments of other financial sector entities. However, investment firms should be able to exempt non#significant holdings of capital instruments in financial sector entities from deductions if held for trading purposes in order to support market making in those instruments. In order to align the composition of own funds with Regulation (EU) No 575/2013, the corresponding ratios of the types of own funds have been mirrored in the context of this Regulation. To ensure that the requirements are proportionate to the nature, scope and complexity of the activities of the investment firms and that they are readily accessible to the investment firms within this Regulation,

the Commission should review the appropriateness of continuing to align the definition and composition of own funds with that of Regulation (EU) No 575/2013.

(14) In order to ensure that investment firms always operate on the basis of the level of own funds required for their authorisation, all investment firms should, at all times, meet a permanent minimum capital requirement equal to the initial capital required for authorisation to conduct the relevant investment services set in accordance with Directive (EU) 2019/2034.

(15) In order to ensure a simple application of the minimum own funds requirement for small and non#interconnected investment firms, they should have own funds equal to the higher of their permanent minimum capital requirement or a quarter of their fixed overheads measured on the basis of their activity of the preceding year. Small and non# interconnected investment firms that prefer to exercise further caution and avoid cliff effects in the case of reclassification should not be prevented from holding own funds in excess of, or applying measures stricter than, those required by this Regulation.

(16) To account for the higher risks of investment firms which are not small and non# interconnected, the minimum own funds requirement for such firms should be the higher of their permanent minimum capital requirement, a quarter of their fixed overheads for the preceding year, or the sum of their requirement under the set of risk factors tailored to investment firms ('K#factors') which sets capital in relation to the risks in specific business areas of investment firms.

(17) Investment firms should be considered to be small and non#interconnected for the purposes of the specific prudential requirements for investment firms where they do not conduct investment services which carry a high risk for clients, markets or themselves and where their size means they are less likely to cause widespread negative impacts for clients and markets if risks inherent in their business materialise or if they fail. Accordingly, small and non#interconnected investment firms should be defined as those that do not deal on own account or incur risk from trading financial instruments, hold no client assets or money, have assets under both discretionary portfolio management and non#discretionary (advisory) arrangements of less than EUR 1,2 billion, handle less than EUR 100 million per day of client orders in cash trades or less than EUR 1 billion per day of client orders in derivatives, and have a balance sheet smaller than EUR 100 million including off#balance#sheet items and total gross annual revenues from the performance of their investment services of less than EUR 30 million.

(18) In order to prevent regulatory arbitrage and to reduce the incentives for investment firms to restructure their operations to avoid exceeding the thresholds above which they do not qualify as small and non#interconnected investment firms, the thresholds for assets under management, client orders handled, balance sheet size and total gross annual revenues should be applied on a combined basis for all investment firms that are part of the same group. The other conditions, namely whether an investment firm holds client money, administers or safeguards client assets, or trades financial instruments and incurs market or counterparty risk, are binary and leave no scope for such restructuring, and should therefore be assessed on an individual basis. In order to capture evolving business models and the risks they represent on an ongoing basis, those conditions and