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New Prudential Regime for Investment Firms

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6. Reporting and disclosure

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Overview

The Investment Firm Regulation (**IFR**) and the Investment Firm Directive (**IFD**) introduce a new reporting regime for investment firms. The regime is designed to be more appropriate and proportionate when compared to the existing requirements set out under the Capital Requirements Regulation (**CRR**). Much of the detail on what investment firms will be required to report remains to be prescribed through the technical standards drafted by the European Banking Authority (**EBA**), but the intention is to limit requirements to those data points relevant to the business model of investment firms. However, some of the concepts such as the K-factors and the areas of concentration risk that firms must monitor are new and will require firms to ensure appropriate governance arrangements and develop new systems and processes.

Similarly, the IFR introduces a proportionate public disclosure regime. Class 3 firms are only required to make public disclosures where they have issued Additional Tier 1 (**AT1**) instruments. For most investment firms, however, the regime introduces new disclosure requirements around remuneration and Environmental, Social and Governance (**ESG**), in line with new requirements and expectations for investment firms in these areas. This will drive a requirement for new systems and processes.

Source materials

(a) IFR Article 40(2), Articles 46 – 53

(b) IFR Articles 54 – 55

(c) IFD Articles 27, 34(4), 44

(d) EBA Consultation Paper EBA/cp/2020/06 setting out Draft Technical Standards dated 4 June 2020

(e) Financial Conduct Authority Discussion Paper DP 20/2 dated June 2020

Reporting obligations

Firms are required to report the level and composition of their own funds, their own funds requirements and the basis of the calculation, their activity profile and size, their liquidity requirements and their adherence to the provisions on concentration risk. See also our **IFR bulletin no 2** on capital requirements and our **IFR bulletin no 5** on liquidity and concentration.

Firms may also be required to report certain remuneration information. See also our **IFR bulletin no 4** on remuneration.

Class 3 firms do not have to report on concentration risk and may be granted an exemption from the liquidity reporting requirements.

Disclosure obligations

The starting point is that firms should publicly disclose certain corporate information, their levels of own funds, own funds requirements, governance arrangements, overall risk profile, risk management objectives and policies, investment policies and remuneration policies and practices in order to provide transparency to their investors and the wider market. Class 3 investment firms are not subject to public disclosure requirements, except where they issue AT1 instruments, in order to provide transparency to the investors in those instruments.

From 26 December 2022, firms will also be expected to disclose information on ESG risks, including physical risks and transition risks, as further defined in the report the EBA is to submit by 26 December 2021.

Each investment firm may determine the appropriate medium and location for their disclosures. However, to the extent possible, all of an investment firm's disclosures should be in the same medium and at the same location. If the information is provided in more than one medium, each medium should include a reference to the others. Competent authorities also have the power to require investment firms other than Class 3 firms which do not issue AT1 instruments, to use specific media and locations for disclosures, in particular the firm's website.

Frequency

The reporting obligations generally arise quarterly, except for Class 3 firms, which are required to report annually. Certain information, such as transfers of exposures exceeding the concentration risk limit or where a firm no longer meets all of the conditions for classification as a Class 3 firm, must be reported immediately or without undue delay. The disclosure obligations are annual and generally tied to the publication of the firm's annual financial statements. The ESG disclosure requirements will apply once in the first year and every six months thereafter.

The IFD also gives competent authorities the power to impose additional or more frequent reporting requirements and disclosures.

Exemptions?

The IFR gives competent authorities the ability to exempt a Class 3 firm from the reporting and/or disclosure requirements where such investment firm is a subsidiary and included in the supervision on a consolidated basis of certain entities, provided certain conditions are met. Commodity and emission allowance dealers also benefit from transitional provisions relating to the application of certain of the disclosure requirements.

Investment firms that benefit from a derogation from the remuneration requirements may also be exempt from the requirement to disclose their investment policies and ESG risks.

What if an investment firm fails to report or publicly disclose?

The IFD provides investigatory powers and powers of competent authorities to impose remedies, and the right of Member States to provide for and impose criminal sanctions. Member States are to lay down rules on administrative sanctions and other administrative measures and ensure that their competent authorities have the power to impose such sanctions and measures in respect of breaches of national provisions transposing the IFR and IFD, including in respect of reporting and disclosure failures.

The roadmap to implementation in the EU

In June 2020, the EBA published its roadmap on investment firms which seeks to provide clarity on the EBA's implementation choices in respect of the mandates it is given in developing the new regime. The EBA states that it will integrate Pillar 3 disclosure requirements with supervisory reporting by standardising the formats and definitions, which should facilitate compliance with both requirements. The EBA published a consultation paper on draft ITS on reporting requirements and on disclosure of own funds in June 2020 which it intends to finalise in December. It also anticipates publishing a consultation paper on draft RTS on disclosure of investment policy in November 2020 with a view to a final draft RTS in June 2021. Investment firms will be expected to submit the first supervisory reporting data with a reference date as of September 2021.

The impact of Brexit

In June 2020, the FCA published "A new UK prudential regime for MiFID investment firms" Discussion Paper which sets out the details of the IFD/IFR, and seeks feedback from stakeholders on the appropriate rules for the UK to apply in this area. In the context of reporting and disclosure, the FCA supports the IFR/IFD's more proportionate approach and would look to introduce a similar concept in its regime. It does not expect the reporting forms will be as complex or detailed as the current common reporting (COREP) forms in the CRR. However, given the new concepts such as K-factors and the areas of concentration risk that firms must monitor, new reporting forms will need to be developed.

The FCA note that a prudential consolidation group might expect to report, as a minimum, its consolidated own funds, consolidated own funds requirements, consolidated concentration risk and consolidated liquidity requirements (and potentially to a similar level of detail as at individual investment firm level). The FCA also currently requires investment firms in the UK to report consolidated financial statements (balance sheet and profit and loss) which are not covered by the current CRR (except where FINREP applies) or by the IFR. The FCA state that they do not expect this to change.

The EBA's technical standards in this area have not been finalised. While the UK has left the EU and would no longer be bound by such future standards and guidance, the FCA considers that it might be appropriate to take them into account when designing the UK regime.

And beyond?

By 26 June 2024, the Commission, in close cooperation with EBA and ESMA, must submit a report, together with a legislative proposal if appropriate, to the European Parliament and to the Council, on the appropriateness of the reporting and disclosure requirements in the IFR and IFD. The report is to take into account the principle of proportionality and the relevance of the application of the disclosure requirements relating to investment policies for other sectors, including those systemic investment firms that remain subject to the capital requirements contained in the CRR and banks.

Expected impact

Whilst the new reporting and disclosure requirements are designed to be more proportionate and relate to more appropriate data points, the new aspects of the regime such as the K-factors, concentration risk and developing ESG requirements will require operational development. Firms must ensure that they have the systems and processes built and in place to capture all relevant data points. Firms should monitor and track the EBA's technical standards, which will provide the necessary outstanding detail in respect of reporting formats, reporting dates and definitions and associated instructions to ensure that their systems will meet the final standards.

The systems must identify trends which may result in an increase in capital requirements for the firm. They must also monitor the numerous thresholds which apply within the new prudential regime. They must be capable of triggering appropriate escalations and disclosures immediately or without undue delay where required (for example where a threshold relevant to the firm's classification is breached).

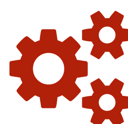
Firms must ensure that they have established clear lines of reporting internally and that the responsibility for reporting has been clearly designated. Firms which have on average on and off balance sheet assets greater than EUR100mn over the four-year period immediately preceding a financial year are required to set up a risk committee. In contrast to the Capital Requirements Directive, national competent authorities cannot waive this requirement but Member States can increase or decrease the threshold.

Risk and remuneration policies should be reviewed and, in some instances, new policies created. New risk management objectives must be set and strategies and processes developed. The firm's management body will also have to approve concise risk statements.

A firm's auditors must also be engaged in relation to certain of the required disclosures.

To summarise, firms should:

Identify and understand the application of the new reporting and disclosure requirements to your firm and group.



Review and where necessary build systems and processes.

Review and ensure appropriate governance structures are in place.

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