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# IFR/D: The new prudential regime for investment firms

## What you need to know

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## What is it?

The Investment Firm Regulation (**IFR**) and Investment Firm Directive (**IFD**)[1] establish a new prudential regime for investment firms. They are both due to apply from 26 June 2021.

The FCA recently published a discussion paper to assist with their implementation in the UK.[2] Firms need to start their preparations for IFR/D now to be ready for next year.

## Does it affect me?

IFR/D will affect a wide range of investment firms authorised under MiFID II, including asset managers and investment banks. Groups containing such institutions will also need to consider their implications.

## Main areas of impact

IFR/D establish a prudential regime designed specifically for investment firms. By contrast, many of the existing rules, eg those contained in CRD IV, were developed largely with deposit-taking institutions in mind.

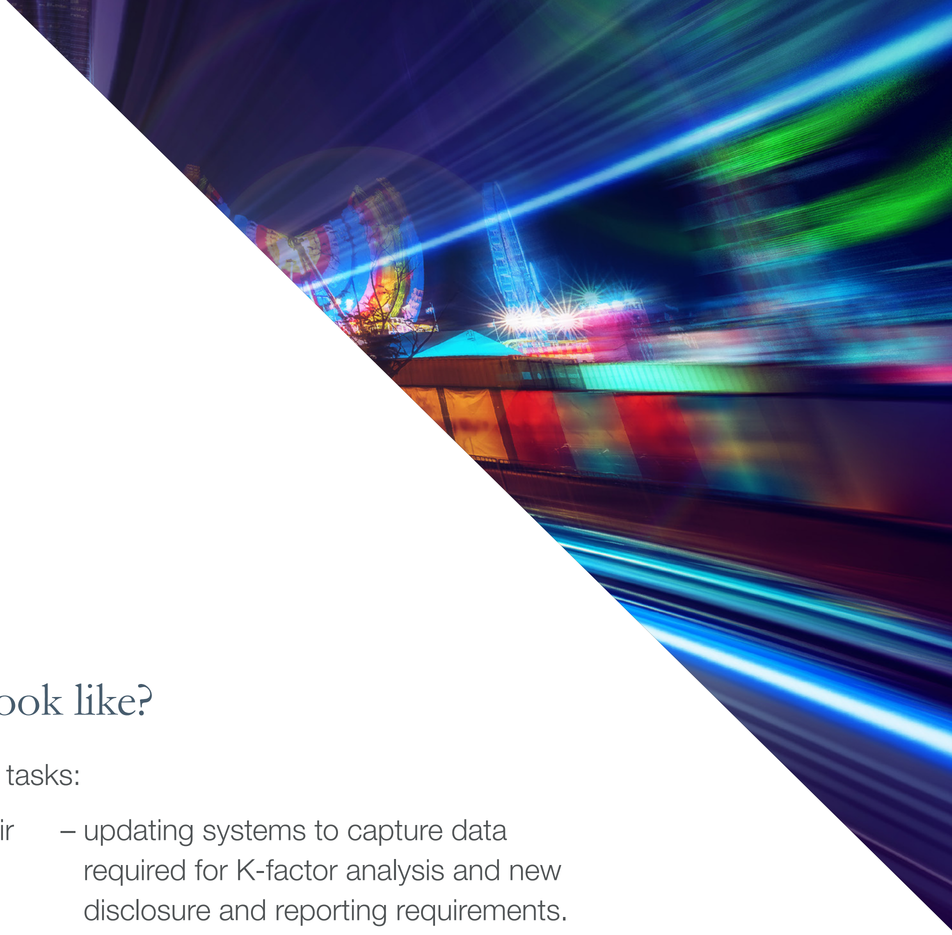
Under the new regime, investment firms fall into one of three categories:

| **Class 1:** | **Class 2:** | **Class 3:** |
|---|---|---|
| Systemic investment firms | Investment firms which exceed certain size and risk thresholds, but are not systemically important | The smallest and non-interconnected firms, that are subject to reduced requirements |

The impact on firms is wide-ranging and includes:

- new capital requirements, to be calculated using the “K-factor” methodology designed to reflect the risks presented by firms;
- new rules on prudential consolidation, liquidity and concentration risk;
- a new approach to the Internal Capital Adequacy Assessment Process (ICAAP);
- new requirements on remuneration policies; and
- extensive reporting and disclosure requirements.

[1] Regulation (EU) 2019/2033 and Directive (EU) 2019/2034.
[2] FCA, “A new UK prudential regime for MiFID investment firms” (DP20/2, available **here**).



## What does implementation look like?

Firms will need to undertake the following tasks:

- a K-factor assessment to determine their classification and capital requirements;
- changes to prudential consolidation arrangements (including, where relevant, group structure optimisation);
- consideration of transitional relief;
- revising internal governance processes;
- reviewing remuneration policies and updating them; and
- updating systems to capture data required for K-factor analysis and new disclosure and reporting requirements.

Implementation will therefore require firms to field a multi-disciplinary team covering corporate treasury, technology, employment and incentives, risk, compliance, finance, company secretarial and legal functions.

## Will IFR/D apply in the UK given Brexit?

Yes, as the UK government has publicly committed to adopting their substance.[3] We are already assisting firms making preparations on this basis. As implementation will take place after the expiry of the Brexit transition period, it will be provided for in a forthcoming Financial Services Bill and regulators' rules.

However, the UK has expressed an intention to diverge in certain limited areas. For example, it will not require systemic investment firms to be re-authorised as credit institutions. This is because in the UK, the PRA designation framework achieves a similar outcome by ensuring the largest investment firms are supervised alongside banks.

[3] HM Treasury, "Prudential standards in the Financial Services Bill: June update" (available **here**).

## What are the next steps?

The FCA has invited firms to submit comments on its discussion paper by 25 September 2020. Responses will then feed into a consultation to be published later this year. These are opportunities for firms and stakeholders to raise any concerns.

The EBA has also recently published a consultation paper containing several draft supplementary legislation[4] and provided a roadmap outlining when the other level 2 and level 3 measures mandated in IFR/D will be available (these include no less than 18 RTS and 3 ITS as well as various guidelines and reports).

Now that we have greater clarity on how IFR/D will affect firms, preparations need to begin for June 2021.

## How we can assist you?

We are already supporting several clients with their implementation projects. In our experience, these typically include:

- confirming a firm's classification under the regime;
- verifying a firm's K-factor assessment;
- evaluating the scope of group consolidation;
- performing a gap analysis in areas of significant change, eg governance and remuneration;
- advocacy to appropriate regulators, eg on consolidation perimeter; and
- resolving points of interpretation where the IFR/D text is unclear.

We also have project management capability to support clients. This has been successfully used on recent Brexit and IBOR transition mandates. Moreover, A&O Consulting is able to provide expert advice on matters such as the corporate governance aspects of IFR/D implementation.

If you would like to discuss the impact of IFR/D on your business, please get in touch with your normal Allen & Overy contact.

[4] EBA, Consultation Paper (EBA/CP/2020/06, available **here**).



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