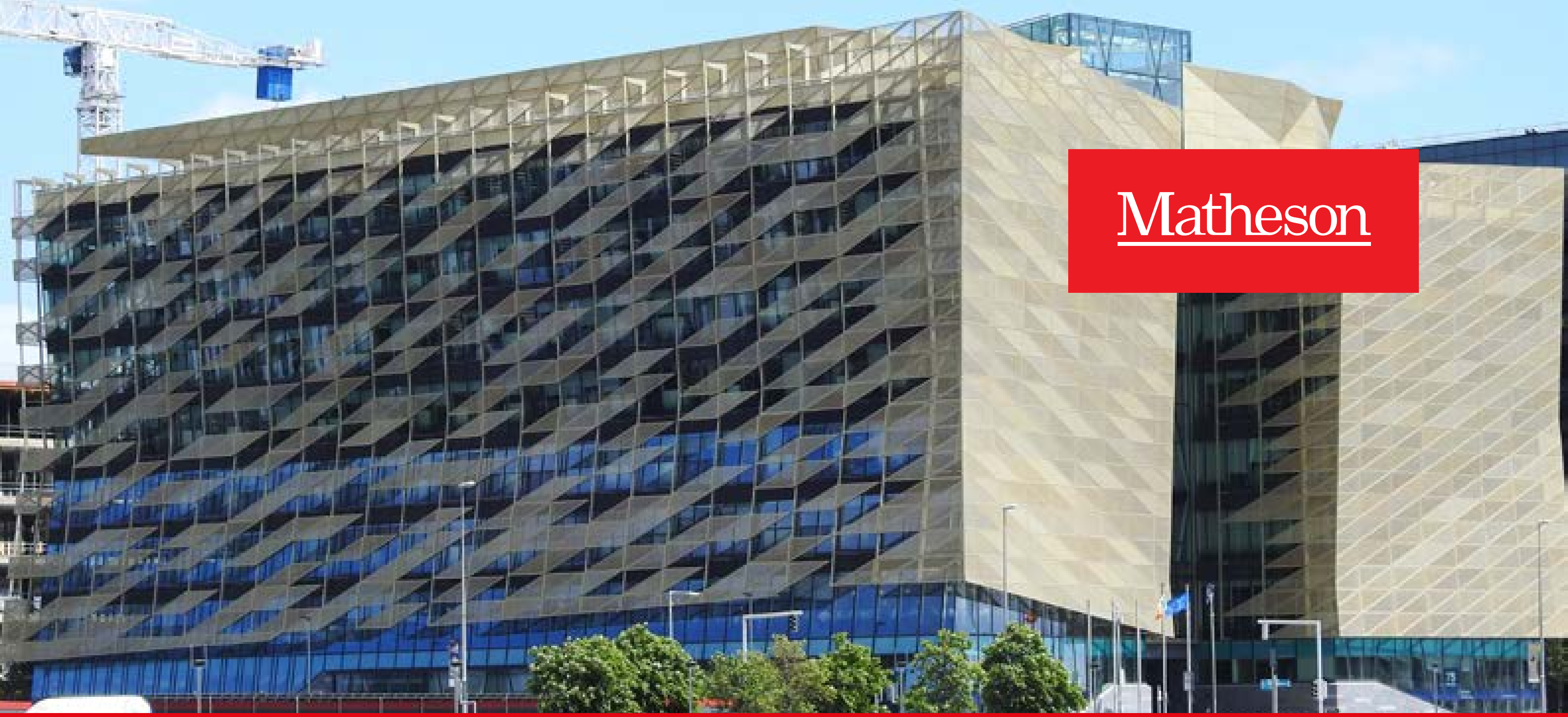


Case by Case Basis – The Central Bank of Ireland's primary approach to Competent Authority Discretions under the new Investment Firm's legislative framework

Introduction:

On 14 January 2021, the Central Bank of Ireland ("**Central Bank**") issued the much anticipated Consultation Paper, CP135 Consultation on Competent Authority Discretions in the Investment Firms Directive and the Investment Firms Regulation ("**Consultation**"), signalling its "*proposed approach and perspectives in relation to provisions contained*" within the Investment Firms Directive ("**IFD**") and Investment Firms Regulation ("**IFR**") "*where the competent authority can or must exercise its discretion.*" These discretions are described as Competent Authority Discretions ("**CADs**"). The Central Bank explicitly states that the manner in which these CADs are "*exercised impacts the supervisory approach to be applied by the Central Bank and will have a fundamental impact on firms' preparation for the new regime. Therefore the Central Bank recognises the importance of setting out how it intends to exercise the discretions on a timely basis.*"

Central Bank Approach the CADs

In considering its position on the CADs, the Central Bank advises that it has been guided by the following general principles:

1. to adopt a prudent approach to the steady-state provisions;
2. to choose the more risk sensitive option, where one is identified; and
3. to be consistent and transparent in the intended approach, and the reasoning behind it.

What is addressed in the Consultation?

The Consultation addresses the CADs which relate to

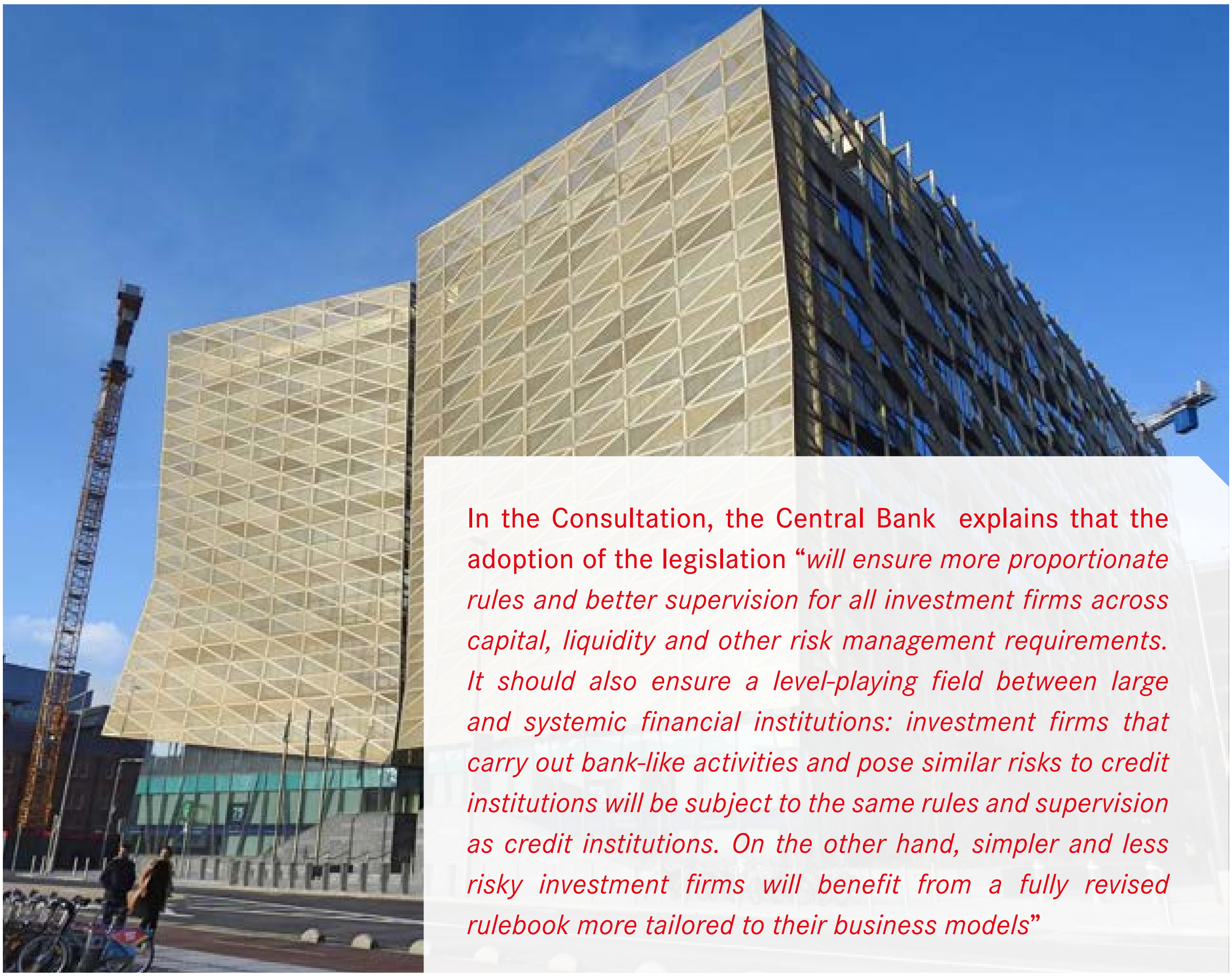
1. the prudential regime that will apply to larger investment firms[1];
2. the application of the new liquidity risk requirements;
3. the application of the requirements relating to the assessment of internal capital of smaller investment firms; and
4. the practical implementation of the new prudential regime for investment firms

1 Class 1 and Class 1 Minus Firms

The application of remuneration-related CADs is not dealt with as this is being considered separately by the Department of Finance. Additionally, in respect of the CADs set out in the IFD/IFR which are replicas of or are materially the same as those in the fourth **Capital Requirements Directive** ("**CRD IV**") and the Capital Requirements Regulation ("**CRR**"), the Central Bank advises that it proposes a "*consistent or equivalent treatment to that already in place*"[2].

Below is a brief outline of the Central Bank's proposal regarding the key CADs.

The overarching observation is that the Central Bank intends to apply these CADs on a case by case basis. While understandable on one level, it does introduce uncertainty for potentially affected firms. With this approach, a firm can't know whether a particular provision will apply or be waived as the case may be, until it has engaged with the Central Bank on the subject. That engagement itself is likely to be a time consuming process both in terms of preparation of a submission and the length of time it takes the Central Bank to make a decision. Supervisors in the Central Bank will need to be sufficiently briefed and trained on these new developments in order that they can give a meaningful steer to firms who are considering looking for one or more waivers.



In the Consultation, the Central Bank explains that the adoption of the legislation "*will ensure more proportionate rules and better supervision for all investment firms across capital, liquidity and other risk management requirements. It should also ensure a level-playing field between large and systemic financial institutions: investment firms that carry out bank-like activities and pose similar risks to credit institutions will be subject to the same rules and supervision as credit institutions. On the other hand, simpler and less risky investment firms will benefit from a fully revised rulebook more tailored to their business models*"

2 These CADs are not discussed in the body of the Consultation but are included in the list of CADs in Appendices 1 and 2.

CAD	Subcategory of CAD	Relevant Provisions	Central Bank's proposed position
Application of the CRD regime to Investment Firms	Investment Firms with consolidated assets between EUR 5 billion and EUR 15 billion	Article 5 (1)(a) and (b) of the IFD	The Central Bank proposes to exercise this CAD to apply the CRR to other investment firms on a **case-by-case basis** should it consider this justified in light of the size, nature, scale and complexity of the activities of the investment firm concerned.
	Investment firms included in consolidated supervision under CRDIV	Article 1(5) of the IFR	The Central Bank is proposing to exercise this CAD on a **case-by-case basis** where the appropriate notification is received by the Central Bank and the Central Bank is satisfied, based on its assessment of the information received from the firm, that the application of CRDIV/CRR to the investment firm on an individual basis will not result in a reduction in the individual Own Funds requirement for the investment firm, that the risks associated with the particular business model of the firm are adequately addressed by the CRD/CRR regime and that the application of the CRD/CRR regime is not undertaken for the purpose of regulatory arbitrage.
Liquidity Requirements	Exemption trom Individual Liquidity Requirements when subject to Consolidated Supervision	Article 6(3) of the IFR	The Central Bank proposes that this CAD is exercised on a **case-by-case basis** where it is satisfied, based on its assessment of information received from the firm, that all conditions outlined under IFR Article 6(3) are met.
	Exemption from Liquidity Requirements for Class 3 firms	Article 43(1) of the IFR	Under IFR Article 43(1) National Competent Authorities may exempt Class 3 firms from the requirement to hold at least one third of their fixed overhead requirement in liquid assets. the Central Bank is proposing not to exercise this CAD on a general basis. The European Banking Authority ("**EBA**") in consultation with European Securities and Markets Authority ("**ESMA**") will issue guidelines specifying the criteria which competent authorities are to take into account when exempting Class 3 investment firms from the liquidity requirement. These guidelines will be taken into account where the Central Bank exercises this CAD on a case-by-case basis in exceptional circumstances.
	Exemption from Consolidated Liquidity Requirements	Article 7(4) of the IFR	The Central Bank proposes to exercise this CAD on a **case-by-case basis** taking into account the nature, scale and complexity of the investment firm group provided that all investment firms within the group apply the liquidity requirements on an individual basis

CAD	Subcategory of CAD	Relevant Provisions	Central Bank's proposed position
Assessment of Internal Capital and Liquid Assets	Requirement for Class 3 firm to perform an assessment of internal capital and liquid assets	Article 24(2) of the IFD	The Central Bank is proposing to **exercise this CAD** and require all Class 3 investment firms to perform an assessment of internal capital and liquid assets to ensure they have adequate capital to cover the nature and level of risks they may post to others or to which they may be exposed.
K-Factor Adjustment		Articles 15, 17, 18, 19, 20 and 33 of the IFD	These CADs are technical in nature and allow for the smooth implementation of the IFD/IFR regime. The Central Bank proposes to exercise these CADs on a **case-by-case basis** where there is a material change to the business model of a Class 2 firm that results in missing data for a particular period. Replacement of missing data points will be based on business projections of the investment firm submitted to support the material change in business activities.

Amendments to the Central Bank Investment Firms Regulations

In addition to the foregoing, the Consultation also highlights that the IFD/IFR will have an impact on Regulation 8 of the Central Bank Investment Firms Regulations which sets out general reporting requirements for investment firms. In response to this, the Central Bank has detailed a proposed amendment to Regulation 8 and the associated Annex, to align reporting requirements with the classification of investment firms under the IFD/IFR.[3]

Next Steps for Investment Firms:

Firms may make submissions to the Central Bank on the Consultation up until 26 March 2021.

The IFD and the IFR are applicable from 26 June 2021[4]. In the Consultation, the Central Bank makes it clear that it expects investment firms to have begun considering the impact the IFD/IFR will have on them and to have commenced preparations to ensure that they can comply with the regime from 26 June 2021[5].

The Central Bank also stipulated that it expects investment firms to adhere to EBA and ESMA outputs where these are applicable to them. With this in mind, investment firms should carefully consider regulations and guidance from the EBA and ESMA already issued, and to monitor any additional regulations and guidance as they emerge. However, there is a certain level of frustration amongst firms due to the delay in publication of some technical standards until March (eg. prudential consolidation RTS), and others not being published until after the implementation of IFD/IFR. This delay is not ideal given the looming deadline of IFD/IFR implementation. It will be interesting to see whether there will be any element of regulatory forbearance in light of these delays.

3 See Appendix 3 of the Consultation

4 As a regulation, the IFR will become directly effective, while the IFD must be transposed into Irish law by 26 June 2021.

5 Exclusions to this date apply to Class 1 Firms, Class1 minus Firms and investment firms that are included in consolidated supervision under CRD that have requested and received permission to continue to apply the CRD regime.

In respect of the CADs, the Central Bank details that where a firm believes that a CAD is relevant to them, the onus is on the firm to apply to the Central Bank for same and flags that this also means reapplying for the continued application the CAD, where the conditions relevant to the exercise of them have changed. It explains that each CAD must be applied for separately, but that this can be done by way of itemising each CAD sought on the same application to the Central Bank.

Next Steps for the Central Bank

As explained above, the Consultation closes to responses on 26 March 2021. Once the Central Bank has finalised its review of the responses, it confirms that it intends to publish an 'Implementation of NCA Discretions in IFD/IFR' Regulatory Notice[6] by the end June 2021[7], which will set out the final position of the Central Bank in respect of the CADs.

Conclusion

The Central Bank's Consultation has been widely anticipated by the industry and it certainly helps to clarify how the Central Bank intends to address the CADs. However, as identified above, the proposed case by case approach to the CADs, will bring challenges for both firms and the Central Bank alike. How these will play out, is yet to be seen.

More generally, with regards to the overall impact of the IFD/IFR, there remain a number of uncertainties for investment firms and management companies with MiFID top up. Further guidance from the Central Bank relating to the application of the IFD/IFR to management companies with MiFID top up would be very welcome, as well as clarification on some apparent inconsistencies between the IFD and requirements under the Corporate Governance Code for Investment Firms.

Should you require any assistance with the Consultation or your analysis of what it means for your business, please do not hesitate to contact us at the details below or your usual Matheson contact.

6 It should be noted that the implementation of the CADs will be subject to binding technical standards developed by the EBA and ESMA.

7 Certain parts of CRDIV/CRR are being amended by Directive (EU) 2019/878 (CRDV) and Regulation (EU) 2019/876 (CRR II) These changes will be subject to a separate consultation process during 2021. This consultation process will be relevant to those firms that will/may be considered Class 1 and Class 1 minus.

Contacts

Joe Beashel
Partner
T +353 1 232 2101
E joe.beashel@matheson.com

Louise Dobbyn
Partner
T +353 1 232 2094
E louise.dobbyn@matheson.com

Claire Scannell
Professional Support Lawyer
T +353 1 232 2287
E claire.scannell@matheson.com