IFR/IFD Webinar

KPMG & Central Bank of Ireland

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Welcome !

With you today…

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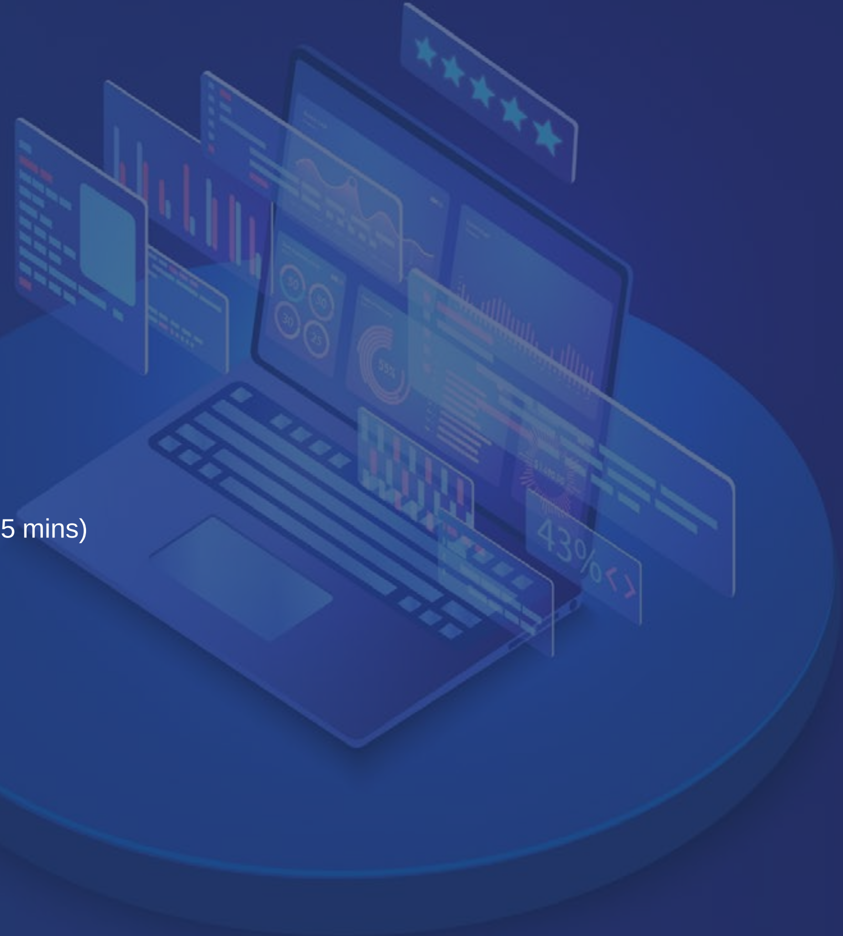
Agenda

- **Welcome** — Ian Nelson (5 mins)
- **IFR / IFD** — Gerry Cross (25 mins)
- **Q&A/Key IFR/IFD issues** — Ian Nelson & Gerry Cross (15 mins)
- **Key Next Steps** — Ian Nelson (10 mins)



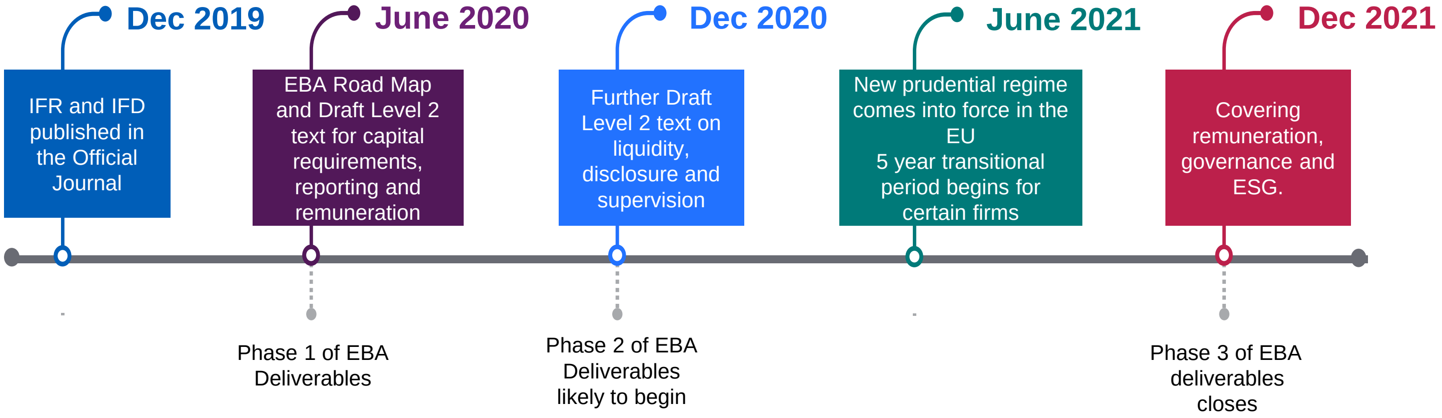
1 What is IFR/IFD?

A new prudential framework for investment firms is being introduced by the Investment Firms Directive and Regulation (IFD & IFR). The IFD and IFR were adopted as legislative proposals on 5 December 2019 and entered into force on 25 December 2019. They are scheduled to be transposed into law by 26 June 2021.

The new framework will allow for differentiated regulation of Investment Firms depending on their classification, with higher impact Investment Firms being subjected to more intensive regulation. The degree of regulation will depend on the firm's particular business activity, risk profile and structure which in turn dictates their new prudential class.

The objective of the IFD and IFR is to provide for capital, liquidity and other prudential requirements for investment firms in the Union that reflect the business models of those firms and proportionately capture the risks posed and faced by these firms.

Timeline



Key next steps

Impact of new requirements - ICAAP

The new requirements will have an immediate impact on firms' ongoing capital requirements and forward planning - most notably through the ICAAP.

- IFD/IFR will preserve the ICAAP and SREP processes, with which most investment firms will be familiar
  - The **Internal Capital Adequacy Assessment Process** (ICAAP) is the firm's own process for ensuring it has adequate levels of internal capital; and
  - The **Supervisory Review and Evaluation Process** (SREP) is a supervisory review of whether the firm complies with the IFD/IFR and whether all risks to the firm are adequately captured.

- Under IFD/IFR, firms **must accurately project and monitor the value of their K-factors** for any trends which could leave to a materially different capital requirement for the next reporting period and notify their regulator of that capital requirement.

- Supervisors may also:
  - **review firms' permission to use internal models** on a regular basis, and in any event at least every three years.
  - **require firms to hold more capital**, or adjust the capital and liquid assets a firm is required to hold if there are material changes to a firm's business.
  - give **"capital guidance"** to ensure that cyclical economic fluctuations do not lead to a breach of the IFR or threaten the ability of the firm to wind down and cease activities in an orderly manner.

- It is probable that many firms will have a **significant increase in their minimum capital requirements** as a result of IFD/FR – determined, in most cases, by the K-factor methodology.

Summary of K-Factors

The new K-Factors cover three primary risks for investment firms – Client, Market and Firm. The methodology will likely have significant capital uplifts for firms that hold client money.

Category	K-Factor	Description
Risk to Custome r (RtC)	K-AUM	Assets under management (discretionary and ongoing non-discretionary advisory).
	K-CMH	Client money held (on a segregated or non-segregated basis.
	K-ASA	Assets under safeguard and administration.
	K-COH	Client orders handled (cash trades and derivatives).
Risk to Market (RtM)	K-NPR	Net position risk on own account trading book positions.
	K-CMG	Total margins required by firm's clearing member (if permitted by component authority).
Risk to Firm (RtF)	K-TCD	Trading counterparty default (own account trading book exposures).
	K-DTF	Daily trading flow for cash trades or derivatives
	K-CON	Concentration risk on own account trading book transactions.

Minimum capital requirements are calculated using the following formula:

Risk to Client (RtC)		Risk to Market (RtM)		Risk to Firm (RtF)
K-AUM + K-CMH + K-ASA + K-COH	+	Higher of: K-NPR K-CMG	+	K-TCD + K-DTF + K-CON

K-Factors: What should you prioritise?

There are three key activities which Class 2 firms must initiate immediately to ensure compliance with IFR/IFD.

1. Undertake initial capital assessment

Perform K-factor calculations to determine the likely increase (if any) on minimum capital requirements – factoring in transitions.

2. Build K-factors into business model analysis

Through development of the business model strategy, incorporate likely variations in capital requirements due to K-factor changes.

3. Incorporate K-factors into ICAAP framework

Estimate potential volatility in current and future capital requirements under base and stress conditions.

How KPMG Can Help?

KPMG are actively supporting clients in their preparation for IFR/IFD to ensure capital levels are appropriate – both now and into the future.

01

Modelling of capital estimates

Undertake calculations and analysis to determine K-factor estimates – ensuring they are accurate and that corresponding regulatory submissions are in line with supervisory expectations.

02

Sensitivity analysis on business model variations

Perform sensitivity analysis on the K-factor calculations to identify critical vulnerabilities within the business model and identify areas for capital efficiency in line with the strategy.

03

ICAAP / Capital Planning

Consider forward looking implications of a firms capital projections under base and adverse conditions and ensure volatility in capital requirements is minimised.

Contact us.....

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Thank You

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