

The task is to get a rough understanding of the objectives of the Investment Firm Regulation and implement a calculator in Python. There are two aspects, one regulatory and one technical.

## 2.1 Reg

In 200 words or less, explain what you think the EBA is trying to achieve with this regulation, pros/cons of this approach and what (if any) is the alternative?

The European Banking Authority is imposing regulations in the form of prudential requirements for investment firms regarding funding requirements, requirements to limit concentration risk, liquidity requirements relating to liquidity risk, and public disclosure requirements. The EBA also imposes regulations on reporting requirements for the aforementioned factors. These prudential requirements seek to mitigate the risks that can cause insolvency or other systemic issues. There are a number of pros that this regulation establishes, such as providing rules for supervision regarding capital, risk, and liquidity management while also providing the relevant exemptions and modifications for smaller investment firms. This makes the regulation helpful and equal to all investment firms regardless of if they are a third-country firm, a large investment firm, or a systemic financial institution. Of course, there will still be firms who are adversely affected by this prudential regulation, and this is certainly a disadvantage for them. For those firms, I am not sure what the alternative could be that would improve the situation for them, I would love to observe the case for this type of firm and brainstorm potential alternatives or improvements for this regulation.

Explain, in simple terms, what are the K-Factors?

K factors in this regulation are used to determine capital requirements and in general, they can reveal the level of risk investment firms impose on customers, the market, and the firm itself. Therefore, there are 3 types of K-factors: Risk-to-Client, Risk-to-Market, and Risk-to-Firm. In Title I, Article 11 (1): investment firms always need to have own funds at least equal to the highest amount from 1) their fixed overheads requirement in Article 13, 2) their minimum capital requirement in Article 14, or 3) their K-factor requirement in Article 15.

The K-factor requirement in Article 15 must be at least the sum of the Risk-to-Client, Risk-to-Market, and Risk-to-Firm K-factors.

Which leg in a SFT create credit risk? The asset or the liability leg?

Securities financing transactions let investors use assets to secure funding for their activities. An example of an SFT is an investor lending a security for a fee in return for a guarantee in the form of financial instruments or cash given by the borrower. Therefore, there are counter party credit risks associated with SFT's where the counterparty could default before the final settlement of the transaction's cash flows, making the liability leg of the counterparty risk bearing.