Suade RegTech Eng Exercise

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Summary. 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.

1. The Task (Reg).

1.1. 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 EBA is trying to control diverse measures of risk for investment firms, such as risk-to-firm, risk-to-client, risk-to-market, concentration risk and liquidity risk. Their goal is to introduce prudential requirements for investments firms to control the risk that an investment firm poses to clients, markets and itself. This regulation is trying to achieve a clear, proportionate and risk-sensitive framework for the business model of investment firms for the EU member states. Before this regulation, investment firms were subject to a more general prudential regime. With this regulation, the EBA is trying to tailor a specific regulation for the sector of investment firms.

1.2. Pros/cons of this approach

Pros: Clear simple rules publicly available that eliminate uncertainty and should boost confidence. The new capital requirements should mitigate risk.
Cons: With the new requirements, there will be costs to investment firms. Costs of adaptation and costs to reconsider their business model. Investment firms will also have to calculate their own funds requirement.

1.3. what (if any) is the alternative?

Going back to the more general regime of regulation of credit institutions, at the cost of not having tailored capital requirements and treatment for investment firms.

Another alternative would be to treat investment firms exactly as credit institutions, but then the activity of investment firms would fall into a regulatory framework that would not suit their activity.

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

The K-factors are the capital requirements for investment firms according to the risk they pose to clients, markets and itself. The K-factors are the capital requirements that are specific for each of the business areas of investment firms.

1.5. Which leg in a Securities financing transaction (SFT) creates credit risk? The asset or the liability leg?

The liability leg. This is because the lender faces the risk of default by the borrower.