**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 regulation aims to add additional risk measures in place for investment firms. A high level summary of is that regulators are essentially aiming for investment firms, particularly larger ones, to have enough capital and liquidity to keep them solvent in a crisis situation. The regulation focuses on capital, liquidity and more comprehensive reporting requirements and segments various regulations depending on the size and complexity of investment firms.

Pros for this approach:

* Segmentation in regulation with respect to larger investment firms which hold greater risks and exposure – less work for smaller investment firms with lower risks.
* Investors may feel more at ease with investing in these firms.

Cons for this approach:

* Additional regulation and reporting for larger investment firms which could lead to inefficiencies.
* Could lead to greater capital requirements for investment firms – which could lead to inefficiencies and anger from investors.

The alternative regulation is the Capital Requirement Regulation which had less segmentation with regards to the size of the investment firm and less stringent capital and liqudity requirements (no K factors).

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

K-factors are a quantitative risk assessment framework which guide the capital requirements of investment firms. Investment firms have capital requirements which are defined by the highest of either their fixed overheads, permanent minimum capital requirement or their K-factor requirement according to the new regulation.

The K-Factors are split into 3 different categories of risk – the Risk-to-Client (RtC), Risk-to-Market (RtM) and Risk-to-Firm (RtF).

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

Credit risk is defined as the possibility of a loss due to a borrower’s failure to meet its obligations. There is therefore credit risk on the asset leg as the provider of the funding is at risk of not receiving back their money due to the risk of the counterparty defaulting and not being able to return the funding by buying back the security. The collateral (asset from the borrower) does not change the probability of default and could be worth less than the funding due to fluctuations in its pricing and hence is not a substitute for credit risk.