OFFICIAL INFORMATION
OF THE CZECH NATIONAL BANK
of 19 December 2023

on risk management requirements
for a small and non-interconnected investment firm

I. Purpose and scope of this official information

1. The purpose of this official information is to inform small and non-interconnected investment firms about legislation relating to compliance with risk management requirements pursuant to Article 12ad(1)(a), (c) and (d) in conjunction with Article 12aa(1) second sentence of Act No. 256/2004 Coll., the Capital Market Undertakings Act, as amended (hereinafter the "CMUA") by a small and non-interconnected investment firm, and about examples of good practice to ensure proper compliance with these requirements.

2. A small and non-interconnected investment firm means an investment firm pursuant to Article 2(3)(u) of the CMUA, i.e. an investment firm meeting the conditions pursuant to Article 12(1) of Regulation (EU) 2019/2033,[1] as amended (hereinafter the "IFR").

3. Risk management of a small and non-interconnected investment firm means the establishment and implementation of reliable and effective strategies, principles, procedures and systems to identify, measure, manage, monitor and regularly review significant sources of liquidity risk, risks that a small and non-interconnected investment firm may pose to customers, or to which it itself is or may be exposed, and to provide information about risks at all relevant levels of the small and non-interconnected investment firm.

4. At the same time, the Czech National Bank provides examples of good practice regarding the setting up of the risk management system for a small and non-interconnected investment firm to exclude, even temporarily, non-compliance with the minimum capital requirements under Article 11 of the IFR and the liquidity requirement under Article 43 of the IFR. The application of the above examples of good practice can make it easier for a small and non-interconnected investment firm to meet the requirements for an investment firm's governance system set out in the CMUA and directly effective regulations.

II. Summary of legislation

5. Article 12 of the CMUA sets out the requirements for governing and supervisory system of an investment firm, thus including a small and non-interconnected investment firm, while this system is intended to ensure effective and prudent management of the investment firm.

6. Under Article 12(2)(a) of the CMUA, a governance and supervisory system also includes a risk management strategy approved by the management body of a small and non-interconnected investment firm, the implementation of which is supervised by the supervisory body of the small and non-interconnected investment firm.

7. The goal of the risk management strategy of a small and non-interconnected investment firm is to ensure consistency between the policy of such small and non-interconnected investment firm in the area of the investment services, activities, products and operations offered or provided, and its risk appetite.

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[1] Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014.

8. Article 23 of Regulation (EU) 2017/565,[2] as amended (hereinafter "Regulation 2017/565") sets out additional requirements for risk management measures for a small and non-interconnected investment firm.

9. Under Article 12ad(1)(a), (c) and (d) of the CMUA in conjunction with Article 12aa(1) of the CMUA, a small and non-interconnected investment firm must have reliable strategies, principles, procedures and systems to identify, measure, manage and monitor significant sources of risk for the client and for the investment firm, as well as significant sources of liquidity risk, in particular those that may have any significant impact on capital or that may exhaust the available capital or liquid resources.

10. Under Article 11 of the IFR, a small and non-interconnected investment firm shall at all times have own funds in accordance with the capital composition requirements under Article 9 of the IFR, which amount to the higher of the amounts of the fixed overheads requirement or the permanent minimum capital requirement.

11. Under Article 13 of the IFR, the fixed overheads requirement shall amount to at least one quarter of the fixed overheads of the small and non-interconnected investment firm of the preceding year, which will ensure its operational functioning for at least three months.

12. Under Article 43 of the IFR, a small and non-interconnected investment firm shall hold an amount of liquid assets equivalent to at least one third of the fixed overhead requirement calculated in accordance with Article 13 of the IFR.

13. A small and non-interconnected investment firm shall have its decision-making procedures and organisational structure clearly documented (Article 21(1)(a) of Regulation 2017/565). This clear documentation (hereinafter the "internal regulation") also covers the risk management strategy and regulates how the obligations under Article 23 of Regulation 2017/565 are to be met.[3] A small and non-interconnected investment firm must ensure the adequacy and effectiveness of the procedures in place on a permanent basis, in particular regularly evaluate and, if necessary, amend the internal regulation (Article 21(5) of Regulation 2017/565) and ensure that all employees are familiar with the internal regulation and any changes thereto to the necessary extent and proceed in accordance with it (Article 21(1)(c) of Regulation 2017/565).

14. Pursuant to Article 12a(1)(a), (c) and (d) of the CMUA, a small and non-interconnected investment firm must have reliable risk assessment procedures. To meet this requirement, it shall compile an overview of the sources of the main risks undertaken, including a brief description of them (risk catalogue) and update this regularly, even when the risk management function is outsourced, as the ultimate responsibility for identifying, measuring, managing and

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[2] Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

[3] Under Article 23 of Regulation 2017/565, a small and non-interconnected investment firm shall

a) establish, implement and maintain adequate risk management policies and procedures which identify the risks relating to the firm's activities, processes and systems and, where appropriate, set the level of risk tolerated by the firm; in doing so, it takes into account sustainability risks;
b) adopt effective arrangements, processes and mechanisms to manage the risks relating to the firm's activities, processes and systems, in light of that level of risk tolerance;
c) monitor:
    1. the adequacy and effectiveness of the investment firm's risk management policies and procedures,
    2. the level of compliance with the arrangements, processes and mechanisms adopted in accordance with risk management,
    3. the adequacy and effectiveness of measures taken to address any deficiencies in those policies, procedures, arrangements, processes and mechanisms, including failures by the relevant persons to comply with such arrangements, processes and mechanisms or follow such policies and procedures.

monitoring risks always lies with the small and non-interconnected investment firm [Article 23 of Regulation 2017/565].

15. A small and non-interconnected investment firm must take into account in its risk management system not only the sources of risks to clients [Article 12ad(1)(a) of the CMUA] and liquidity risks [Article 12ad(1)(d) of the CMUA], but also the sources of risk for the investment firm itself [Article 12ad(1)(c) of the CMUA] and the possible financial and non-financial impacts arising from them. These include e.g. information and communications technology risks, concentration risk, operational event risk, reputational risk, legal risk, risk of failure to comply with regulations relating to money laundering and the financing of terrorism and other financial crimes, outsourcing risk, currency risk, and commercial and strategic risk.

III. Examples of good practice[4]

16. A small and non-interconnected investment firm is exposed not only to the risks covered by the capital requirement under Article 13 of the IFR,[5] but also to other significant risks that may adversely affect its capital and liquidity situation. The Czech National Bank considers it good practice for a small and non-interconnected investment firm to also establish and apply policies and procedures to determine and maintain internally determined capital and liquid assets on an ongoing basis that are adequate to cover the nature and level of risks that it may pose to others or to which it itself is or could be exposed. The purpose of applying this good practice is in particular to ensure that, in the event of adverse developments, impacts from significant sources of risk do not exhaust the available capital or liquid assets of the small and non-interconnected investment firm and thus jeopardise the continued maintenance of capital at least at the level of the capital requirement under Article 11 of the IFR and liquid assets at least at the level of the liquidity requirement under Article 43 of the IFR.

17. The Czech National Bank considers it good practice if the risk management system of a small and non-interconnected investment firm consistently links its business strategy with its risk appetite, risk management framework, capital management framework and liquidity management framework. The purpose of applying this good practice is to ensure not only that the capital of a small and non-interconnected investment firm continuously reaches the minimum capital requirement under Article 11 of the IFR and that its liquid holdings comply at least with the liquidity requirement under Article 43 of the IFR, but that its own funds and liquid assets reach the internally determined capital and liquidity requirements and are able to cover the impact of all significant risks to which the small and non-interconnected investment firm is or could be exposed.

18. The Czech National Bank considers it good practice if a small and non-interconnected investment firm conducts an internal review of the established and implemented strategies and procedures for setting up and maintaining internal capital and liquid assets on an ongoing basis at least once a year. However, it should always be ensured that such strategies and procedures are commensurate with the current risk appetite and sufficiently cover all significant risks to clients and risks to the investment firm itself, including the liquidity risk to which it is or could be exposed, to avoid exhausting the available capital and liquid assets. A small and non-interconnected investment firm should be capable of informing the Czech National Bank of the outcome of the internal review if requested to do so by the Czech National Bank.

19. In the annex to this official information, the Czech National Bank provides the appropriate structure and content of the resulting information on the regular internal review of the internally

[4] The Czech National Bank emphasizes that good practice is not an obligation and that compliance with legal obligations in other ways is not excluded. The examples of good practice serve primarily to strengthen certainty on the part of market participants that following them will, with certitude, be considered by the Czech National Bank as compliance with regulatory requirements.

[5] The fixed overheads requirement under Article 13 of the IFR in conjunction with the permanent minimum capital requirement under Article 14 of the IFR should cover the risk of a shortfall in income of a small and non-interconnected investment firm that could jeopardise the operation of the investment firm as it would not be able to cover its overheads.

determined capital and liquid assets, which a small and non-interconnected investment firm may also use to help him inform the Czech National Bank.

20. The Czech National Bank considers it good practice if a small and non-interconnected investment firm submits to it the results of internal reviews carried out under paragraph 18 and summarised in the information referred to in paragraph 19 for the past reporting period without being requested to do so, and in electronic form via the Czech National Bank's collection system no later than four months after the end of the reporting period, unless otherwise agreed with the Czech National Bank.

IV. Conclusion

21. When setting the requirements for the risk management strategies and procedures of a small and non-interconnected investment firm and when supervising it, the Czech National Bank applies the principle of proportionality to ensure that the determined risk management strategies and procedures, including the level of internally determined capital and liquid resources, are appropriate to the nature, scope and complexity of the activities carried out by the small and non-interconnected investment firm.

22. This official information comes into effect on the date of its publication in the Bulletin of the Czech National Bank.

Member of the Bank Board:

Jan Kubíček

Annex: Structure and content of information on the regular internal review of internally determined capital and liquid assets

Financial Regulation and International Cooperation Department
Financial Market Regulation Division II

Annex

Structure and content of information on the regular internal review of internally determined capital and liquid assets

ICA (CNB) Report 01-01 “Information on the system of internally determined capital and liquid assets”

1. Data on planned and continuously maintained capital and the internal capital needs of a small and non-interconnected investment firm, with differentiation between the capital requirements under Article 11(2) of the IFR and subsequently internally determined capital requirements to cover the main risks to which it is or could be exposed, and a description of the management and organisational assumptions, arrangements and outputs of the system of internally determined capital, including the control mechanisms within the governing and supervisory system.

2. Data on planned and continuously maintained liquid assets and the internally determined liquidity requirement, distinguishing between the liquidity requirements under Article 43 of IFR and the specific internally determined liquidity requirements, indicating the main risk factors affecting the liquidity of the small and non-interconnected investment firm, and a description of the management and organisational assumptions, arrangements and outputs of the liquidity adequacy assessment system, including its control within the internal governing and supervisory system.

3. Data on the planned economic results of the small and non-interconnected investment firm for the coming three years, including a description of the main factors influencing the expected profit or loss.

4. Supplementary indicators, including
   a) the main limits used by the small and non-interconnected investment firm for risk management,
   b) an overview of the most significant operational risk events, including in the area of information and communication technology, in the past period,
   c) an overview of new products and services with significant impact on the risk profile of the small and non-interconnected investment firm,
   d) data needed to assess the risk of abrupt cessation of activities and risks not sufficiently covered by IFR requirements,
   e) a list of significant outsourcing relationships used in the past period,
   f) an overview of exposures outside the trading portfolio for the past period.