A new UK prudential regime for MiFID investment firms

Consultation Paper
CP21/7***

April 2021

How to respond

We are asking for comments on this Consultation Paper (CP) by **28 May 2021**.

You can send them to us using the form on our website at: www.fca.org.uk/cp21-07-response-form

Or in writing to:

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How to navigate this document

- returns you to the contents list
- takes you to helpful abbreviations
- takes you to the previous page
- takes you to the next page
- prints document
- email and share document

Contents

1 Summary

Why we are consulting

1.1 We are seeking views on the second tranche of our proposed rules to introduce the Investment Firm Prudential Regime (IFPR) The IFPR is a new prudential regime for UK firms authorised under the Markets in Financial Instruments Directive (MiFID). This is the second in a programme of Consultation Papers (CPs) and Policy Statements (PSs) that we will issue to introduce the regime. Our proposals depend on the progress and amendments to the Financial Services Bill (FS Bill).

1.2 As stated in 'CP20/24: A new UK regime for MiFID investment firms', the aim of the new regime is to streamline and simplify the prudential requirements for MiFID investment firms that are prudentially regulated by the FCA in the UK (FCA investment firms). In line with our objectives and Mission, it will refocus prudential requirements and expectations away from the risks the firm faces, to also consider and look to manage the potential harm the firm itself can pose to consumers and markets.

1.3 We encourage FCA investment firms and other interested stakeholders to read and provide your views on the proposals in this CP and our subsequent CP, which we will publish later this year. Your feedback will allow us to draft final rules that achieve both our and Parliament's objectives for the regime, and that are also workable for FCA investment firms.

Who this applies to

1.4 The proposed rules will apply to:

- Any MiFID investment firm authorised and regulated by the FCA that is currently subject to any part of the Capital Requirements Directive (CRD) and the Capital Requirements Regulation (CRR) including:
  - investment firms that are currently subject to BIPRU and GENPRU
  - 'full scope,' 'limited activity' and 'limited licence' investment firms currently subject to IFPRU and CRR
  - 'local' investment firms
  - matched principal dealers
  - specialist commodities derivatives investment firms that benefit from the current exemption on capital requirements and large exposures including:
    - oil market participants (OMPS)
    - energy market participants (EMPS)
  - exempt CAD-firms
  - investment firms that would be exempt from MiFID under Article 3 but have 'opted-in' to MiFID
- Collective Portfolio Management Investment Firms (CPMIs)

- regulated and unregulated holding companies of groups that contain an investment firm authorised and regulated by the FCA and that is currently authorised under MiFID and/or a CPMI.

1.5 Our proposals on capital requirements for the activities of trading firms might also be of broader interest to exchanges, central counterparties and clearing members. We would welcome feedback from these entities.

What we want to change

1.6 The FCA is the competent authority for the prudential regulation of approximately 3,600 investment firms authorised under MiFID.

1.7 The current prudential regime for FCA investment firms is based on requirements designed for globally active systemically important banks. Its main aim is to protect depositors by ensuring that it is difficult for a bank to fail.

1.8 By contrast, the IFPR is specifically designed for FCA investment firms and represents a significant change to how they will be prudentially regulated. The new requirements seek to capture the potential harm posed by these firms to their clients and the markets in which they operate. It also considers the amount of capital and liquid assets the FCA investment firm should hold so that if it does have to wind-down or exit the market, it can do so in an orderly way.

1.9 The IFPR means that there will be a single prudential regime for all FCA investment firms, simplifying the current approach. It should reduce barriers to entry and allow for better competition between investment firms. Some FCA investment firms will have meaningful capital and liquidity requirements for the first time, aligned with the potential harm they can cause.

Specific changes to the existing prudential regime for FCA investment firms

1.10 This is the second CP setting out our proposals for changing prudential regulation for FCA investment firms. It should be read in conjunction with CP20/24, published in December 2020. The draft legal rules are additional to the draft legal rules we published in CP20/24. Our draft legal rules in this CP also include some non-material additions, clarifications and amendments to the text from CP20/24, such as updating cross-references and terminology.

1.11 The remainder of this section only highlights proposals that are included in this CP.

Own funds requirements

1.12 We are proposing to introduce a fixed overheads requirement (FOR) that will apply to all FCA investment firms. This will be another of the 'floors' below which the own funds of an FCA investment firm must not fall.

1.13 We set out our proposals for the remaining activity-based capital requirements known as K-factors (ie those in addition to the K-factors we proposed in CP20/24). The K-factors proposed in this CP are those that may apply to any type of FCA investment firm.

1.14 In CP20/24 we asked should there be the option of an adjustment to calculating the coefficients for the daily trading flow K-factor in periods of extreme market stress and volatility. In this CP we now propose how this should be done.

1.15 We also set out specific proposals on own funds requirements and firm categorisation for FCA investment firms when they provide clearing services as clearing members and indirect clearing firms.

1.16 We consulted on the permanent minimum requirement (PMR) and the K-factors (eg the daily trading flow) that only apply to FCA investment firms with permission to deal in investments as principal in our first CP, published in December 2020.

1.17 We give more detail in Chapters 4 and 5 of this CP.

Basic liquid asset requirement

1.18 We propose that all FCA investment firms now have a basic liquid asset requirement. This would be based on holding an amount of core liquid assets equivalent to at least one third of the amount of their FOR. We explain the concept of core liquid assets and how this provides an appropriate set of assets that can be used to meet the basic liquid asset requirement.

1.19 We provide further detail on the new requirements in Chapter 6 of this CP.

Risk management & Governance (ICARA and SREP)

1.20 We propose to introduce an internal capital and risk assessment (ICARA) process for all FCA investment firms. Through this, firms will be expected to meet an Overall Financial Adequacy Rule (OFAR). This establishes the standard we will apply to determine if an FCA investment firm has adequate financial resources.

1.21 We propose how we expect FCA investment firms to determine through the ICARA process any necessary appropriate own funds and liquid assets requirements, in addition to the own funds and basic liquid assets requirements above. This includes that they consider harm to consumers and markets, including risks to their ability to engage in an orderly wind-down, as well as those from their ongoing activities.

1.22 With the ICARA, we are consolidating our requirements for business model analysis, stress-testing, recovery planning and actions, and wind-down planning. We propose new relevant expectations for senior managers and governance arrangements.

1.23 We also set out new guidance on intervention points, actions we expect of firms in certain situations and what they can expect from us. As part of this, we intend to re-orientate our prudential supervisory approach for FCA investment firms towards being harm-led and in support of sector supervision. We will introduce an ICARA Questionnaire reporting template to support this.

1.24 We give more detail in Chapters 7 and 8 of this CP.

Remuneration requirements

1.25 We propose that all FCA investment firms must have a clearly documented remuneration policy and comply with at least a small number of basic remuneration rules in respect of all their staff. Non-SNI firms must comply with further requirements, which include identifying material risk takers and setting an appropriate ratio between variable and fixed remuneration. Under our proposals, only the largest non-SNI firms would need to meet the full requirements by also applying rules on deferral and pay-out of variable remuneration in instruments. We explain our proposals in more detail in Chapters 9-12.

Regulatory reporting requirements

1.26 We propose to significantly reduce the amount of information that FCA investment firms need to report to us about their remuneration arrangements.

1.27 We intend to simplify the additional reporting form for CPMI firms. We have also amended the MIF002 form for reporting liquid assets that accompanied CP20/24 to take account of our liquidity proposals in this CP and are consulting on the new layout.

1.28 As noted above, we propose to introduce an ICARA reporting form for FCA investment firms. This will replace the existing FSA019 ('pillar 2') return for these firms.

1.29 We provide further details of our proposals in Chapter 13 of this CP.

Outcomes we are seeking

1.30 Our staged approach to consulting will address different aspects of the regime and our proposed changes. Throughout this process, we are seeking the following outcomes:

- The prudential regime for FCA investment firms is more aligned to the way that investment firms run their business. The regime will take account of the different business models of FCA investment firms, and better protect consumers and markets from the harm these may pose.
- All FCA investment firms are subject to consistent prudential standards, not just those subject to the current CRR regime. This will help reduce the potential harm to consumers and markets, and ensure a more level playing field between FCA investment firms.
- FCA investment firms spend less time on complex capital requirement calculations that do little to help them to manage risk. This will free up management time to focus on running the business and managing and mitigating any harm and risk. We will also be able to focus on how a firm is managing itself.
- The relevant prudential standards for FCA investment firms are understandable and accessible, with most rules brought into a new single prudential sourcebook (MIFIDPRU).

Next steps

1.31 We want your feedback on our proposed rules and other issues discussed in this CP. Please send your answers to the questions in this CP by Friday 28 May 2021 using one of the methods in the 'How to respond' section on page 2. We are particularly interested in any suggestions for making the IFPR work better for different business models.

1.32 We plan to publish a further CP in Q3 2021, as set out in Table 1 in Chapter 2 of this CP. Following each consultation, we will consider your feedback, and publish a PS and near final rules. We will publish the final rules once the Financial Services Bill (FS Bill) has passed through Parliament and all the consultations are complete.

2 The wider context of this consultation

2.1 This is the second of 3 CPs, setting out our proposals to introduce the IFPR. We published CP20/24 in December 2020, and we aim to publish our third CP in Q3 2021. We will also publish our first PS in late spring setting out the feedback we received to CP20/24 and the related near-final rules.

2.2 When the UK was a member of the European Union (EU), we were heavily involved in policy discussions on creating the regime that took place through the EU and European Banking Authority (EBA) papers and consultations. We support the aims of the EU's Investment Firm Directive (IFD) and Investment Firm Regulation (IFR) and are proposing that the IFPR will achieve the same overall outcomes.

2.3 However, we are introducing our regime after the UK has exited the EU. So we believe it is right that we also consider the changes that are appropriate to account for the specifics of the UK market and our duties to have regard to certain factors, including those set out in the Government's recently introduced FS Bill.

2.4 As set out in CP20/24 and in line with our consultation map below (Table 1), we are consulting on the different aspects of the IFPR in stages. This should allow firms to read and respond to our proposals in a more manageable way.

Table 1: Our consultation map*

CP20/24 – Published December 2020	CP2 – This Publication	CP3 – Early Q3 2021
MIFIDPRU1: Application (aspects of)	MIFIDPRU1: Application (remainder)	MIFIDPRU8 – Disclosure
MIFIDPRU2: Prudential consolidation and the group capital test	MIFIDPRU4 – Own funds requirements (remainder)	OTHER – Consequential amendments to Handbook and CRR technical standards
MIFIDPRU3 – Own funds resources	MIFIDPRU6 – Liquidity	OTHER – Approach to existing BRRD and FICOD provisions
MIFIDPRU4 – Own funds requirements (aspects of)	MIFIDPRU7 – Risk Mngt & Governance, ICARA and SREP	OTHER – Final overall application provisions
MIFIDPRU5 – Concentration risk	MIFIDPRU9 – Regulatory reporting (remainder)	
MIFIDPRU9 – Regulatory reporting (aspects of)	OTHER – Remuneration requirements	
	MIFIDPRU10 – Clearing members and Indirect clearing Firms – own firm requirements	
	OTHER – Interaction between MIFIDPRU and other prudential sourcebooks	
	OTHER – Permissions and application forms	

* Please note that the content of CP3 and its publication date is provisional and subject to change based on feedback received to this CP, progress of the FS Bill, and other factors.

2.5 By the time we publish our second PS this summer, stakeholders will have seen the near-final rules setting out the key points of the regime. We intend the third CP and the subsequent PS to address final points of the regime, consequential amendments to the Handbook and any gaps or issues our consultation process has identified.

2.6 This means that the cost-benefit analysis (CBA) in this consultation paper and our approach to our new accountability measures set out in the FS Bill will only cover the draft rules that we are publishing in this consultation. Our third CP will set out our view on the impact of our rules and the basis on which we have drafted them over all 3 consultations.

How it links to our objectives

Market integrity

2.7 Our proposals are based on requiring FCA investment firms to consider the potential harm they can cause to others, clients and markets, by the type and scale of activities they undertake. This is a change from the previous regime which was based on FCA investment firms mainly considering the risks to their own balance sheet.

Competition

2.8 Our proposals mean that there will be one overarching regime for all FCA investment firms. There is proportionality according to their size and the type and scale of activities they undertake. This will be a significant improvement on the 11 regimes that are currently in place for these firms. FCA investment firms with similar business models will now have similar prudential standards, rather than markedly different ones due to historical quirks. This will help to improve competition between existing FCA investment firms as well as simplifying matters for new entrants.

Protecting consumers

2.9 Our proposals mean that FCA investment firms will have to consider the potential harm they can cause to their retail customers, as well as their wholesale and financial services clients. Our proposed requirements place more focus upon MiFID investment services provided by FCA investment firms to consumers.

Equality and diversity considerations

2.10 We have considered the equality and diversity issues that may arise from the proposals in this Consultation Paper.

2.11 Overall, we do not consider that the proposals materially impact any of the groups with protected characteristics under the Equality Act 2010. But we will continue to consider the equality and diversity implications of the proposals during the consultation period and will revisit them when making the final rules.

2.12 In the meantime, we welcome your input to this consultation on this.

3 How these rules will apply

3.1 This section covers how rules will apply to different types of FCA investment firm. We cover CPMIs, international firms and tied agents.

3.2 The rules relevant to this chapter are in MIFIDPRU 1.

Collective Portfolio Management Investment Firms (CPMIs)

3.3 The definition of an FCA investment firm includes a CPMI firm. The requirements in MIFIDPRU will therefore apply to CPMIs. They are currently subject to IFPRU or BIPRU.

3.4 CPMIs will use the method set out in MIFIDPRU 4 to calculate the fixed overheads requirement (FOR) for the whole firm. Chapter 4 of this CP explains how to calculate the FOR and other information relevant to a CPMI's capital requirements.

3.5 However, many other requirements in MIFIDPRU apply only to the MiFID business of a firm. Where this is the case, a CPMI will only apply them to its MiFID business. It will not apply them to its collective portfolio management business.

3.6 The prudential requirements for the collective portfolio management business of Alternative Investment Fund Managers Directive (AIMFD) and Undertakings in Collective Investments in Transferable Securities (UCITS) managers are currently set out in Chapter 11 of IPRU-INV. These are essentially unchanged, apart from aligning the calculation of their fixed overheads requirement with the methodology in MIFIDPRU and other consequential changes necessary to ensure that those rules continue to work as a result of the IFPR. Details on the proposed consequential changes necessary to Chapter 11 of IPRU-INV are set out in Chapter 14 of this CP.

International firms

3.7 MIFIDPRU imposes obligations on UK parent entities and responsible UK parents for entities established overseas that form part of the same investment firm group, even though these entities may not be carrying on business in the UK. Firms should refer to our proposals on groups and our draft rules in MIFIDPRU 2 in CP20/24 for further information on this.

3.8 Where an overseas investment firm is applying for authorisation in the UK, we are not proposing that MIFIDPRU should apply directly to that firm. Instead, we need to be satisfied that an investment firm established overseas will be subject to broadly equivalent prudential supervision to MIFIDPRU in its home jurisdiction before giving it a Part 4A permission. If this is not the case, we would generally expect the firm to establish a UK subsidiary, which would be subject to our rules in MIFIDPRU, instead.

3.9 We propose to consider the following factors when assessing an application.

- whether the requirements of the relevant jurisdiction are likely to achieve similar prudential outcomes to MIFIDPRU
- how the relevant overseas regulator supervises and enforces those requirements
- the broader legal framework applicable to the firm in the relevant jurisdiction
- whether there are adequate arrangements in place between the FCA and the overseas regulator to enable supervisory cooperation

3.10 We consider our proposals in this regard to be consistent with the relevant requirements in the threshold conditions. These are, in particular

- the effective supervision condition described in COND 2.3
- the appropriate resources condition described in COND 2.4
- the suitability condition described in COND 2.5

3.11 It is also consistent with 'Our Approach to International Firms', approach document published in February 2021.

Tied agents

3.12 Certain provisions in MIFIDPRU, including requirements in MIFIDPRU 2 on groups and MIFIDPRU 4 on own funds requirements, apply to business carried on by tied agents. We propose to include guidance in MIFIDPRU 1 that reminds firms of this and explains the concept of a tied agent.

3.13 A tied agent in MIFIDPRU means someone who, on behalf of an FCA investment firm (or, where applicable, a third country investment firm):

- promotes investment services and/or ancillary services to clients or prospective clients
- receives and transmits instructions or orders from the client in respect of investment services or financial instruments
- places financial instruments
- and/or provides advice to clients or prospective clients in respect of those financial instruments or investment services

3.14 The references in MIFIDPRU to tied agents do not include appointed representatives that do not meet the definition of a tied agent. This could be because the relevant appointed representative does not carry on its activities for the MiFID business of its principal firm.

3.15 But FCA investment firms should note that they should still consider potential risks from business carried on by appointed representatives (whether or not they are tied agents) as part of their ICARA process (see Chapter 7 of this CP for further information).

Q1: Do you agree that CPMIs should apply MIFIDPRU requirements to their MiFID business? If not, please provide details of an appropriate prudential regime for the MiFID business of a CPMI.

4 Own funds requirements

4.1 In this chapter, we explain our proposals for the remaining own funds requirements, which cover the calculation of:

- a fixed overheads requirement (FOR)
- the remaining K-factor requirements (KFR) that may apply to any FCA investment firm, which are based on
  - assets safeguarded and administered
  - client money held
  - assets under management
  - client orders handled
- an adjusted coefficient in stressed market conditions to use when calculating the K-factor for daily trading flow (K-DTF)

4.2 These proposals are in addition to the own funds requirements proposals that we consulted on in CP20/24, A new UK prudential regime for MiFID investment firms. This included the following proposals:

- permanent minimum requirement (PMR) – Chapter 5 of CP20/24
- calculating the K-factors that only apply to FCA investment firms that trade in their own name or deal on their own account – Chapter 5 of CP20/24
- prudential consolidation of own funds requirements – Chapter 3 of CP20/24
- the transitional provisions on own funds requirements available to FCA investment firms – Chapter 6 of CP20/24.

4.3 The rules we are now consulting on in this chapter are set out in MIFIDPRU 4.

Fixed overheads requirement (FOR)

4.4 We propose that the fixed overheads requirement (FOR) will apply to all FCA investment firms. The proposed rules for the FOR are found in MIFIDPRU 4.5.

4.5 The FOR is intended to calculate a minimum amount of capital that an FCA investment firm would need available to absorb losses if it has cause to wind-down or exit the market. We also expect that FCA investment firms will consider in more detail the amount needed to wind-down as part of their internal capital adequacy and risk assessment (ICARA) process. More information about the ICARA process can be found in MIFIDPRU 7 and is described in Chapter 7.

4.6 We propose that an FCA investment firm's FOR will be an amount equal to one quarter of its relevant expenditure in the previous year. This will result from the accounting framework used by the FCA investment firm. The figures used will be those in its most recent audited annual financial statements. Where these are not available, an FCA investment firm may use unaudited financial statements until audited annual financial statements are available.

Calculating the FOR

4.7 To calculate relevant expenditure for the purposes of the FOR, we propose that an FCA investment firm will first determine its total expenditure after it has made any distribution of profits. It may then deduct certain other expenses (to the extent that those items have been included in expenditure) as follows:

- any of the following items if they are fully discretionary and have not already been treated as a distribution of profits
  - staff bonuses and other variable remuneration
  - employees', directors', and partners' shares in profits
  - other appropriations of profits
- shared commission and fees payable, subject to meeting all of the following conditions
  - they are directly related to commission and fees receivable
  - the commission and fees receivable are included within total revenue
  - the payment of the commission and fees payable is dependent on the actual receipt of the commission and fees receivable
- fees paid to tied agents
- non-recurring expenses from non-ordinary activities
- fees, brokerage and other charges paid to the following, where these are for the purposes of executing, registering and clearing transactions, and are directly passed on and charged to customers:
  - central counterparties
  - exchanges
  - other trading venues
  - intermediate brokers
- interest paid to customers on client money, where there is no obligation to pay interest
- expenditures from taxes that are related to the annual profits of the FCA investment firm
- losses from trading on own account in financial instruments
- payments related to contract-based profit and loss transfer agreements
- payments into a fund for general banking risk
- expenses reflecting the amortisation of prudently valued software assets where the FCA investment firm has already deducted these assets from own funds as an intangible asset

4.8 An FCA investment firm cannot deduct fees or other charges necessary to remain a member of, or meet loss-sharing obligations to, a central counterparty, exchange or other trading venue.

Commodity and emission allowance dealers

4.9 We are proposing that FCA investment firms that are commodity and emission allowance dealers may also deduct expenditure on raw materials. This only applies where this commodity underlies the derivatives that the FCA investment firm trades.

Expenses incurred on behalf of the firm by third parties

4.10 An FCA investment firm must add to its total expenses any relevant expenditure incurred on its behalf by third parties, including tied agents.

Material change in relevant expenditure during the year

4.11 A significant event, such as changes to business lines, buying or selling a business or investing in a major upgrade or restructuring programme, may cause material change to an FCA investment firm's relevant expenditure. Where these events are planned, we expect the FCA investment firm to calculate the expected impact on both its FOR and basic liquid assets requirement before making the relevant change. Where the change leads to an increase in its FOR, the FCA investment firm must make sure that its own funds will be enough to cover this increase. An FCA investment firm must also consider any impact upon its ICARA process (see Chapter 7 of this CP for details on that process).

4.12 We propose that where there is a material increase in relevant expenditure during a financial year, the FCA investment firm must immediately recalculate its FOR based on the revised relevant expenditure and apply the new amount of FOR. We also propose that the FCA investment firm immediately recalculate its basic liquid assets requirement, as this is calculated by reference to the FOR (see Chapter 6 of this CP for details on that requirement).

4.13 A material increase is defined in our proposals as either:

- a projected increase in relevant expenditure for the current year of 30% or more, or
- an increase in the FOR of £2 million or more based on projected relevant expenditure for the current year

4.14 Where there is a material decrease in an FCA investment firm's relevant expenditure during a financial year, we propose that the firm can recalculate its FOR based on the revised relevant expenditure. It may then substitute the revised FOR in place of its existing FOR as long as it gets our prior permission to do so.

4.15 A material decrease is defined in our proposals as either:

- a projected decrease in relevant expenditure for the current year of 30% or more, or
- a decrease in the FOR of £2 million or more based on projected relevant expenditure for the current year

FCA investment firms that have been providing investment services and activities for less than a year

4.16 Where an FCA investment firm has been in business for less than a year, it should use the relevant expenditure in its projections as included in its application for authorisation.

K-factor requirements

4.17 The K-factor own funds requirements are essentially a mixture of activity- and exposure-based requirements. The K-factors that apply to an individual FCA investment firm will depend on the MiFID investment services and activities it undertakes.

4.18 In this section we cover the K-factors that could apply to any FCA investment firm. We have also updated our proposals for the daily trading flow (K-DTF) own funds requirement to deal with how to adjust the coefficient in periods of market stress. Details are towards the end of this chapter. We covered the remaining K-factors that only apply to FCA investment firms that have permission to deal on own account in CP20/24.

4.19 The following summarises the K-factors that may apply to the MiFID investment business of any FCA investment firm (whether or not it deals on own account) depending on the services and activities it conducts.

K-factor	Requirement based on the value of	Coefficient
K-ASA	client assets safeguarded and administered	0.04%
K-CMH	client money held	0.4% (segregated accounts)
		0.5% (non-segregated accounts)
K-AUM	assets under management	0.02%
K-COH	the client orders handled	0.1% (cash trades)
		0.01% (derivatives trades)

4.20 Where applicable, these K-factors will also apply to an FCA investment firm group that is subject to prudential consolidation. See Chapter 3 of CP20/24 for more information on prudential consolidation.

4.21 Our proposed rules and guidance (in MIFIDPRU 4.7 to 4.16) explain how an FCA investment firm should calculate each component of its overall K-factor requirement. The way FCA investment firms carry on activities that are potentially relevant to one or more K-factor metrics may vary considerably. It is not practical for us to give a complete set of rules and guidance covering every conceivable business arrangement that firms may operate when carrying on such activities.

4.22 If an FCA investment firm is unsure whether an arrangement is within scope of one or more components of the K-factor requirement, we expect it to interpret the requirement in the light of its purpose, as required by GEN 2.2.1R. We expect an FCA investment firm will be able to explain to us how it applies the K-factor requirement to an activity

4.23 Even if an activity does not contribute towards the K-factor requirement, an FCA investment firm should still consider under the ICARA process whether that activity may create potential material risks of harm or may be relevant to the firm's wind-down analysis. (See Chapter 7 of this CP for details on the ICARA process).

Assets safeguarded and administered K-factor requirement (K-ASA)

4.24 The K-factor requirement for assets safeguarded and administered, K-ASA, is designed to capture the potential for harm caused by an FCA investment firm holding client assets in connection with MiFID business. It does not matter whether those assets appear on the FCA investment firm's own balance sheet or whether it has deposited those assets into accounts opened with third parties.

4.25 Where an FCA investment firm cannot determine if a proportion of its assets safeguarded and administered (ASA) should be classified as relating to its MiFID business, we propose that it must include such amounts in its ASA calculations.

4.26 We propose that when it is calculating ASA, an FCA investment firm must include any client assets received by its tied agents for MiFID business conducted on the FCA investment firm's behalf. The activities of appointed representatives (including UK tied agents) are restricted, which is explained further in SUP 12.2.7G. So we generally expect that this would not be relevant to an FCA investment firm when it calculates ASA on an individual basis. However, CP20/24 gave our proposals for how a UK parent entity should calculate ASA on a consolidated basis when it is subject to prudential consolidation under MIFIDPRU 2.5. When the requirement for client assets received by tied agents applies on a consolidated basis, this will mean that any amounts that tied agents receive in connection with the business of third country investment firms will need to be included in consolidated ASA.

4.27 We propose that an FCA investment firm must exclude from its measurement of ASA any units or shares in a qualifying money market fund (QMMF) that result from the firm depositing client money in accordance with CASS 7.13.2R(4), where that money is received in connection with MiFID business. As noted under K-CMH below, such amounts must be counted towards measuring CMH instead.

Calculating K-ASA

4.28 We propose that the K-ASA requirement of an FCA investment firm is calculated as:

- 0.04% of average ASA

4.29 An FCA investment firm must calculate its K-ASA requirement on the first business day of each month.

Calculating average ASA

4.30 To calculate its average ASA, we propose that an FCA investment firm must

- measure the amount of ASA it had at the end of each business day for the previous 9 months
- exclude the values for the 3 most recent months
- then calculate the arithmetic mean of the daily values of the remaining 6 months of data

4.31 The FCA investment firm should use the market value of the relevant assets where this is available. Otherwise, it should use an estimated value of an asset calculated on a 'best efforts' basis.

4.32 The values used should be consistent with the information on client assets contained in any relevant regulatory data the FCA investment firm has reported to us, and in any internal or external reconciliations and records maintained in accordance with CASS 6.6. (Except where a rule or relevant guidance expressly requires the firm to take a different approach).

4.33 In both of the following situations, we propose that an FCA investment firm must include these assets when measuring its ASA:

- the FCA investment firm has delegated the safeguarding and administration of assets to another entity.
- another entity has delegated the safeguarding and administration of assets to the FCA investment firm

4.34 We do not consider this to be a 'double counting' of the assets. There is a potential risk of harm from an FCA investment firm's direct safeguarding responsibilities, including where it is safeguarding assets delegated to it by another entity. It also has responsibilities in its arrangements for delegating safeguarding to another firm. The selection, appointment and periodic review of any third party to which the firm has delegated safeguarding is a separate potential source of harm. It means that an FCA investment firm cannot reduce its level of ASA by delegating the safeguarding of assets to a third party.

FCA investment firms that have been safeguarding assets for less than 9 months

4.35 Where an FCA investment firm has been conducting activities giving rise to ASA for less than 9 months we propose that it must:

- Use historical data to calculate average ASA as soon as it becomes available, or
- Use other amounts that we may specify. These will be based on the business projections that the FCA investment firm supplied to us when obtaining permission to perform MiFID safeguarding activities.

Client money held K-factor requirement (K-CMH)

4.36 The client money held K-factor requirement, K-CMH, is designed to capture the potential for harm caused by an FCA investment firm holding client money in connection with MiFID business. For the purposes of MIFIDPRU, this includes:

- where this money has been deposited into a client bank account, including any amounts of the firm's own money as a result of applying the provisions on prudent segregation
- where this money has been placed in a QMMF in accordance with CASS 7.13.3R(4)
- any amount of this money which a third party holds in accordance with CASS 7.14

4.37 Where an FCA investment firm cannot determine if a proportion of its client money should be classified as relating to its MiFID business, we propose that it must include the amount in its calculations of client money held (CMH). This does not affect how this proportion should be treated under other sections of the Handbook (such as CASS or COBS) or under any other applicable legislation.

4.38 We propose that when an FCA investment firm is calculating CMH, it must include any client money received by its tied agents in connection with MiFID business conducted on behalf of the FCA investment firm. Due to the prohibition in SUP 12.6.5R, appointed representatives in the UK are generally prohibited from holding client money. Under SUP 12.6.15R, this prohibition also applies in relation to any FCA registered tied agents. As a result, we expect that the requirement to include client money received by tied agents in CMH would not normally be relevant to an FCA investment firm on an individual basis. However, CP20/24 gave our proposals for how a UK parent entity should calculate CMH on a consolidated basis when it is subject to prudential consolidation under MIFIDPRU 2.5. When the requirement for client money received by tied agents applies on a consolidated basis, this will mean that any amounts received by tied agents for the business of third country investment firms will need to be included in consolidated CMH.

4.39 CMH does not include client money that an FCA investment firm controls using a mandate in accordance with CASS 8 but does not hold.

Calculating K-CMH

4.40 We propose that the K-CMH requirement of an FCA investment firm is calculated as the sum of:

- 0.4% of average CMH held by the firm in segregated accounts, and
- 0.5% of average CMH held by the firm in non-segregated accounts

4.41 An FCA investment firm must calculate its K-CMH requirement on the first business day of each month.

4.42 Where an FCA investment firm is complying with the applicable requirements of CASS 7 for an amount of client money, there is a presumption that such an amount is being held in a segregated account.

4.43 We consider that the K-CMH requirement for non-segregated accounts is most likely to be used where it is applied on a consolidated basis under MIFIDPRU 2.5. For example, this may be relevant where the investment firm group includes an entity to which CASS does not apply, such as a third country investment firm. And that entity holds client money under arrangements that do not meet the general conditions to be a segregated account.

General conditions to be a segregated account

4.44 For the purposes of calculating the K-CMH requirement in MIFIDPRU 4.8, we propose that an arrangement will constitute a segregated account if an FCA investment firm ensures that:

- it keeps records and accounts enabling it, at any time and without delay, to distinguish assets held for one client from assets held for any other client and from its own assets
- it maintains its records and accounts in a way that ensures their accuracy, that they correspond to the assets held for clients and may be used as an audit trail
- it conducts, on a regular basis, reconciliations between its internal accounts and records and those of any third parties by whom those assets are held

- it takes the necessary steps to ensure that deposited client funds are held in an account or accounts identified separately from any accounts used to hold funds belonging to it, and
- it operates adequate organisational arrangements to minimise the risk of the loss or diminution of client assets or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence, and
- the applicable national law provides that, in the event of its insolvency or entry into resolution or administration, client funds cannot be used to satisfy claims against it, other than claims by the relevant clients

4.45 We propose that compliance by an FCA investment firm with the following CASS requirements (in so far as they apply to a particular amount of client money) would generally be evidence that an arrangement can be classified as a segregated account.

- organisational requirements for client money in CASS 7.12
- segregation of client money in CASS 7.13 or client money held by a third party in CASS 7.14
- records, accounts and reconciliations in CASS 7.15, and
- acknowledgement letters in CASS 7.18

Calculating average CMH

4.46 To calculate average CMH, we propose that an FCA investment firm must

- measure the amount of CMH at the end of each business day for the previous 9 months
- exclude the values for the 3 most recent months
- calculate the arithmetic mean of the daily values for the remaining 6 months of data

4.47 The FCA investment firm should measure amount of client money held in accordance with the requirements of CASS 7.15. For third country investment firms that are part of an investment firm consolidation group the amount of client money held should, to the extent applicable, be measured in accordance with the values in any relevant accounting records.

FCA investment firms that have been holding client money for less than 9 months

4.48 Where an FCA investment firm has been holding client money for MiFID business for less than 9 months it should:

- Use historical data to calculate the average CMH as soon as soon as it becomes available, or
- Use other amounts that we may specify. These will be based on the business projections that the FCA investment firm gave to us when getting permission to perform the MiFID activities to which the client money relates.

Assets under management – K-AUM

4.49 Our proposed rules for the assets under management K-factor requirement, K-AUM, are set out in MIFIDPRU 4.7. K-AUM is designed to capture the potential for harm when an FCA investment firm manages assets for its clients in connection with MiFID business. This includes:

- assets managed on a discretionary portfolio management basis, and
- assets managed under non-discretionary advisory arrangements of an ongoing nature

4.50 We propose that a MIFIDPRU investment firm must include within assets under management (AUM) any amounts from its MiFID business that is carried on by any tied agents acting on its behalf.

4.51 Under our proposals, the definition of AUM does not include amounts related to

- the provision of advice to undertakings on capital structure, industrial strategy and related matters
- advice and services relating to mergers and the purchase of undertakings

Calculating K-AUM

4.52 Our proposal is that the K-AUM requirement for an FCA investment firm will be 0.02% of its average AUM.

4.53 An FCA investment firm must calculate its K-AUM on the first business day of each month.

Calculating average AUM

4.54 We propose that, to calculate average AUM, an FCA investment firm should

- measure the amount of AUM it had on the last business day of each of the previous 15 months
- exclude the 3 most recent monthly values
- calculate the arithmetic mean of the remaining 12 monthly values

4.55 We propose that when measuring the value of its AUM on the last business day of each month, an FCA investment firm must convert any amounts in foreign currencies on that date into its functional currency. The FCA investment firm must apply a conversion rate for that date by reference to an appropriate market rate and record that rate. Once the AUM for a given month is in the FCA investment firm's functional currency, it should always use the same value each time that particular month's data appears as part of the 12 monthly values used to calculate the average AUM. It should not be revalued if the exchange rate varies over time.

4.56 When measuring its AUM, we propose that an FCA investment firm must

- use the market value of the relevant assets, where available
- use an alternative measure of the fair value of an asset, where a market value is not available, which may include an estimated value calculated on a 'best efforts' basis
- exclude any amounts that are included in its calculation of its CMH

4.57 When measuring its AUM, our proposals allow an FCA investment firm to use the net total value of the relevant assets. So it may choose to offset any negative values or liabilities attributable to positions within the relevant portfolios.

Formal delegation of portfolio management

4.58 We propose that an FCA investment firm must include in the measurement of its AUM any assets where **it has delegated** the management to another entity.

4.59 In order to avoid 'double counting', we propose an FCA investment firm may exclude from its AUM the value of any assets that have been formally **delegated to it** (to manage) by a financial entity, which we define as:

- an FCA investment firm, including a CPMI firm
- a collective portfolio management (CPM) firm
- a third country entity that is subject to an AUM-based financial resources requirement that is similar to the K-AUM requirement

4.60 However, we also propose that an FCA investment firm must include in its AUM the value of any assets that have been delegated to it if the financial entity that has delegated this asset management to it:

- is also acting as a delegated manager and
- has excluded these assets from the calculation of its own capital requirements

4.61 This means that where there is sub-delegation of the management of assets, the FCA investment firm can only apply relief from 'double counting' to one of the delegated levels.

4.62 We propose that formal delegation will occur where there is a legally binding agreement in place between the financial entity and the FCA investment firm that sets out the rights and obligations of each party for the relevant delegation activities.

4.63 A financial entity may be providing investment advice of an ongoing nature to an FCA investment firm that undertakes discretionary portfolio management. However, such an arrangement is not a formal delegation of the management of assets. It involves 2 distinct activities: ongoing investment advice provided by the financial entity and discretionary portfolio management by the FCA investment firm. In this situation, if the financial entity is also an FCA investment firm, we propose that it must include any assets for which it is providing such advice in its measurement of AUM. The FCA investment firm that is undertaking discretionary portfolio management for the same assets must also include those assets in its own measurement of AUM.

FCA investment firms that have been required to calculate K-AUM for less than 15 months

4.64 Where an FCA investment firm has been managing assets for its clients under discretionary portfolio management or non-discretionary arrangements constituting investment advice of an ongoing nature:

- for less than 15 months, or
- for 15 months or longer, but has been classified as a non-SNI investment firm for less than 15 months

we propose that for the purposes of calculating its average AUM the FCA investment firm must use:

- Historical data as soon as soon as it becomes available, or
- Other amounts that we may specify. These will be based on the business projections that the FCA investment firm gave us when getting permission to perform the relevant activities

Client orders handled – K-COH

4.65 Our proposed rules for the client orders handled K-factor requirement, K-COH, are set out in MIFIDPRU 4.10. K-COH is designed to capture the potential for harm from an FCA investment firm handling client orders. This includes the execution of orders on behalf of the client and the reception and transmission of client orders. This also includes where this is happening as part of a chain.

4.66 An FCA investment firm must include within its client orders handled (COH) any amounts for MiFID business carried out by tied agents acting on its behalf.

4.67 It is not practical for us to give a complete set of rules and guidance covering every conceivable business arrangement that firms may operate when handling client orders. However, in MIFIDPRU 4.10.6 G to MIFIDPRU 4.10.17G we propose guidance on whether particular arrangements are included within the measurement of COH. Given their very detailed nature, we do not describe such arrangements in this chapter.

4.68 As noted earlier in this chapter, if an FCA investment firm is unsure whether an arrangement is within scope of one or more components of the K-factor requirement, we expect it to interpret the requirement in the light of its purpose, as required by GEN 2.2.1R.

Calculating K-COH

4.69 We propose that the K-COH requirement for an FCA investment firm is the sum of:

- 0.1% of the average COH for cash trades, and
- 0.01% of the average COH for derivatives trades

4.70 An FCA investment firm must calculate its K-COH on the first business day of each month.

4.71 In CP20/24 we consulted on the definition of a cash trade, which includes an exchange traded option. We also proposed that any order for the buying or selling of a financial instrument that is not a cash trade will be a derivatives trade.

Transactions that can be excluded from COH

4.72 We propose that an FCA investment firm is not required to include the following in its measurement of COH:

- orders executed in its own name (including where executing an order in its own name on behalf of a client)

- orders that a firm handles when acting in the capacity as the operator of a multilateral trading facility or organised trading facility
- transactions that are caught within the definition of reception and transmission of client orders only as a result of the situation described in recital 44 of MiFID
- orders that are not ultimately executed

4.73 Instead, the FCA investment firm must include orders executed in its own name, even if on behalf of a client, in the FCA investment firm's measurement of its daily trading flow (DTF) when calculating its K-DTF requirement. (See CP 20/24 for details on K-DTF).

4.74 An FCA investment firm which is operating a multilateral trading facility or an organised trading facility does not need to include any orders it handles solely in that capacity in its measurement of COH. Nonetheless, it should consider as part of its ICARA process whether that activity creates the risk of material potential harm which might require it to hold additional own funds or liquid assets under MIFIDPRU 7. However, if the operator of an organised trading facility is undertaking matched principal trading, as permitted by MAR 5A.3.5R, any matched principal trades are included in its measurement of DTF under MIFIDPRU 4.15.

4.75 Where an FCA investment firm executes client orders on a multilateral trading facility or an organised trading facility when it is not acting in the capacity of the trading venue operator, it must include these orders in its measurement of COH. However, if the FCA investment firm executes these orders in its own name, it must include them in its measurement of DTF.

4.76 The same FCA investment firm may both act as the operator of a multilateral trading facility or an organised trading facility and be submitting an order on that trading venue on behalf of a client. In this case it is not required to measure COH in relation to its role as the operator of the trading venue. But it must still measure COH, or DTF if it is possible to enter into transactions in its own name on the trading venue, for the order that it is executing for the client.

4.77 Transactions that are described in recital 44 of MiFID are, in summary, transactions that result from a firm bringing together 2 or more investors (such as introducing an issuer to a potential source of funding). And where the firm does not otherwise interpose itself within the chain of execution of any resulting order. An example of this would be corporate finance or venture capital business. However, the FCA investment firm must be sure that its role does not go beyond the 'extended' definition of reception and transmission as described in recital 44 of MiFID. Further guidance is available in PERG 13.3.

4.78 We propose that where an FCA investment firm receives a client order, but that order is not ultimately executed, it does not have to include the value of that order in its measurement of COH. However, as part of its ICARA process, an FCA investment firm should consider whether the fact that an order has not been executed creates any material risks to the firm or to its clients. This may depend upon the reasons why client orders have not been executed.

Calculating average COH

4.79 To calculate its average COH we propose that an FCA investment firm must:

- calculate the total COH measured throughout each business day over the previous 6 months
- exclude the 3 most recent months, and
- then take the arithmetic mean of the remaining 3 months

Measuring the value of orders for COH

4.80 In measuring its COH, we propose that an FCA investment firm must use the total of the absolute value of each buy and sell order, determined as follows:

- for cash trades this is the amount paid or received on the trade at the time it is executed (unless the FCA investment firm has chosen to apply the alternative approach set out below)
- For derivatives trades (other than interest rate derivatives) this is the notional amount of the contract. We propose that the notional amount of the contract be arrived at using the same approach as for the trading counterparty default requirement (K-TCD) set out in MIFIDPRU 4.14.20R (2) in CP20/24
- For interest rate derivatives, this is the notional amount of the contract (determined as above) multiplied by the duration, where the duration is the time to maturity in years divided by 10
- For cash trades relating to exchange-traded options, the amount paid or received is the premium paid for the option.

4.81 We propose that FCA investment firms can exclude transaction costs from the value of an order to reflect the amount received or paid by the client for the relevant instruments. This is provided that the client does not pay these costs separately to the FCA investment firm but they are reflected in the amount paid for the order itself.

Alternative approach for calculating the value of cash trades

4.82 Where an FCA investment firm is receiving and transmitting an order that is a cash trade, we also propose that it may choose to use an alternative approach to valuation (than the amount paid or received at the time the order is executed). Under the alternative approach the value of the order is determined by:

- the price specified in that order where this is a fixed price or a limit price at which the order should be executed, or
- the market price of the relevant instrument at the end of the day on which the order is transmitted by the FCA investment firm

4.83 We propose that where an FCA investment firm chooses to use this approach, it should

- use it for all cash trades it is receiving and transmitting, or
- use it only for cash trades received and transmitted for which it has not received timely information about the terms on which the order was executed and must document the basis on which it has chosen to do so.

Firms with less than 6 months data on COH

4.84 Where an FCA investment firm has been handling client orders for less than 6 months we propose that it must

- Use historical data to calculate average COH as soon as soon as it becomes available, or
- Use other amounts that we may specify. These will be based on the business projections that the FCA investment firm gave us when getting permission to perform the relevant MiFID activities

Interaction between K-AUM and K-COH requirements

4.85 In Table 2 we set out different scenarios to help explain the outcome of our proposals for when an FCA investment firm must calculate K-AUM and/or K-COH in different situations.

4.86 It should be remembered that K-AUM captures both discretionary portfolio management and non-discretionary arrangements constituting investment advice of an ongoing nature. And that K-COH captures both execution of, and reception and transmission of, client orders.

4.87 For example, as in row 2 of the table, we propose that an FCA investment firm may exclude from its calculation of COH any orders that it generates as part of providing portfolio management or investment advice of an on-going nature. But this exclusion is only permitted where the relevant portfolio is included in the FCA investment firm's calculation of its K-AUM requirement. This is designed to reflect the fact that, for example, the FCA investment firm providing the relevant service to the client needs to execute or place any client orders in order to re-balance the portfolio accordingly.

4.88 However, we also propose that excluding these orders from its measurement of COH does not apply to any orders that the FCA investment firm executes in the course of providing portfolio management for a delegated portfolio where the firm does not calculate K-AUM in respect of that portfolio.

4.89 Table 2 is only a summary and no substitute for reading the detailed provisions, which are set out in MIFIDPRU 4.10.26 to 4.10.32. The table shows the activities carried on by an FCA investment firm (IF1) and the relevant K-factors that apply. Where applicable, it also shows how the arrangements between IF1 and another FCA investment firm (IF2) may affect which K-factors are applicable to each firm.

Table 2: interaction between K-AUM and K-COH requirements

	IF 1	K-AUM	K-COH	IF 2	K-AUM	K-COH
1	DPM, executes those orders	Yes	No	–	–	–
2	DPM, delegates DPM to IF2	Yes	No	Undertakes delegated DPM, and executes those orders	No	Yes
3	DPM, delegates DPM to IF2. Receives orders back from IF2 to execute	Yes	No	Undertakes delegated DPM, and passes orders back to IF1 to execute	No	No
4	DPM, delegates DPM to IF2	Yes	No	Undertakes delegated DPM, orders passed onto IF3 to execute	No	No
5	DPM, delegates DPM to IF2. Receives orders back from IF2 and passes on to IF3 to execute	Yes	No	Undertakes delegated DPM, does not execute, passes orders back to IF1	No	No
6	DPM, orders passed to IF2 for execution	Yes	No	Executes orders on behalf of IF1	No	Yes
7	DPM, receives on-going advice from IF2	Yes	No	Ongoing advice on assets managed by IF1	Yes	No
8	Assets under on-going advice and executes those orders.	Yes	No	–	–	–
9	Assets under on-going advice, orders executed by IF2	Yes	No	Executes the orders received from IF1 for execution	No	Yes
10	Provides 'one-off' advice to a client. Any orders passed to IF2 for execution.	No	Yes	Executes the orders received from IF1 for execution	No	Yes
11	Provides 'one-off' advice to a client. Executes any resulting orders.	No	Yes	–	–	–
12	Execution only of client orders	No	Yes	–	–	–
13	Client orders received are passed to IF2 for execution	No	Yes	Executes orders received from IF1 for execution	No	Yes

Key:
DPM = discretionary portfolio management
IF1 = FCA investment firm 1
IF2 = FC investment firm 2
IF3 = a third FCA investment firm
A dash indicates that there is no second FCA investment firm involved in the activity

4.90 FCA investment firms will still need to consider any additional potential harm that could be caused by these activities when considering their ICARA. This is especially the case where there may be no K-factors associated with the activity – for example, see Investment Firm 2 under scenarios 3, 4 and 5.

Daily trading flow K-factor requirement (K-DTF)

4.91 In Chapter 5 of CP 20/24 we set out our proposals for the transactions that FCA investment firms should include when calculating the daily trading flow own funds requirement (K-DTF) as well as how to calculate K-DTF for cash and derivatives trades.

4.92 In CP20/24 we asked should there be the possibility of an adjustment to calculating the coefficients for K-DTF in periods of extreme market stress and volatility? We now propose to add a section to MIFIDPRU 4 setting out how FCA investment firms should calculate an adjusted coefficient for use in times of stressed market conditions. For these purposes, stressed market conditions are as defined in Article 6 of the on-shored UK version of Regulation (EU) 2017/578, the Market Making Regulatory Technical Standard (RTS).

4.93 The aim of this proposed adjustment to the coefficient is that when market circumstances are stressed, market-making is incentivised, reducing the potential risk of lower market liquidity and potential harm to financial stability.

4.94 An FCA investment firm should only use the adjusted coefficient where a proportion of its average daily trading flow (DTF) used in the K-DTF calculation occurred under stressed market conditions. It must calculate the relevant coefficient separately for cash trades and derivatives trades.

4.95 The adjusted coefficient proposed for cash trades is $\text{CadjCash} = \text{C} * \left(\frac{\text{DTFexl}}{\text{DTFincl}}\right)$

where

C = the original coefficient for cash trades (0.1%)

DTFexcl = the average DTF of cash trades, excluding the value of any cash trade that occurred on a trading segment of a trading venue between the time at which the trading venue determined that:

- stressed market conditions began to apply, and
- stressed market conditions ceased to apply

DTFincl = the average DTF of all cash trades

4.96 The adjusted coefficient for derivative trades is $\text{CadjDer} = \text{C} * \left(\frac{\text{DTFexl}}{\text{DTFincl}}\right)$

where

C = the original coefficient for derivative trades (0.01%)

DTFexcl = the average DTF of derivative trades, excluding the value of any derivative trade that occurred on a trading segment of a trading venue between the time at which the trading venue determined that:

- stressed market conditions began to apply, and
- stressed market conditions ceased to apply

DTFincl = the average DTF of all derivative trades

4.97 We propose that an FCA investment firm may choose to apply the adjusted coefficient approach when calculating its K-DTF requirement, but it is not required to use this. Instead it may continue to apply the original coefficient, as this is both simpler and more prudent.

Example of how to calculate the adjusted co-efficient, using cash trades

An FCA investment firm executes total cash trades in its own name worth £9,600m during the 6-month calculation period for determining average DTF. That 6-month period includes 128 business days.

The total £9,600m of cash trades includes £375m of cash trades that were executed on trading venues during stressed market conditions (as defined in article 6 of the Market Making RTS).

In this example

DTFincl	=	£9,600m / 128 days = £75m
DTFexcl	=	(£9600m – £375m) / 128 days = £9,225m / 128 days = £72.07m
C	=	0.1%
CadjCash	=	0.1% x (72.07 / 75) = 0.1% x 0.961 = 0.0961%

To calculate its K-DTF requirement for this calculation period, the firm would therefore multiply the full amount of its average DTF for the period by the adjusted coefficient (CadjCash). Therefore:

K-DTF requirement for cash trades = £75m x 0.0961% = £72,075.

Other minor amendments to K-DTF

4.98 We have also proposed some minor amendments to the terminology used in the rules for calculating the K-DTF requirement in MIFIDPRU 4.15. These amendments do not change the calculation we proposed in CP20/24. They are designed to make the methodology clearer and to clarify its interaction with the new provisions for the adjusted coefficient.

Q2: **Do you have any specific comments on our proposed approach to the calculation of the FOR and the specific items of expenditure that may be deducted from total expenses? If yes, what items would you suggest are/are not deducted, and why?**

Q3: **Do you agree with our proposals for calculating K-ASA and that this should address the potential risk of harm from an FCA investment firm's direct safeguarding responsibilities, including where it is safeguarding assets delegated to it by another entity ASA? If you disagree, please explain why.**

Q4: **Are our proposals on the calculation of K-CMH, especially when amounts of CMH should be treated as being in a segregated account, sufficiently clear? If not, what specific suggestions do you have for improvement?**

Q5: **Do you agree with our proposals on how the value of assets should be calculated, and for when formal delegation takes place, when calculating K-AUM? If not, please explain any alternative suggestions you may have.**

Q6: **Do you agree with our proposals for calculating K-COH? Especially for measuring the value of cash trades, and for when certain transactions may be excluded from the measurement of COH? If not, please explain why and provide evidence to support any alternative suggested treatments.**

Q7: **Are our proposals that cover the interaction between K-AUM and K-COH clear and prudent? If not, what specific suggestions do you have to improve this?**

Q8: **Do you foresee any issues with our proposals for how to calculate an adjusted coefficient for use in times of stressed market conditions? If so, how might we address them, or what alternative practical suggestions do you have for achieving the desired outcome without unnecessary complexity?**

5 Firms acting as clearing members and indirect clearing firms

5.1 In this chapter we set out the specific requirements, including firm categorisation, we are proposing for FCA investment firms that are clearing members and indirect clearing firms. By an 'indirect clearing firm', we mean a firm that is a client (including an indirect client) of a clearing member and that also provides indirect clearing services to other recipients.

5.2 We explain how we are proposing to apply K-DTF to clearing activities, and the own funds requirement of K-TCD to central counterparty (CCP) default fund exposures.

5.3 The rules relevant to this chapter are in MIFIDPRU 10.

5.4 Our discussions with stakeholders since CP20/24 have shown that FCA investment firms play a part in the overall provision of clearing services to other FCA investment firms. We will therefore be addressing this further as part of our subsequent Policy Statement in response to CP20/24, in terms of the users of such services.

Categorisation

5.5 We are proposing that all FCA investment firms that are clearing members or indirect clearing firms should be non-SNI investment firms. This will be the case even if they meet all the other requirements for being an SNI firm.

5.6 We consider that these FCA investment firms are, by the very nature of their activities, interconnected to other financial institutions in a way that precludes them from being SNI firms.

5.7 This also means that where an FCA investment firm group that is subject to prudential consolidation contains either a clearing member or an indirect clearing firm it cannot be an SNI group. The UK parent entity must therefore comply with the obligations of MIFIDPRU 2 as if it were a non-SNI firm on a consolidated basis.

5.8 FCA investment firms that are self-clearing firms will also be non-SNI firms.

Application of K-DTF to clearing activities

5.9 We are proposing to apply the own funds requirement for the daily trading flow (K-DTF) to the transactions where an FCA investment firm provides clearing services as a clearing member or an indirect clearing firm. These transactions should be included in the calculation of daily trading flow (DTF) in the following way:

- where the order is a cash trade, the clearing transaction will also be treated as if it were a cash trade
- where the order is a derivatives trade, the clearing transaction will also be treated as if it were a derivatives trade

5.10 Please refer to MIFIDPRU 4.15 as set out in CP20/24 for our proposed rules on calculating K-DTF.

Avoiding of double counting

5.11 An FCA investment firm may both execute an order and provide clearing services for the resulting transaction. In this situation, it does not need to include the clearing transaction in its DTF calculation provided the value of the executed order is already included in its calculation of:

- COH in line with MIFIDPRU 4.10, or
- DTF in line with MIFIDPRU 4.15

5.12 This is to avoid the transaction being double counted where the FCA investment firm is providing both execution and clearing services for the same trade.

Own funds requirements for CCP default fund exposures

5.13 CCPs will typically have default funds that are pre-funded by contributions from their clearing members. The UK CRR includes an own funds requirement for counterparty risk on such exposures. We are proposing that FCA investment firms that are clearing members should include these contributions as part of their trading counterparty default (K-TCD) calculations. This will also apply to investment firm groups subject to prudential consolidation that have one or more clearing members that have made pre-funded contributions to a CCP.

5.14 The default fund is set up by the CCP to cover losses for when a clearing member defaults, where those losses are not covered by that clearing member's various margin requirements and default fund contributions. This means that the clearing member has a counterparty credit risk type exposure to the CCP.

5.15 We consider that it is appropriate for this risk to the FCA investment firm to be captured on a consistent basis as part of the K-factor framework, rather than solely as part of its ICARA process.

Calculating K-TCD for CCP default fund exposures

5.16 For the K-TCD calculation on pre-funded default fund contributions using MIFIDPRU 4.14, we are proposing that:

- the replacement cost of the contribution will be the book value of the asset,
- the risk factor will be 8%, and
- the credit valuation adjustment will be 1

Q9: Do you agree with our proposed treatment of FCA investment firms when acting as clearing members and indirect clearing firms? If not, what alternatives could be used to calculate the own funds requirements for such activity? Are there any other circumstances in which FCA investment firms may have exposures to a CCP that should be captured by K-TCD?

6 Basic liquid assets requirement

6.1 In this chapter we set our proposals for the basic liquid assets requirement for FCA investment firms and the type of assets that can be used to meet this requirement. We explain the following concepts:

- basic liquid assets requirement
- core liquid assets

6.2 The basic liquid assets requirement can apply on both an individual and consolidated basis. In CP20/24 we also consulted on allowing firms to apply for an exemption from this requirement on either an individual or consolidated basis, where certain conditions are met.

6.3 Where the basic liquid assets requirement applies on an individual basis, we generally expect an FCA investment firm to meet the requirement using assets it holds itself. However, we do recognise that there are circumstances in which it may be appropriate for an FCA investment firm to rely on liquidity support provided by other entities within its group. That is why we proposed that firms subject to prudential consolidation could apply for an exemption from this requirement on an individual basis as proposed in section 2.3 of MIFIDPRU in CP20/24.

6.4 The basic liquid assets requirement is based on a proportion of an FCA investment firm's fixed overheads requirement and any guarantees provided to clients. The rules relating to this chapter can be found in MIFIDPRU 6. Our proposals on the fixed overheads requirement are described in Chapter 4 of this CP and set out in MIFIDPRU 4.5.

6.5 We propose to give commodities and emissions allowance dealers 5 years to meet these requirements. See TP 8 for further details. This is to reflect the specialised nature of those markets.

6.6 We also propose to amend the information that we wish to collect from FCA investment firms about the liquid assets they hold to reflect these new concepts. This is a change from the reporting that we consulted on in CP20/24. More information about this is set out in Chapter 13 on regulatory reporting of this CP.

Basic liquid assets requirement

6.7 We propose to require FCA investment firms to hold an amount of liquid assets that is at least equal to the sum of:

- one third of the amount of its fixed overheads requirement, and
- 1.6% of the total amount of any guarantees provided to clients

6.8 This will be the first time that all FCA investment firms have a quantified liquid assets requirement. The purpose is to ensure that FCA investment firms always have a minimum stock of liquid assets to fund the initial stages of a wind-down process, if wind-down becomes necessary. The basic liquid assets requirement will help to build upon the existing requirement that FCA investment firms have adequate financial resources to be able to meet their liabilities as they fall due.

6.9 Our view is that the basic liquid asset requirement is a proportionate minimum requirement that FCA investment firms should be able to meet.

Calculating guarantees

6.10 When calculating the total amount of any guarantees provided to clients, we propose to give FCA investment firms the option of

- using the total value of guarantees outstanding at the end of each business day, or
- calculating a historic average to smooth out fluctuations in the daily amount

6.11 We have illustrated the second option using the example of a firm that guarantees the settlement of orders it executes between a client and a third party. We suggest that such a firm could use the principles for calculating the value of the client orders it handles (COH) to calculate its liquid assets requirement for guarantees. This is set out in MIFIDPRU 6.2.

Core liquid assets

6.12 We propose a list of core liquid assets that FCA investment firms can use to meet the basic liquid assets requirement. These are the straightforward liquid assets that they are likely to hold and do not require any reduction (or 'haircut') given their certainty of value. Any amount of the following may be used:

- coins and banknotes,
- short-term deposits at a UK bank
- assets representing claims on or guaranteed by the UK government or the Bank of England (for example UK gilts and Treasury bonds)
- units or shares in a short-term regulated money market fund, or in a comparable third country fund.

Trade receivables

6.13 We also propose to allow the following firms to include trade receivables (including fees and commissions) as core liquid assets:

- SNI investment firms, or
- non-SNI investment firms that do not have permission to deal on own account, or underwrite/place financial instruments on a firm commitment basis

6.14 However, we are proposing that FCA investment firms can only use trade receivables to meet up to one third of the liquid assets requirement based on the fixed overheads requirement. They cannot be used to meet any liquid assets requirement based on guarantees.

6.15 Trade receivables will also have to be:

- receivable within 30 days
- subject to a 'haircut' of at least 50%

Sterling and non-sterling currencies

6.16 We are generally proposing that any core liquid assets used to meet the basic liquid assets requirement must be denominated in pound sterling, because we generally expect FCA investment firms' liquidity needs to be in pound sterling.

6.17 However, we recognise that some FCA investment firms and consolidation groups may incur relevant expenditure or guarantees in other currencies. Where a different currency is involved, we propose to allow an FCA investment firm to use comparable core liquid assets denominated in a foreign currency. This includes deposits held at overseas banks and assets issued or guaranteed by overseas governments or central banks.

6.18 These assets can be included in the same proportion as the relevant expenditure or guarantees that the FCA investment firm incurs in that currency.

Not a liquid asset

6.19 We are proposing to exclude from the definition of a core liquid asset any asset that:

- belongs to a client (eg client money or client assets under our client assets sourcebook (CASS)), even if the asset is held in the firm's own name
- is encumbered or subject to some restriction that prevents it being realised.

Overall liquidity needs

6.20 The basic liquid assets requirement forms part of the overall framework that an FCA investment firm must adopt for assessing its individual liquidity needs. This overall framework is called the ICARA process and is set out in MIFIDPRU 7. Where the ICARA process results in the need to hold additional liquid assets (above the basic liquid asset requirement), our proposals allow an FCA investment firm to use a wider range of 'non-core' liquid assets to meet this additional requirement. (See Chapter 7 of this CP for details).

Q10: Do you agree with our proposals for a basic liquid asset requirement, to be met by holding core liquid assets? If not, please explain what alternative proposal you would suggest and why.

7 Risk Management, ICARA and SREP

Overview

7.1 In this chapter, we set out how we propose FCA investment firms should manage their risks. This includes the Internal Capital Adequacy and Risk Assessment (ICARA) process and how we will assess this.

7.2 We view the introduction of the IFPR as an opportunity to re-establish our expectations for FCA investment firms' internal governance and risk management. Our proposals reflect and build upon the framework established last year in our guidance 'FG20/1 Assessing Adequate Financial Resources' (June 2020). We recommend that FCA investment firms should use that guidance as a starting point for our proposals in this chapter.

7.3 The rules relevant to this chapter are in MIFIDPRU 7. There is additional material in the annexes to MIFIDPRU 7.

Key principles

7.4 Our proposed approach is underpinned by several key principles:

- **FCA investment firms must consider and account for the risk of harm they pose to consumers and markets**. Our expectation is that FCA investment firms consider the potential harm they could cause to consumers and markets, as well as risks to their own safety and soundness. They must assess the degree to which the activities they undertake pose harm to others, and account for this appropriately. This includes credible and accountable wind-down planning, which we consider a critical feature of FCA investment firms' internal risk assessment process under our new framework.
- **The ICARA process is the centrepiece of firms' risk management processes**. Under our proposals it will cover:
  - identification, monitoring and mitigation of harms
  - business model planning and forecasting; recovery and wind-down planning
  - assessing the adequacy of financial resources

  Our expectation is that the assumptions used by FCA investment firms to underpin these elements are consistent and holistic.
- **Senior management is responsible for ensuring the appropriateness of their firm's governance and risk management**. Our expectation is that it is the responsibility of a firm to recognise, monitor, control and mitigate the risks to which they are exposed, and potential for harm their activities pose to consumers and markets. We will hold senior management and governing bodies responsible for this. Our proposed rules clarify FCA investment firms' risk management responsibilities for the IFPR under the Senior Manager and Certification Regime (SM&CR).

- **We will intervene at given intervention points if FCA investment firms fail to act appropriately or their actions prove unsuccessful**. We propose that FCA investment firms must notify us where their level of own funds and/or liquid assets fall below these intervention points. This reflects feedback that firms are not always clear on our expectations and how we expect them to respond in certain situations.
- **Our expectations on firms are proportionate to the risk of harm posed**. Our proposals contain core requirements for all firms. They also set out additional guidance and expectations for larger or more complex firms.

Summary of our proposed rules

7.5 The remainder of this chapter sets out our proposals, and what this means in practice. In summary, we propose to:

- Introduce an Overall Financial Adequacy Rule (OFAR), establishing the standard we will apply to determine if an FCA investment firm has adequate financial resources.
- Place specific emphasis on FCA investment firms' own risk management practices and governance responsibilities to determine the non-financial and financial resources necessary on an ongoing basis, and to wind-down. This will include holding additional own funds and liquid assets, where necessary.
- Establish the ICARA process as the central means through which this is monitored and delivered by FCA investment firms. Our proposals include guidance for our expectations of the ICARA and management accountability to deliver this.
- Provide specific guidance on what we expect of FCA investment firms at certain intervention points when they run into difficulties, and what they can expect from us.
- Introduce an ICARA Questionnaire reporting template.
- Establish how we will set FCA requirements following our review of an FCA investment firm's ICARA, if this is necessary.

Terminology

7.6 Our proposals in this chapter are commonly referred to under Basel Committee of Banking Supervisors (BCBS) terminology as 'Pillar 2'. This is also a term used in our existing IFPRU rules ('The overall Pillar 2 rule'). With the introduction of the IFPR and the move away from a deposit-taker focused prudential regime, we are taking the opportunity to move away from BCBS terminology.

7.7 The firm's responsibilities for risk management under 'Pillar 2' will be the 'ICARA process'. Any further amounts that need to be held on top of the PMR, FOR or KFR from MIFIDPRU 4 will be an 'additional own funds' requirement. And any further liquid assets needed on top of the basic liquid asset requirement will be an 'additional liquid assets' requirement. The total own funds or liquid assets that the firm needs to hold to meet threshold conditions will be its 'threshold requirement'.

Introduction of the Overall Financial Adequacy Rule

7.8 Every FCA-authorised firm must meet threshold conditions, requiring firms to have appropriate resources (see COND 2.4 Appropriate resources in the FCA handbook).

This means an authorised firm's financial and non-financial resources must be appropriate to the regulated activities it carries on or seeks to carry on.

7.9 We propose to introduce the Overall Financial Adequacy Rule (OFAR). This establishes the standard we will apply to determine if an FCA investment firm has adequate financial resources. OFAR will require an FCA investment firm, at all times, to hold adequate own funds and liquid assets to:

a. to ensure it can remain viable throughout the economic cycle, with the ability to address any potential harm from its ongoing activities; and,
b. to allow its business to wind-down in an orderly way

7.10 Our proposals therefore provide an objective link between the financial resources an FCA investment firm holds under its IFPR requirements, and its threshold conditions.

7.11 We propose to monitor this by introducing the 'own funds threshold requirement' and 'liquid assets threshold requirement'. FCA investment firms will determine these requirements through their ICARA process. These will represent the FCA investment firm's view of what is required to meet the OFAR, unless we advise it otherwise. Not meeting these requirements would be evidence that the FCA investment firm had breached our threshold conditions.

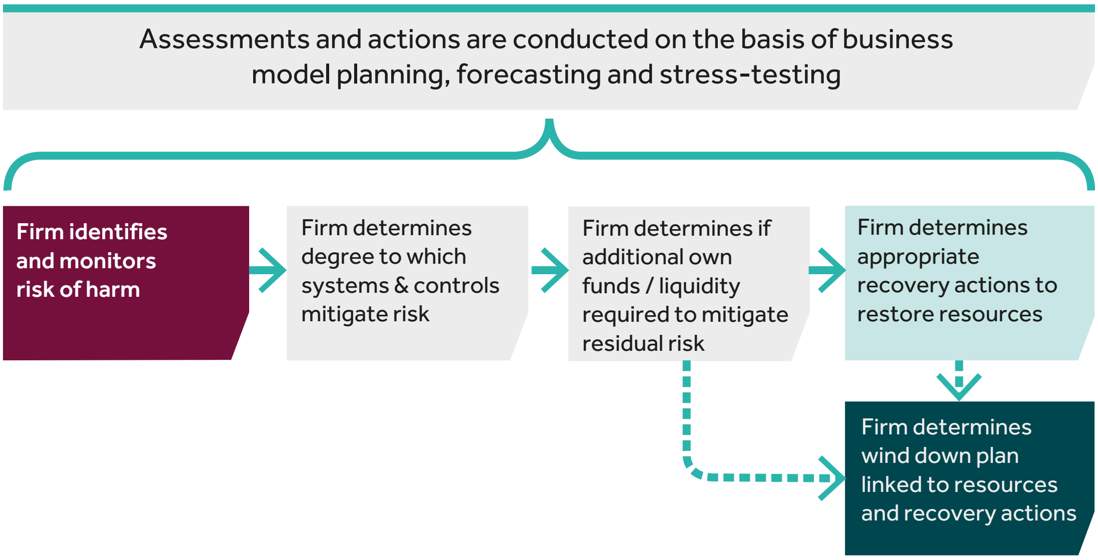
7.12 We will expect the FCA investment firm to take action to address any breach. We may also make specific interventions. If these prove ineffective, we will expect the FCA investment firm's governing body to determine it is unable to meet its threshold conditions and should begin winding down.

ICARA process: Overview

7.13 We are proposing to introduce a requirement for all FCA investment firms to undertake an ICARA. The ICARA will be the centrepiece of an FCA investment firm's risk management and will be a continuous process through which it should:

- **Identify and monitor harms**: Operate systems and controls to identify and monitor all material potential harm.
- **Undertake harm mitigation**: Consider and put in place appropriate financial and non-financial mitigants to minimise the likelihood of crystallisation and/or impact of the material harm.
- **Undertake business model assessment, planning and forecasting**: Forecasting capital and liquidity needs, both on an ongoing basis and were they to have to wind-down. This must include expected- and stressed-scenarios.
- **Undertake recovery action planning**: Determine appropriate and credible recovery actions to restore own funds or liquid resources where there is a risk of breaching threshold requirements tied to specific intervention points.
- **Undertake wind-down planning**: Set out at entity-level credible wind-down plans, including timelines for when and how to execute these plans.
- **Assess the adequacy of own funds and liquidity requirements**: Where, in the absence of adequately mitigating risks through systems and controls, the FCA investment firm assesses that additional own funds and liquid assets are required to cover the risk.

Overview of the ICARA process



7.14 We propose that the assumptions behind an FCA investment firm's ICARA process and its findings should be consistent and coherent. Any assumptions must make sense internally to the ICARA process and any findings should not be considered in isolation. This will help ensure the ICARA process is effective.

Example

7.15 An FCA investment firm conducts a stress-test and finds that it will breach its own funds requirement during a mild economic downturn. If it does not account for this as part of its capital management planning and its recovery planning, the assumptions in its ICARA process will not be consistent.

7.16 An FCA investment firm that links its wind-down planning to specific indicators of success or failure in its recovery actions would demonstrate that the assumptions used in its ICARA process are consistent and coherent.

7.17 We propose that the FCA investment firm's governing body will document and sign off this process annually. We are consulting on specific arrangements that will apply to investment firm groups.

7.18 The ICARA process will replace the current Internal Capital Adequacy Assessment Process (ICAAP) for FCA investment firms that are currently subject to IFPRU and BIPRU.

Identifying harm

7.19 We propose that an FCA investment firm's responsibilities under the ICARA will be to monitor and address both risks that it faces, and harm it can pose to clients, counterparties and markets.

7.20 Our conceptual view of harm is set out in 'Our Mission 2017: How we regulate financial services'. FG20/1 explains that identifying and assessing the potential harm to consumers and markets is a fundamental part of assessing adequate financial resources.

7.21 Our expectations for FCA investment firms when identifying harm will be proportionate to the amount of harm posed. This means that we will expect SNI firms to do a lower level of analysis than we would expect from non-SNI firms. We expect that the larger trading firms will carry out a significant amount of analysis.

7.22 We have provided examples in Annex 1 of MIFIDPRU 7 of the types of potential harm that firms should consider.

Risk mitigation

7.23 It is not possible or appropriate to mitigate every risk an FCA investment firm faces or harm it can pose to clients and markets. However, we do expect them to have considered, through the ICARA process, the appropriateness of different measures – financial and non-financial – they can take.

7.24 It is likely that some FCA investment firms, if not most, will decide that non-financial mitigants alone are will not appropriately address risks to their soundness or the crystallisation of harm. We expect all firms to have appropriate systems and processes in place to make this decision.

7.25 The application, and our expectations, will vary on a proportionate basis, reflecting the level of potential harm posed. We still expect that all FCA investment firms to approach this assessment using the following steps:

- considering the risks before any controls are taken into account
- assessing the significance of the risks and what controls are in place to mitigate them
- assessing how much residual harm remains after applying the controls, and determine the necessary financial mitigants on that basis

7.26 Our proposed guidance recognises that an FCA investment firm may make use of non-financial mitigation where appropriate. This includes:

- implementing additional internal systems and controls
- strengthening governance and oversight processes
- changing how it undertakes certain lines of business

The application and appropriateness of these measures should reflect the FCA investment firm's risk appetite.

7.27 For example, an FCA investment firm that is particularly dependent on an IT platform for its revenue generation might improve its back-up systems and servers to increase its resilience and minimise the risk of outages. Whereas one that has identified that it is at particular risk of money laundering, and consequent regulatory penalty and sanction, might put additional oversight and checks in place to strengthen its anti-money laundering processes.

7.28 An FCA investment firm may find that a residual risk of harm remains in spite of the mitigation it has put in place. It then should decide if it should hold additional own funds and liquid assets, above the minimum requirements, to mitigate this.

Business model assessment, forecasting and stress-testing

7.29 The purpose of an FCA investment firm setting out its business model and strategy is to help it, and us, understand its vulnerabilities as a profit-generating operation. Risks posed to an FCA investment firm's capacity to generate sustainable profits have a clear impact on its ability to maintain adequate financial resources.

7.30 We propose that it is not enough for an FCA investment firm to only consider the impact of a business model and strategy on its current and future cash-generative powers. We also expect it to identify misalignments between the business model and the interests of clients and the wider market. This is directly linked to one of the prudential drivers of harm identified in FG20/1 – if a business model can only be cash-generative through activities that boost returns at the possible expense of consumers' interests, for example through portfolio churning to boost fees, we are likely to consider this unacceptable. In such cases, we would expect the FCA investment firm's senior management to have already reached the same conclusion.

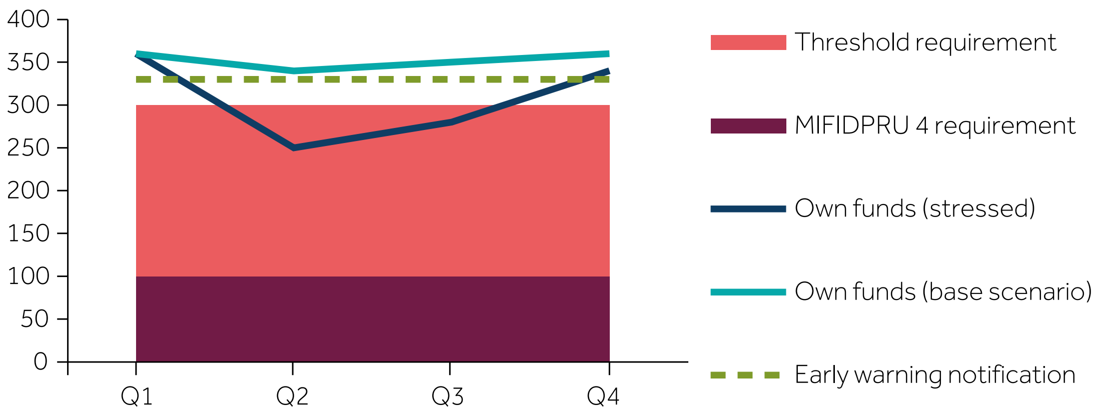
7.31 Our proposals will require FCA investment firms to conduct a forward-looking assessment of capital and liquidity requirements as part of business, capital and liquid assets planning. This must include an assessment of how a severe but plausible economic or idiosyncratic stress could affect the its ability to meet the OFAR. FCA investment firms should set out the assumptions that underpin their chosen scenarios, and the impact on individual business lines and portfolios, as well as the firm overall.

7.32 The following gives an example of how an FCA investment firm might consider its own funds resources and requirements under a scenario of economic stress.

An example of the impact of economic stress

	Base case forecast				Stressed scenario			
£m	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
CET 1 Capital	360	340	350	360	360	250	280	340
MIFIDPRU 4 requirement	100	100	100	100	100	100	100	100
Additional requirement	200	200	200	200	200	200	200	200
Threshold requirement	300	300	300	300	300	300	300	300
Capital surplus (deficit)	60	40	50	60	60	-50	-20	40
Own funds ratio	120%	113%	117%	120%	120%	83%	93%	113%

Capital Stress scenario (£m)



The FCA investment firm has determined that its total own funds requirement is £300m. It holds £360m of own funds in Q1 then experiences a decrease in capital in Q2.

In the stressed scenario, the increase is larger and causes a breach of its threshold requirement from which it does not fully recover until Q4.

The FCA investment firm should account for this in the ICARA process through management actions, controls, or own funds it would apply to mitigate the impact of this scenario.

7.33 For larger or more complex businesses, for example, larger trading FCA investment firms, we are also proposing that they conduct reverse stress testing. We expect them to identify a range of adverse circumstances that would cause their business model to become unviable, and to assess the likelihood these will occur. Where this risk is found to be higher than the FCA investment firm's risk appetite, we would expect it to take steps to mitigate it. This may include making appropriate changes to its business model or operating model.

7.34 Annex 1 to MIFIDPRU 7 includes guidance on the types of potential harm FCA investment firms might need to consider.

Recovery planning

7.35 We propose that FCA investment firms should identify appropriate recovery actions as part of the ICARA process that will:

- help them to avoid a breach of the OFAR
- restore compliance with the OFAR where it is breached

7.36 We expect all FCA investment firms to do recovery planning. It covers identifying quantitative and, if appropriate, qualitative indicators that provide an early identification that the firm is running into capital and/or liquidity/funding difficulties. It also covers setting out credible management actions the FCA investment firm will take, linked to these indicators, to try to improve the situation.

7.37 Recovery planning needs to be linked to the firm's own business model forecasting and scenarios. We expect FCA investment firms to consider how they would recover from a credible stressed scenario and prepare accordingly.

7.38 To be credible, a recovery action must have a reasonable likelihood of success in the context of the anticipated wider economic and business environment. But it must also set out the required governance arrangements to allow for executing the recovery action, and likely impediments to it such as requiring regulatory clearance to go ahead. A credible recovery plan will also set out what success looks like. This is important as we will expect FCA investment firms to begin carrying out their wind-down plans where they have exhausted all credible recovery actions without success. We expect the ICARA to set out the assumptions underpinning recovery plans accordingly.

7.39 We recognise that there may be a considerable overlap between the recovery planning requirements set out for firms as part of their ICARA process and the current requirements in IFPRU 11. The Treasury published a consultation on the application of the UK resolution regime (including the IFPRU 11 requirements) to FCA investment firms in February 2021. As a result, we may amend our proposals to integrate the recovery planning requirements within the ICARA process. In our third consultation due in Q3 2021, we will set out in detail our planned approach for all the elements of IFPRU 11, once the outcome of the Treasury's consultation is clear.

Wind-down planning and triggers

7.40 The purpose of wind-down planning is to identify the scenarios that may lead to an FCA investment firm having to wind-down, and how under those scenarios it would do so. The intention is to reduce the impact of an FCA investment firm's exit from the market on its clients and the wider markets it serves. This includes inability to pay redress, inability to return or transfer client assets and money or to interrupt continuity of service.

7.41 We propose that FCA investment firms will, through their wind-down plans:

- identify the steps and resources needed to ensure the orderly wind-down and termination of their business over a realistic timescale
- evaluate the potential harm from winding down and actions required to mitigate this
- apply consistent assumptions between these steps and other elements of the ICARA process, including business model forecasting and scenarios

7.42 Our expectations for wind-down planning for FCA investment firms reflect our recently-published guidance 'Wind-Down Planning Guide and Finalised Guidance' (March 2021).

7.43 Wind-down planning should also be reflected in the level of own funds and liquid assets the firm determines are necessary to ensure an orderly wind-down (for the purposes of the overall financial adequacy rule).

7.44 We propose to introduce an 'own funds / liquid assets wind-down trigger'. The own funds wind-down trigger is the higher of an FCA investment firm's FOR, and any amount we set. The liquid assets wind-down trigger is the higher of its basic liquidity liquid assets requirement and any amount we set.

7.45 The concept of wind-down triggers will be new to FCA investment firms, so it is important that they familiarise themselves with our proposals. They are the minimum ring-fenced amount of financial resources that an FCA investment firm should hold at all times to ensure that wind-down can begin in an orderly way.

7.46 These triggers are separate from the Threshold Requirement. However, it is possible that the Threshold Requirement and the wind-down trigger will be the same amount. This would be where we or the FCA investment firm have determined that the FOR and/or the basic liquid assets requirement are enough to meet the OFAR. Please refer to the diagrams in Annexes 3 and 4 to see how we anticipate this working.

7.47 If an FCA investment firm's own funds fall below the own funds wind-down trigger or if its liquid assets fall below the liquid assets wind-down trigger, we would – in the absence of a governing body-level determination of an imminent and credible likelihood of recovery – normally expect that it would start winding-down. This would be preceded by a number of expected actions by the firm and potentially by us (as set out below in the section on 'Interventions').

Assessing the adequacy of own funds and liquid assets

7.48 FCA investment firms should first consider how adequate their controls are when assessing what appropriate risk mitigation techniques can be used to address material harm. The FCA investment firm will need to hold own funds or liquid asset resources to comply with the OFAR where its controls alone are not enough to cover the risk.

7.49 We propose that FCA investment firms will need to consider the extent to which any residual risk is covered by its MIFIDPRU 4 own funds requirements and its MIFIDPRU 6 basic liquid asset requirement, when determining an appropriate level of own funds and liquid assets.

7.50 We will expect an FCA investment firm to compare the nature of the identified risk against what would typically be covered under the relevant requirement. Where it determines this is unlikely to be enough, additional financial resources may be needed. This is likely to be the case where the identified risk of harm is unusual or might be particularly severe. It will also be the case where the particular MIFIDPRU 4 requirement was not intended to address the identified risks. For example, risks from undertaking corporate finance activity are not addressed by any K-Factor. FCA investment firms also need to consider the potential harm from any regulated activities that do not constitute MiFID business and from any unregulated activities, where, in each case, the harm may be material.

7.51 This determination should cover both the FCA investment firm's ability to remain financially viable throughout the economic cycle, and to ensure it can wind-down in an orderly way.

Determining the own funds threshold requirement

7.52 The MIFIDPRU 4 own funds requirements are built around the PMR, the FOR, and, for non-SNIs, the KFR. These requirements serve different purposes. The FOR is a proxy for the amount of own funds we would expect all investment firms to hold to allow them to begin wind-down in an orderly way. The KFR is the amount of own funds required to cover the risk of harm from the ongoing operation of the firm's business. And the PMR is a flat minimum required to underpin the FOR and the KFR. Unlike the FOR and KFR, the PMR does not scale with harm.

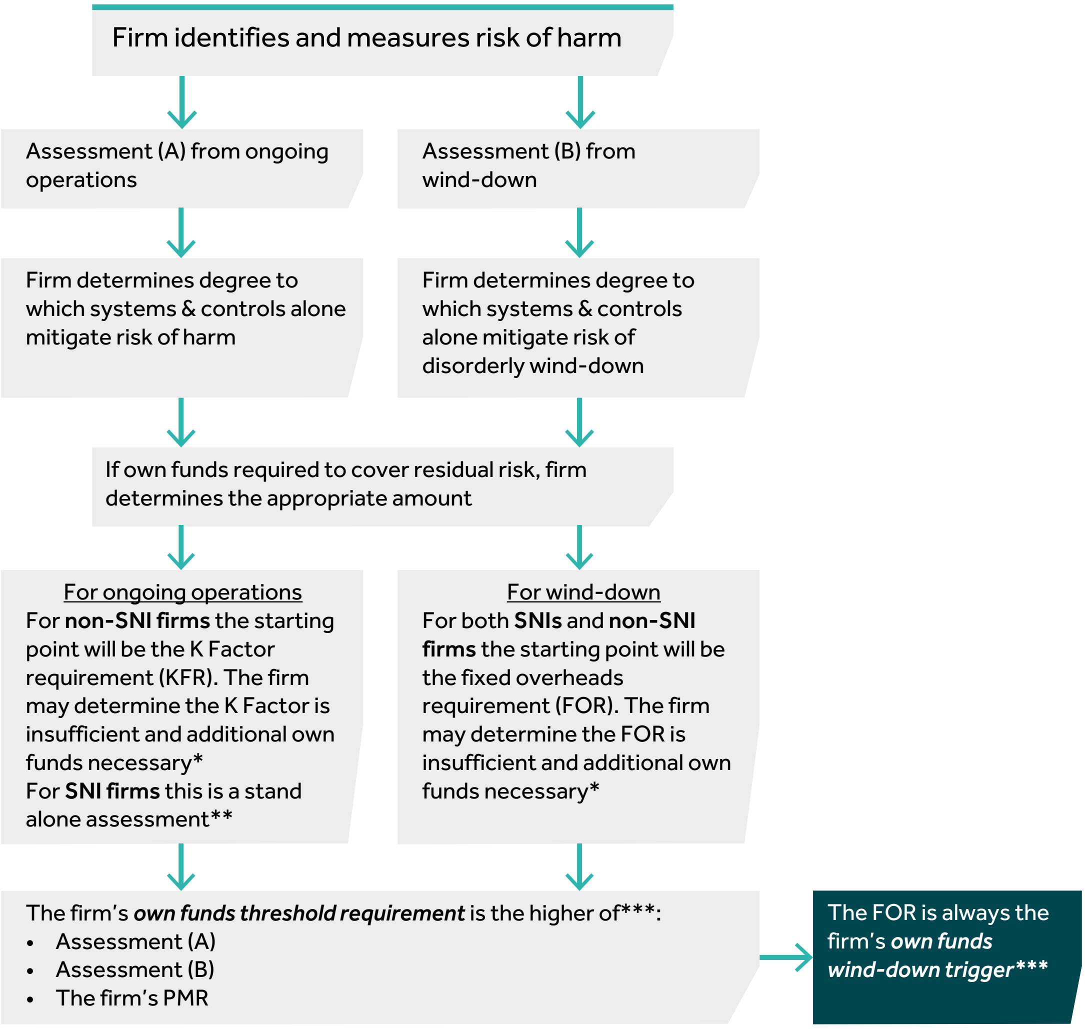
7.53 The PMR and FOR are standard requirements that apply to all FCA investment firms. The KFR is a standard requirement that applies to non-SNI firms. Meeting these alone may not be enough to mean that they are meeting threshold conditions. This will depend on the size, business model and complexity of the FCA investment firm's activities.

7.54 We propose that an FCA investment firm will need to estimate the financial impact of any harm that is not covered by its PMR, FOR or KFR. This will help it to determine the overall amount of own funds it will need to hold to meet the OFAR. This will be its 'own funds threshold requirement' and it will need to meet this requirement at all times. If it does not we propose that it will be in breach of threshold conditions.

7.55 We propose that FCA investment firms will set their own funds threshold requirement at the higher of the i) PMR, ii) own funds necessary to cover harms from ongoing operations, or iii) own funds as necessary for wind-down. We may set this as a higher amount. Diagram 1 shows the process for this.

7.56 SNIs also need to consider the risk of harm from the ongoing operation of their business. If the SNI decides this harm can only be mitigated by holding own funds greater than the PMR or FOR, this becomes its own funds threshold requirement.

Diagram 1: Process for calculating the own funds threshold requirement



* The own funds threshold requirement cannot be lower that the KFR or the FOR.
** The KFR does not apply to SNI firms and the PMR is not linked to harm.
*** Unless we specify otherwise.

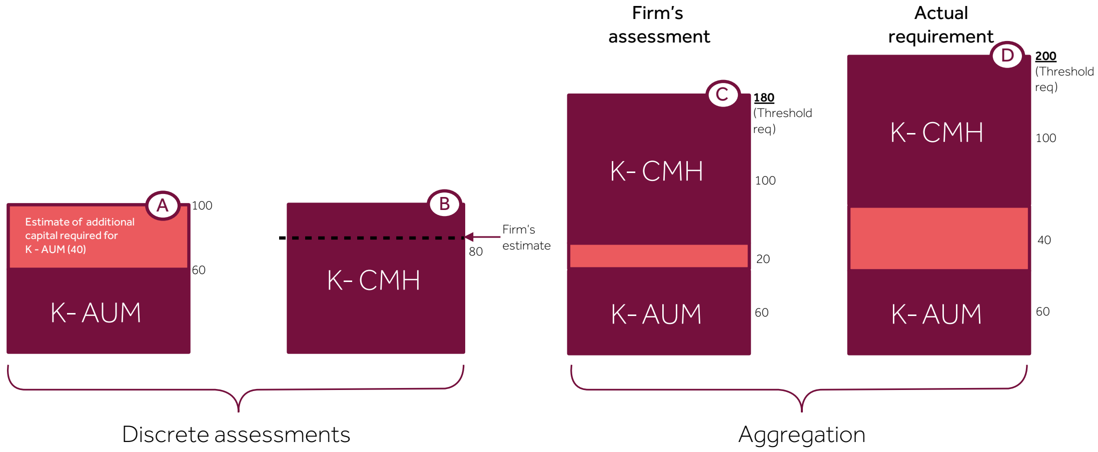
7.57 We do not propose to allow:

- a firm to determine that its own funds threshold requirement is lower than its minimum binding requirement from MIFIDPRU 4
- the firm to attribute the component parts of its KFR to address other sources of harm

7.58 An FCA investment firm may determine internally that a particular requirement is too high for the given source of harm. Under our proposals we will not allow its determination of any 'excess' to be used to address other sources of harm. Each component of the KFR is the minimum that we believe is necessary to address that source of harm, and we do not propose to allow it to be used for other purposes.

7.59 Diagram 2 below illustrates how we expect firms to take this into account.

Diagram 2: Showing that FCA investment firms cannot take account of any 'excess' they have identified



(A) An FCA investment firm has assessed that its K-AUM requirement is not enough to address the risk of harm posed by its asset management activities. It decides it is appropriate to hold an additional 40 to address this.

(B) It then assesses that its K-CMH requirement of 100 is excessive for the risk posed in holding client money, in the firm's view 80 would be enough.

(C) Under our proposals the FCA investment firm is not permitted to offset the additional own funds required for the AUM risk with its view on the excess required for the CMH.

(D) It must aggregate the K-AUM and K-CMH requirements and the additional identified as necessary for AUM.
K-AUM 60 + Additional AUM 40 + K-CHM 100 = 200 Threshold Req.
This is because the KFR requirement is a minimum, and each component requirement is discrete from the others.

7.60 The illustrations in Annex 3 provide examples of how non-SNIs and SNIs will go about determining the own funds threshold requirement necessary to meet the OFAR. They also set out how the wind-down trigger (see above) and early warning indicator (see below) are calculated.

7.61 We propose that FCA investment firms should meet any own funds threshold requirement using the same proportions of own funds as set out in MIFIDPRU 3 (see CP20/24), ie at least:

- 75% of the own funds threshold requirement must be met by the sum of common equity tier 1 capital and additional tier 1 capital
- 56% of the own funds threshold requirement must be met with common equity tier 1 capital

Determining the liquid assets threshold requirement

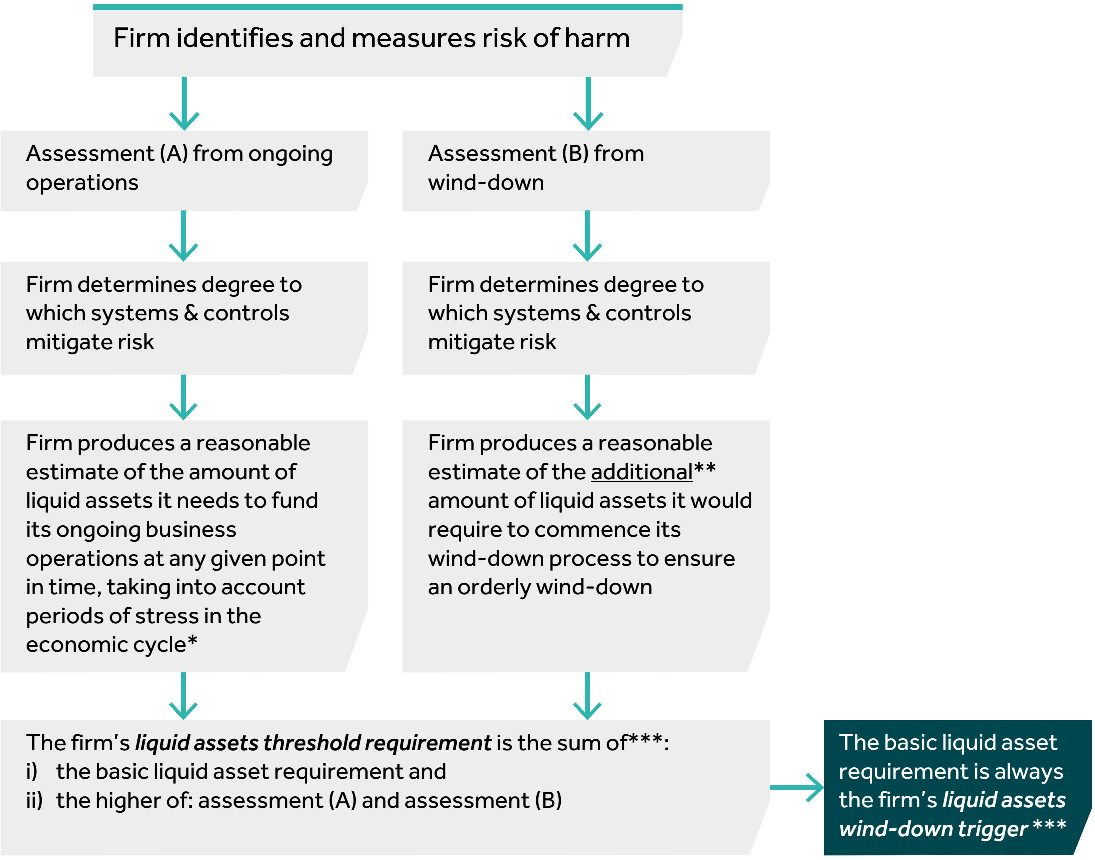
7.62 The basic liquid assets requirement is based on FCA investment firms having a minimum amount of core liquid assets that will allow them to begin wind-down in an orderly manner. Meeting this requirement may not be enough to mean that they are meeting threshold conditions. This will depend on the size, business model and complexity of the FCA investment firm's activities.

7.63 We propose that an FCA investment firm will need to determine if it should hold additional liquid assets to fund its ongoing business and ensure it can be wound down in an orderly way. This total amount will be its 'liquid assets threshold requirement' and an FCA investment firm will need to meet this requirement at all times. If it does not it will be in breach of threshold conditions.

7.64 We propose that FCA investment firms will set their liquid assets threshold requirement as the sum of the basic liquid assets requirement and the higher of:

- the additional liquid assets necessary at any given point in time to fund ongoing operations, taking into account potential periods of financial stress during the economic cycle
- the additional liquid assets required to begin its orderly wind-down, taking into account inflows of liquid assets that can be reasonably expected to occur during the wind-down period

Diagram 3: Process for calculating the liquid assets threshold requirement



* FCA investment firms are reminded that when they assess the amount of liquid assets they need for ongoing operations they cannot use the value of the core liquid assets to meet the basic liquid assets requirement.

** The basic liquid assets requirement may not be enough to provide the liquid assets the FCA investment firm has assessed as necessary to facilitate orderly wind-down. It may need to hold an additional amount of liquid assets for its funding needs at the start of the wind-down process.

*** Unless we specify otherwise.

Liquid assets to fund ongoing operations

7.65 When assessing the amount of liquid assets required to fund its ongoing business operations, an FCA investment firm should consider, among other factors:

- the basic level of liquid assets that would typically be required to operate the firm's underlying business
- any material harms that may realistically occur during the next 12 months and their potential impact on the firm's liquidity position
- any liquid assets that a firm may need to use as collateral or to meet margining requirement
- any estimated funding gaps including during periods of stress

7.66 The liquid assets an FCA investment firm requires at any given time may fluctuate. This depends on the timing of a firm's expected liabilities and the nature of its business. Therefore, a firm should divide the 12-month period after its ICARA assessment date into quarters and assess the highest amount of liquid assets that it would require at any given time in each quarter.

7.67 We recognise that forecasts of the liquid assets required may become less accurate for later quarters. However, we expect FCA investment firms to use a 12-month time horizon in the ICARA process to ensure it gives enough attention to potential harms and significant liquidity outflows that may occur during that period. It should also adequately assess how it aims to mitigate them by holding additional liquid assets to cover potential shortfalls. The proposed ICARA Questionnaire (MIF007) will require firms to input their liquid assets values for each of the forthcoming quarters.

7.68 The purpose of the basic liquid assets requirement is to ensure that an FCA investment firm always has a minimum stock of liquid assets to fund the initial stages of its wind-down process if needed. So they cannot use the value of the core liquid assets that they hold to meet the basic liquid assets requirement for the liquidity needs of their ongoing business.

7.69 We propose that an FCA investment firm's liquid assets threshold requirement, cannot be lower than the basic liquid assets requirement.

Non-core liquid assets

7.70 Our proposals for core liquid assets to meet the basic liquid asset requirement are described in Chapter 6 of this CP. We also propose in MIFIDPRU 7 to introduce the concept of non-core liquid assets. These are liquid assets that are not core liquid assets, but can still easily and promptly be converted into cash, even in stressed market conditions. Examples include liquid non-UK government bonds or other liquid financial instruments. We have proposed guidance on the types of features we expect FCA investment firms to take into account when deciding if an asset qualifies as a non-core liquid asset.

7.71 FCA investment firms will not be able to treat as a non-core liquid asset any asset that:

- belongs to a client
- is encumbered
- is issued by the firm or an affiliated entity

7.72 FCA investment firms will have to consider applying 'haircuts' to determine the value of non-core liquid assets that contribute to meeting the liquid assets threshold requirement. The haircut should reflect the potential loss of value when converting the asset into cash during stressed market conditions. We have proposed guidance on the minimum haircuts we expect FCA investment firms to apply for different types of non-core liquid asset.

7.73 We propose that FCA investment firms will be able to hold any combination of non-core liquid assets and core liquid assets to comply with the portion of the liquid assets threshold requirement that is above the basic liquid assets requirement.

7.74 The illustrations in Annex 4 give examples of how FCA investment firms will go about determining the liquid assets threshold requirement necessary to meet the OFAR. They also set out how the liquid assets wind-down trigger is calculated.

Our approach to notification and intervention

7.75 Our proposals should provide greater transparency for our expectations of the actions we expect FCA investment firms to take in certain situations. These should be supported by and linked to their recovery action or wind-down plan as set out in the ICARA. Our proposals also clarify what firms can expect from us if we feel it necessary to intervene through a supervisory response outside of the SREP. We refer to these as intervention points.

7.76 FCA investment firms should note that the invention points are just a guide for what they can expect from us. We reserve the right to make interventions as we see fit in order to secure our objectives. In most circumstances though, we would expect to follow this framework.

7.77 We propose to introduce notification requirements for FCA investment firms. This will support our supervisory assessment of firms and monitoring of own funds and liquid asset intervention points. They will ensure that we are provided with the necessary information from an FCA investment firm if it meets an intervention point. Our proposals do not replace firms' existing notification obligations and Principle 11 and SUP 15.3.

7.78 We propose that we are notified with the following types of information:

- the FCA investment firm's current resources compared to threshold requirements
- an explanation of why the resources have reached this level
- actions it is taking to address the situation
- its intentions about wind-down (if relevant)

7.79 In our proposed rules we set out the following intervention points and their notifications:

Intervention point	Notification requirement	Intervention actions
Early warning indicator (own funds only)	Sent by the firm when its own funds resources fall to within 110% of the own funds threshold requirement (or as required by the FCA). Provides us with an early warning indication that the firm could be facing risks to its financial resilience.	At this point we would expect firms to have taken any relevant actions in their recovery plan. For example, if a firm's recovery plan identifies that own funds resources falling below 115% of the threshold requirement is a trigger for management consideration of various recovery actions, we would expect to see evidence that this has occurred at this point. If we have specific concerns about the firm's ability to continue to meet its threshold conditions, and the credibility of its proposed response, we may intervene. For example, we may request that aspects of the recovery plan are triggered, that the firm cease discretionary capital distributions, and/or that the firm provide us with enhanced reporting of its situation. The early warning indicator should not be seen as an additional FCA-set own funds requirement. If there is a sound reason for a firm to be within 110% of its threshold requirement, it is sufficient simply that we are informed and kept up-to-date on events. For example, if the firm has identified and accounted for this in scenario planning and/or it is necessary for the purposes of undertaking an important strategic action.
Threshold requirements breach (own funds & liquid assets)	Sent by the firm when its own funds or liquid assets fall below the respective threshold requirement. Makes aware that the firm no longer meets it threshold conditions.	At this point, the focus for us and the firm should very much be on the firm's recovery, unless the firm chooses to exit the market by voluntarily winding down. However, any proposed actions for recovery must be credible and achievable within a reasonable and realistic timeframe. As set out in our proposed rules, at this point we will have expected that the firm will have triggered all relevant recovery actions, and ceased all discretionary distributions and payments. If necessary, we may intervene to secure our objectives, for example through requesting that the firm's parent entity provide additional own funds to the firm, and/or placing restrictions on activities the firm can undertake until its situation improves.
Wind-down trigger (own funds & liquid assets).	Sent by the firm when its own funds resources fall below the FOR, or its liquid assets fall below the basic liquid assets requirements (or other amounts as set by the FCA). Makes us aware that the firm is now making a decision on if to wind-down.	To maximise the potential for an orderly wind-down, we will expect a firm that breaches this trigger normally starts winding down immediately, according to its wind-down plan. If necessary, we may intervene in order to secure our objectives, for example through taking action to protect any client money or client assets, and/or preventing the firm from continuing to carry on regulated activities.

Reviewing and documenting the ICARA process

7.80 We propose that FCA investment firms review their ICARA process at least once every 12 months. They should also review this immediately following a material change in their business model or operating model. We expect larger or more complex FCA investment firms to consider if a half-yearly review basis is more appropriate.

7.81 We also propose that this review is documented by the FCA investment firm in an 'ICARA document'. This document must contain:

- A clear description of its business model and strategy.
- An explanation of the activities it carries out, with a focus on the most material activities.
- An explanation of why it has concluded its ICARA is fit for purpose. Or, where this isn't the case, an explanation of the deficiencies identified, the steps taken to remedy them, and who is responsible for implementing any remedies.
- An explanation of any other changes to the its ICARA process that have occurred following the review and the reasons for those changes.
- An analysis of the effectiveness of its risk management processes during the period covered by the review.
- A summary of the material harms it has identified and any steps taken to mitigate them.
- An overview of its business model assessment and capital and liquidity planning.
- An explanation of how it is complying with the OFAR. This should include a clear break-down at the review date of available own funds, available liquid assets, and its assessment of its threshold requirements.
- A summary of any stress testing and reverse stress testing it has carried out.
- An overview of its wind-down planning, including any key assumptions or qualifications.

Governance and Senior Manager oversight of ICARA

7.82 It is important that senior management's responsibility for the ICARA process is clearly understood. Under our proposals, the ICARA process is central to an FCA investment firm's management of the risks that they face and pose to others. The ICARA process brings together planning and forecasting, risk identification, assessment and mitigation, recovery and wind-down planning. It is the responsibility of the FCA investment firm's senior management to ensure the process meets our expectations. We will hold senior management and governing bodies responsible for this, and our proposals clarify FCA investment firms' risk management responsibilities under SM&CR.

7.83 We propose that the FCA investment firm's governing body must review and approve the content of the ICARA document within a reasonable period after the review has been completed.

7.84 Because we view the ICARA process as a key requirement of the regulatory system for investment firms, we expect that Senior Managers will take an active role in contributing to the required analysis and embedding the requirements in their business areas. We refer these staff to the relevant provisions in COCON, specifically COCON 3 and 4.

The ICARA Questionnaire

7.85 We propose to replace the Pillar 2 reporting template (FSA019) with the ICARA Questionnaire reporting template (MIF007 – see Chapter 13). This Questionnaire will only require FCA investment firms to report the key information they will have prepared as part of their ICARA process, so the reporting burden will be low. For example, we will be asking for a breakdown of the additional own funds required based on the analysis of harms. The Questionnaire will also ask some questions about the firm's business model so that we can understand more about the business activities of firms, where no changes in regulatory permissions are needed.

7.86 Key dates that firms will need to be aware of in the ICARA process are:

- **The ICARA reference date**: the date on which the underlying data used to carry out the review of the ICARA process were prepared
- **The ICARA review date**: the date on which an FCA investment firm's review of the ICARA process is carried out
- **The ICARA submission date**: the date on which the ICARA Questionnaire (MIF007) is submitted to us

7.87 We expect FCA investment firms to design their ICARA process review and reporting timetables so that the time between the reference date and review date, and the review date and submission date is reasonable. This means the assessment will be robust and using relevant timely data. And that we will receive timely information on the outcomes of the ICARA process.

7.88 We propose to allow FCA investment firms the flexibility, in the first instance, to adopt an ICARA review and reporting timetable that fits best with their internal processes. We will be requiring FCA investment firms to notify us of the date on which they will submit MIF007.

7.89 We reserve the right to specify that an FCA investment firm uses a different submission date if we do not feel that we are receiving the ICARA Questionnaire in a timely manner. An FCA investment firm will be able to notify us to amend the submission date as long as there is not more than 12 months between submissions. Firms should also resubmit MIF007 before their next annual submission if there is a significant change in its business or operating model, or due to external factors.

7.90 We are considering introducing additional reporting templates to complement the ICARA Questionnaire. These would be used when we have concerns about an FCA investment firm's prudential position or where our peer analysis indicates outliers. An example is a template that asks FCA investment firms to report a breakdown of their core and non-core liquid assets balances by types of liquid asset. Any additional reporting forms will be consulted on in the usual way.

Record keeping requirements

7.91 We propose that FCA investment firms keep adequate records, for at least 3 years from the date on which the relevant document was finalised, of their ICARA documents. We also propose they keep documentary evidence of the review and approval of the ICARA document by their firm's governing body for the same amount of time.

Firms forming part of a group

7.92 Many FCA investment firms are part of larger groups and some groups may contain several investment firms. The ICARA process should be consistent with the basis on which they manage their business and risks on a day-to-day basis. So we propose that FCA investment firms which are part of investment firm groups (as defined in our rules) have the option to conduct the ICARA process on a group-basis, unless we give specific direction otherwise, if that reflects their wider risk management framework. If we are not satisfied with how the ICARA process is being operated or documented on a group level, we may ask for it to be done at an individual FCA firm basis. A group to which MIFIDPRU 2.5 applies is not required to operate the ICARA process on a consolidated basis.

7.93 In any case, each FCA investment firm must still comply with the OFAR on an individual basis and any additional own funds or liquidity resources required should be allocated to the individual entities. Each entity must also have its own specific wind-down plan including wind-down triggers. Own funds and liquidity intervention point notifications will also apply on an entity basis.

7.94 As part of their ICARA process, FCA investment firms should also consider any material risks from membership of their group. Where risks are managed on a group basis, the risk management must be done either by an entity which is subject to MIFIDPRU (whether the firm itself or another MIFIDPRU investment firm in the group) or the firm's UK parent entity. It cannot be undertaken by another type of regulated or unregulated firm

7.95 The ICARA document must be approved by the governing body of the entity which carries out the risk management. Groups with multiple FCA investment firms can produce 1 combined ICARA document that sets out how risks are managed on a group and individual-entity basis. It should also explain how each individual-entity complies with the requirements that are applied to it. This includes how each individual-entity complies with the OFAR and its wind-down planning. This is because the solvency of FCA investment firms is assessed on this basis, and wind-down happens on an individual-entity basis.

Supervisory Review and Evaluation Process (SREP)

7.96 We are changing the way we do many things as part of Transformation, including how we assess firms' prudential standing. Assessing whether an FCA investment firm continues to meet threshold conditions is an important role of supervision and the SREP is one of our key tools for assessing its compliance with the OFAR under the IFPR. We use the SREP to carry out the prudential aspects of our strategic objective – to ensure that relevant markets function well – and to meet our 3 operational objectives.

7.97 With the introduction of the IFPR, we propose to re-orientate our approach to SREP. We propose to move away from a minimum SREP cycle for most FCA investment firms currently subject to one. Instead we will use a harm-led approach. We will gather intelligence from a range of sources, not least through benchmarking of FCA firm reporting and the data provided in the ICARA Questionnaire. We may still apply a minimum SREP cycle to certain firms which present a higher risk of harm. We may also undertake multi-firm review work (eg sectoral reviews) in line with our priorities.

What firms can expect from us

7.98 When conducting a SREP, we propose to normally consider information from the ICARA document, as well as any other relevant information provided by the FCA investment firm. This could be from reporting, by interviews with the firm or other information we may request for the purposes of the SREP.

7.99 We propose to consider a variety of factors as part of the SREP, such as:

- the extent to which the FCA investment firm's risk management framework defines its risk appetite
- the FCA investment firm's governance, including whether there are clear lines of accountability and evidence of appropriate senior management involvement
- whether the FCA investment firm has appropriately identified and assessed the materiality of the harm that may arise from its ongoing operations and from a disorderly wind-down
- whether the FCA investment firm has adequate systems and controls in place to monitor and manage the risks from its business
- the FCA investment firm's integration of its ICARA process into its day-to-day decision making
- whether the FCA investment firm has adequate own funds and liquid assets to comply with the OFAR
- whether the FCA investment firm's capital and liquidity planning and business model analysis (and, where applicable, more detailed stress testing and reverse stress testing) is based on plausible and relevant scenarios, linking to our expectations on the consistency and coherence of the ICARA process
- whether the FCA investment firm's wind-down planning assessment is adequate, contains a clear explanation of the key steps needed to ensure an orderly wind-down, and is based on realistic assumptions

7.100 A SREP may be more or less extensive, depending on the nature of our concerns and the potential degree of risk posed by the FCA investment firm or group. In certain cases, we may decide to limit our review to only some of the information and factors that we would normally consider.

When and how we will set additional requirements

7.101 Once the SREP is complete, we propose to consider whether any action is needed to ensure an FCA investment firm

- is complying with the OFAR
- is appropriately managing its risks
- does not have a funding profile that indicates that there may be a significant liquidity mismatch between amounts payable and receivables
- has adequate plans in place to prevent a disorderly wind-down.

These actions may involve issuing guidance or placing additional requirements on the firm.

7.102 The actions that we may take include:

- requiring an FCA investment firm to hold additional own funds or liquid assets
- directing an FCA investment firm to implement new risk management or governance arrangements

- imposing additional reporting requirements on a firm
- directing an FCA investment firm to hold an own funds or liquid assets in excess of the amounts necessary to comply with the OFAR
- withdrawing a permission previously granted under MIFIDPRU to apply a specific treatment such as a K-CMG permission, or a permission to use an internal model for the purposes of the K-NPR requirement
- requiring the firm to adopt a different wind-down trigger

7.103 If we conduct a sectoral review, we may specify an additional amount of own funds or liquid assets that all FCA investment firms in that sector should hold, or other measures, without conducting an individual SREP for each one.

7.104 Following a SREP we will let the FCA investment firm know if we are placing any additional requirements on it and why we are. These requirements may include specifying the amount of own funds or liquid assets that the FCA investment firm must hold to meet the OFAR. This amount will become its own funds or liquid assets threshold requirement.

7.105 If subsequently, as part of the ICARA process, the FCA investment firm assesses that it should hold a higher amount of own funds or liquid assets, this amount will become its threshold requirement. FCA investment firms are still required to meet the OFAR at all times.

7.106 We may specify an own funds or liquid asset threshold requirement which exceeds those identified by the FCA investment firm in situations that include:

- its business may result in material harm that has not otherwise been adequately mitigated
- the way it operates its business suggests that there is a significant risk that it will fail to comply with the OFAR within a reasonable period
- its funding profile indicates that there may be a significant liquidity mismatch between amounts payable and receivables
- its wind-down plan does not contain realistic wind-down triggers
- we have significant concerns over its risk management

7.107 We propose that we may set an own funds threshold requirement as:

- a percentage of the firm's MIFIDPRU 4 own funds requirement,
- a requirement based on applying a modified co-efficient to one or more K-factor metrics for the purposes of the KFR
- a fixed amount

7.108 An FCA investment firm must meet its basic liquid assets requirement using core liquid assets. We propose that usually the liquid assets threshold requirement can be met using core and non-core assets. However, in some cases, we may require an FCA investment firm to meet all or part of its liquid assets threshold requirement with a more limited subset of liquid assets or for it to apply modified haircuts to non-core liquid assets.

7.109 We propose that any additional requirements following a SREP may be set by individual guidance or by applying a requirement to the FCA investment firm. Where possible, we will invite the FCA investment firm to apply for a voluntary requirement (VREQ). We reserve the right to use an own initiative requirement (OIREQ).

7.110 Other actions we may take, depending on the concerns we have, include varying or cancelling some or all of an FCA investment firm's permissions, imposing a requirement on a parent undertaking, or requiring a report by a skilled person.

How requirements will be updated

7.111 An FCA investment firm's business model may change significantly, meaning the requirement we specified no longer aligns with the amount of own funds or liquid assets that the firm requires to comply with the OFAR. In this case, the FCA investment firm should reassess its threshold requirements and may contact us to request a review. If we update the review and then agree with the FCA investment firm's assessment, we may remove or amend the FCA-specified requirement.

Transition

7.112 FCA investment firms that have been set Individual Capital Guidance or Individual Liquidity Guidance should contact us to discuss how they can transition to the new threshold requirements.

Bringing this all together – our expectations

7.113 Our proposals are a significant change from the current approach. It may take FCA investment firms time to adapt to the changes and new expectations. We may decide that additional rules and/or guidance are required, both following feedback to this consultation and after the rules have come into force, based on the experience we and investment firms have adapting to the new approach.

7.114 Diagram 4 is intended to help FCA investment firms understand how we see this process coming together. It shows both the discrete and continuous actions that we and they will have to undertake and how they interact. This diagram is illustrative and is not intended to reflect all the aspects of our proposals.

Diagram 4: Actions under the ICARA process

	Firm Actions			FCA Actions
Continuous actions	Firm complies on an ongoing basis with the outcome of its ICARA assessment (MIFIDPRU 7.4).	Firm provides regular regulatory reporting (MIFIDPRU 9).		FCA undertakes continuous monitoring and benchmarking of firm based on regulatory reporting, the Questionnaire, and other relevant sources (MIFIDPRU 7.10).
Discrete actions	Firm undertakes 12-/6-monthly ICARA review to assess the ICARA's compliance with the component elements set out in MIFIDPRU 7 (MIFIDPRU 7.8). This is documented and signed off by the Governing Board (MIFIDPRU 7.10).	Firm notifies the FCA of the outcome of its assessment through submission of the ICARA Assessment Questionnaire (MIFIDPRU 9.2).	Firm notifies the FCA if it is in difficulty and/or has met an intervention point (MIFIDPRU 7.6 & 7.7).	FCA undertakes SREPs based on determined level of harm-posed, at an individual firm- or sectoral-level (MIFIDPRU 7.10).

Questions

Q11: **Are our expectations of firms regarding the ICARA and meeting the OFAR sufficiently clear? If not, which areas would benefit from further clarification?**

Q12: **Is the rationale for and explanation of the own funds and liquid assets wind-down trigger sufficiently clear? If not, which areas would benefit from further clarification?**

Q13: **Do you agree with our proposal to use an early warning indicator?**

Q14: **Do you agree with our proposed approach to the ICARA for firms forming part of a group?**

8 Governance

8.1 Effective internal governance arrangements help a firm to achieve its strategic objectives while also ensuring that risks to the firm, its stakeholders and the wider market are effectively identified, managed and mitigated.

8.2 In this chapter we describe our proposals for:

- internal governance and controls
- which FCA investment firms must establish risk, remuneration and nomination committees
- the composition and role of these committees

Internal governance and controls

8.3 Given the diversity of FCA investment firms, we propose to set out high-level requirements on firms' internal governance to ensure minimum standards in all of them. Under our proposals, all FCA investment firms must have robust governance arrangements that include:

- a clear organisational structure with well defined, transparent and consistent lines of responsibility
- effective processes to identify, manage, monitor and report the risks they are or might be exposed to, or pose or might pose to others
- adequate internal control mechanisms, including sound administration and accounting procedures

8.4 We consider these general requirements are sufficiently flexible to allow each firm to develop and maintain internal governance arrangements appropriate to its legal and ownership structure, business model, the activities it carries out, and the risks the firm is exposed to or might pose to others.

8.5 In meeting these requirements, FCA investment firms must also comply with:

- our proposed rules on risk management (set out in Chapter 7)
- our proposed MIFIDPRU Remuneration Code (set out in Chapters 9 to 12) and any other remuneration rules to which the firm may be subject
- all other relevant requirements in the Senior management arrangements, Systems and Controls sourcebook (SYSC) of our Handbook

8.6 A firm's internal governance and controls should always be appropriate and proportionate to the nature, scale and complexity of the risks inherent in its business model and activities. As part of MIFIDPRU 7, we propose to give guidance on the minimum criteria that an FCA investment firm should take into account. These include:

- whether it is subject to basic, standard or extended remuneration requirements (see Chapters 9 to 12)
- its legal form, including its ownership and funding structure

- whether it is part of a group
- the type of activities for which it is authorised, including their complexity and volume
- its business model and strategy, including risk strategy, risk appetite and risk profile
- its types of clients
- its outsourced functions and distribution channels
- its existing IT systems, including continuity systems

Risk, remuneration and nomination committees

8.7 Establishing committees helps management bodies in their supervisory function. Committees draw on the specific knowledge and areas of expertise of individual management body members. While committees should prepare decisions and make recommendations to the management body in its supervisory function, the management body has overall responsibility.

Firms in scope

8.8 We propose to require the largest non-SNI firms to have risk, remuneration and nomination committees. A non-SNI firm would be subject to this requirement if:

- the value of its on-and off-balance sheet assets over the preceding 4-year period is a rolling average of more than £300m, or
- the value of its on-and off-balance sheet assets over the preceding 4-year period is a rolling average of more than £100m but less than £300m, and it has trading book business of over £150m and/or derivatives business of over £100m

8.9 Our proposal would replace the current requirement for 'significant IFPRU firms' to establish these committees. While the new requirement will mean more FCA investment firms needing to establish committees, we believe it is appropriate and in line with the wider objectives of the IFPR to apply the same rules to all MiFID investment firms meeting the criteria above.

8.10 Similarly, retaining the conditions and thresholds associated with the definition of 'significant IFPRU firm' would mean combining elements of the current prudential regime with those of the IFPR. It would also add an additional layer of complexity to the new regime.

8.11 We would encourage non-SNI firms outside the scope of our proposed requirement to consider whether establishing or maintaining risk, remuneration and/or nomination committees might benefit their internal governance.

Committees at individual entity and investment firm group level

8.12 We propose to require the non-SNI firms in scope of this requirement to establish the 3 committees at individual entity level. This would ensure they provide focused support and advice to the firm's management body.

8.13 We received feedback to our discussion paper, 'DP20/2 – A new UK prudential regime for MiFID investment firms' from industry stakeholders who argued that having committees at individual entity level could result in duplication of structures and tasks, particularly in FCA investment groups with multiple non-SNI firms. They also pointed out that groups frequently manage their risks and remuneration policies primarily at group level, meaning that separate committees in each entity may result in fragmentation and have a negative impact on the FCA investment firm's overall risk management.

8.14 We have listened to this feedback and propose to permit firms to apply to us for a modification of the requirement to establish 1 or more of the committees at individual entity level.

8.15 An FCA investment firm would need to set out in its application why it considers setting up the relevant committee at individual entity level would be unduly burdensome. It would also need to explain how relying on the group level committee would not adversely affect any of the FCA's 3 operational objectives. This may be done by demonstrating that the group level committee meets the composition requirements set out below, and has members with appropriate knowledge, skills and expertise on the individual entity.

8.16 Modifying the committees requirement may also be relevant to FCA investment firms permitted to use the group capital test. This is because 'group level' in this context refers not to the prudential consolidation group but to the UK parent undertaking and its subsidiaries (investment firm group).

8.17 Firms should use our standard waivers and modifications form for these applications.

8.18 We intend to take the following approach to FCA investment firms that are currently 'significant IFPRU firms' and have waivers or modifications of the existing requirements:

- If a firm has an existing waiver or modification that expires before 31 December 2021, it should apply to renew it before the date of expiry. A firm should indicate in its application whether it expects to be in scope of the committees requirement under the new regime. Where this is the case, we will consider whether it is appropriate to grant the waiver or modification so that it transfers to the new regime.
- If a firm has an existing waiver or modification that expires after 31 December 2021, we will transfer it automatically to the IFPR regime. Upon expiry, the firm will need to submit a new application if it wants to continue to rely on the waiver or modification.

8.19 If a significant IFPRU firm no longer requires its waiver or modification because it will not be subject to the committees requirement under the new regime, the waiver or modification will automatically fall away.

8.20 If a firm is not a significant IFPRU firm and expects to be in scope of the committees requirement under the new regime, it may make a waiver or modification application. We would encourage firms to submit their applications as early as possible after summer 2021 to ensure the application can be determined in time for the start of the new regime.

8.21 Our general approach to applications under the IFPR is in Chapter 15.

Composition of committees

8.22 We propose to require firms in scope of the committees requirement to ensure at least 50% of members of each of the 3 committees are non-executive members of the management body. This must include the committee chair. For example, if a committee is composed of the chair and 2 further members, the chair and 1 of the other members must be non-executives. This composition rule would apply to FCA investment firms with legal structures which permit them to have non-executive members of their management body.

8.23 We consider that this would ensure the committees are sufficiently independent from the executive to be able to prepare decisions for and make recommendations to the management body. At the same time, it would not place an undue burden on FCA investment firms to recruit large numbers of non-executives.

8.24 Committees in FCA investment firms outside the scope of the committees requirement would not be subject to this rule on composition.

8.25 We do not propose as part of this consultation to introduce requirements on the diversity of committee members. As part of our broader work on diversity and inclusion, we will consider whether it would be appropriate for us to introduce further requirements on the diversity of management body members.

Role of committees

8.26 Our proposals for a new MIFIDPRU Remuneration Code in Chapters 9 to 12 give examples of how we consider an FCA investment firm's remuneration committee should be involved in establishing, implementing and monitoring the firm's remuneration policies and practices.

8.27 We do not propose to set out the role of each of the committees in more detail, as this should be decided by the FCA investment firm's management body. The UK Corporate Governance Code also provides a guide to standards of internal governance policies and practices.

Senior Manager Functions

8.28 Under the SM&CR, an FCA solo-regulated firm is an Enhanced firm if it meets any 1 of 6 criteria. One of these is being a 'significant IFPRU firm'. 17 Senior Manager Functions (SMFs) apply to Enhanced firms. These include the Chair of the Risk Committee (SMF10), Chair of the Remuneration Committee (SMF12) and Chair of the Nomination Committee (SMF 13). An Enhanced firm must only have an individual approved for an SMF if the role exists in that firm.

8.29 Our proposals may mean that a small number of firms that are not 'significant IFPRU firms' but are Enhanced firms under the SM&CR will need to establish committees. This would mean they would also need to appoint a chair, who would need to be approved as an SMF10, SMF12 or SMF13.

8.30 Firms should note that anyone who is to perform an SMF needs to be approved by us before they can start their role. You can find more information, including how to apply for approval of an SMF, on our SM&CR webpage for solo-regulated firms.

Consequential changes to internal governance rules

8.31 Some sections of SYSC contain governance requirements which overlap with or are closely related to our proposals on internal governance and committees. Many of the provisions apply to only some MIFIDPRU firms, for example those currently classified as significant IFPRU firms or BIPRU firms. Some also apply to other types of firms we regulate, such as banks and designated investment firms.

8.32 In our next IFPR consultation we will propose changes to the SYSC governance requirements which result from our proposals in this CP and CP20/24. This may include replicating in or moving some provisions into MIFIDPRU 7.

Q15: **Do you have any comments on our proposals for high-level rules on internal governance and controls?**

Q16: **Do you agree with our proposals to require certain non-SNI firms to have a risk committee, remuneration committee and nomination committee?**

9 MIFIDPRU Remuneration Code: scope and application

9.1 In this chapter, we set out the proposed scope and application of our new remuneration regime for FCA investment firms. The draft rules and guidance are in SYSC 19G and in the revised version of our General guidance on the application of ex post risk adjustment to variable remuneration (Appendix 2).

9.2 This chapter covers:

- overview of our approach
- scope and application to firms
- scope and application to individuals

9.3 In Chapters 10, 11 and 12, we cover the remuneration requirements applicable to different categories of FCA investment firms. Firms should read these chapters as follows:

Table 3: Relevant chapters on remuneration by category of FCA investment firm

Category of FCA investment firm	Chapters on remuneration
SNI firms	Chapter 10
Non-SNI firms which do not meet the conditions set out in paragraph 9.22 below	Chapters 10 and 11
Non-SNI firms which meet the conditions set out in paragraph 9.22 below	Chapters 10, 11 and 12

9.4 We set out our proposals for regulatory reporting on remuneration in Chapter 13 on reporting. These are relevant to SNI firms and non-SNI firms.

9.5 We intend to consult on public disclosure of remuneration information in our third IFPR CP.

Overview of approach

What we want to achieve

9.6 Remuneration is a key driver of behaviour for all firms and individuals. Appropriate remuneration policies and practices help support prudential soundness and risk management in firms. They also ensure appropriate outcomes for customers and markets, and so reduce the likelihood of harm.

9.7 The objectives of our proposed approach are to:

- promote effective risk management in the long-term interests of the firm and its customers
- ensure alignment between risk and individual reward

- support positive behaviours and healthy firm cultures
- discourage behaviours that can lead to misconduct and poor customer outcomes

9.8 Most stakeholders who commented on the remuneration aspects of DP20/2 encouraged us to create a remuneration regime for FCA investment firms that is appropriate for the UK market and allows for proportionality between investment firms. We have taken on board this feedback when developing the proposals in this chapter and Chapters 10, 11 and 12.

The MIFIDPRU Remuneration Code

9.9 We propose to create a single remuneration code for all FCA investment firms – SYSC 19G in our Handbook. Our proposed rules and guidance are tailored for FCA investment firms, building on the remuneration provisions in our existing remuneration codes.

9.10 Creating a single remuneration code for FCA investment firms means deleting the IFPRU Remuneration Code (SYSC 19A) and the BIPRU Remuneration Code (SYSC 19C). We will also revoke our non-Handbook guidance documents on these codes:

- FG17/6: General Guidance on Proportionality: the IFPRU Remuneration Code (SYSC 19A)
- FG20/6: IFPRU investment firms Remuneration Code (SYSC 19A) – Frequently asked questions on remuneration
- FG17/7: General Guidance on Proportionality: The BIPRU Remuneration Code (SYSC 19C) and Pillar 3 disclosures on Remuneration (BIPRU 11)

9.11 We also propose to extend the scope of our existing General guidance on the application of ex post risk adjustment to variable remuneration to FCA investment firms.

9.12 We explain in this chapter how firms in scope of both the MIFIDPRU Remuneration Code and the Alternative Investment Fund Manager (AIFM) Remuneration Code (SYSC 19B) or the Undertakings for Collective Investment in Transferable Securities (UCITS) Remuneration Code (SYSC 19E) should apply them.

9.13 The scope, application and content of our rules on staff incentives and the remuneration of sales staff and advisers (SYSC 19F) remain unchanged.

9.14 Following the UK's exit from the EU, the final EBA guidelines on sound remuneration policies under the IFD will not apply to FCA investment firms.

Timing of application

9.15 The proposals on remuneration would enter into force on 1 January 2022. Firms would need to apply the new rules from the start of their next performance year beginning on or after 1 January 2022.

9.16 Firms currently in scope of the IFPRU or BIPRU Remuneration Codes should continue to apply those until 1 January 2022, or the beginning of their next performance year after that date, whichever is later.

Scope and application to firms

SNI firms

9.17 In Chapter 2 of CP20/24, we proposed criteria that an FCA investment firm would need to meet to qualify as an SNI. Our view is that it would be disproportionate to require these smaller, less complex firms to comply with all aspects of the IFPR given they are less likely to cause significant harm to customers and markets.

9.18 We propose to apply this proportionality approach to the MIFIDPRU Remuneration Code by requiring SNI firms to comply with only a small number of remuneration rules. We call them the 'basic remuneration requirements' and explain them in Chapter 10.

9.19 Because they are principles-based, they give firms a high degree of discretion in how they comply with them. Many SNI firms are in scope of the IFPRU or BIPRU Remuneration Codes. This means they are currently subject to more detailed remuneration requirements than we are proposing to apply under the new MIFIDPRU Remuneration Code.

9.20 We consider that applying these requirements to SNI firms will support the overall objectives outlined in paragraph 9.7 above. Given the total number of SNI firms, exempting them from all remuneration rules could negatively impact the prudential and conduct standards of the UK investment firm sector as a whole. This could have implications for customers and the market.

Non-SNI firms

9.21 We also propose to apply proportionality to non-SNI firms to recognise the different risks they pose. For example, some FCA investment firms are categorised as non-SNI firms solely because they are permitted to deal on their own account or hold client money, but their overall size and significance means the potential harms to customers and impacts on the market are more limited.

9.22 We propose that a non-SNI firm is in scope of all the remuneration rules in SYSC 19G if:

- the value of its on-and off-balance sheet assets over the preceding 4-year period is a rolling average of more than £300m, or
- the value of its on-and off-balance sheet assets over the preceding 4-year period is a rolling average of more than £100m (but less than £300m), and it has trading book business of over £150m, and/or derivatives business of over £100m

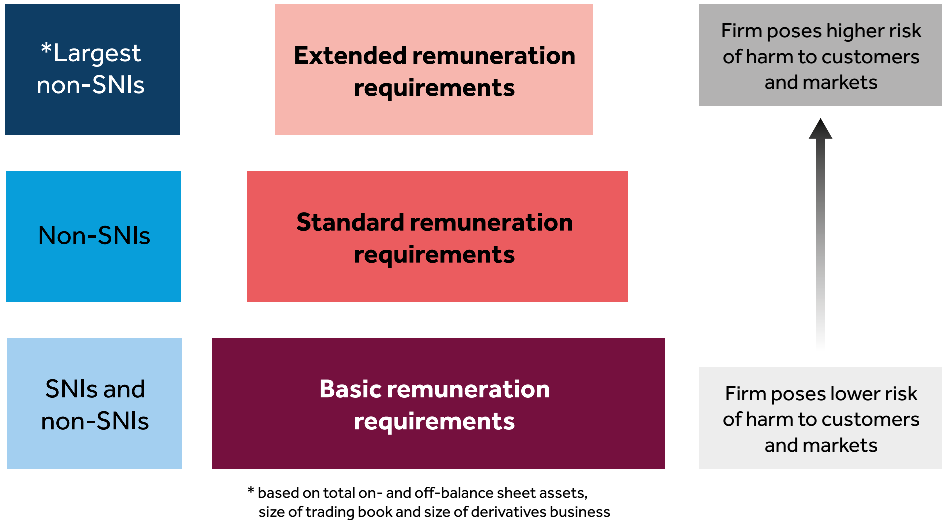
9.23 We summarise these criteria in a flow diagram in Annex 5.

9.24 A non-SNI firm above these thresholds would be in scope of the rules on deferral of variable remuneration, use of non-cash instruments and retention periods. We call these the 'extended remuneration requirements'. We explain them in Chapter 12.

9.25 A non-SNI firm below the thresholds would not be in scope of these more complex remuneration rules. It would be subject to the 'standard remuneration requirements'. We explain these in Chapter 11.

9.26 Nevertheless, we would encourage all firms to consider whether choosing to apply further rules (or parts of them) might be helpful in ensuring effective risk management and providing appropriate incentives for some or all of their staff.

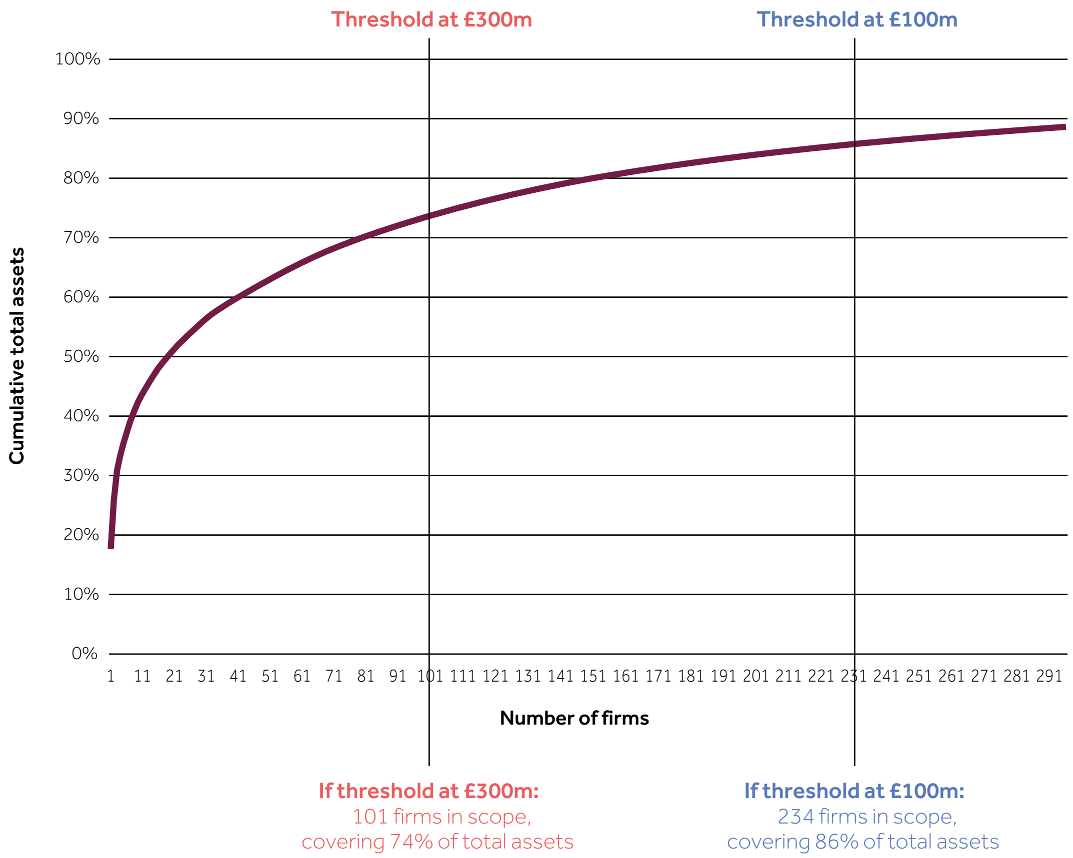
Diagram 5: Overview of application of remuneration requirements



Total assets threshold

9.27 To work out the appropriate place to set the proportionality threshold for non-SNI firms, we looked at how many non-SNI firms would be in scope and the percentage of the total assets in the market that would be covered if we were to set the threshold at £100m or £300m.

Diagram 6: Non-SNIs in scope of extended remuneration requirements under potential thresholds



9.28 By setting the threshold at £300m, we expect around 101 firms to be in scope of the extended remuneration requirements. Together, these firms hold 74% of the total assets in the market. If we were to set the threshold at £100m, more than twice as many firms would be in scope but only an additional 12% of the total assets. This is likely to result in a disproportionate burden on the additional 133 firms in scope because they would be much smaller in terms of total assets.

9.29 The 101 firms in scope are the largest firms whose activities are of a nature and scale that they have greater potential to cause harm to customers and markets. We consider it is appropriate to require them to apply deferral and pay out a portion of variable remuneration in shares/instruments.

Trading book and derivatives business

9.30 If we used the total on- and off-balance sheet assets as the sole criterion, all firms with assets of £300m or below would be out of scope of the extended remuneration requirements. A small number of firms have assets below this level but have significant trading books or derivatives business.

9.31 By also having a requirement to have a trading book value of £150m or less and a derivatives business value of £100m or less, we intend that these firms are also subject to the rules on deferral and pay-out in shares/instruments. This reflects the greater level of potential harm to customers and the market that could arise from misalignment between risk and individual reward in trading activity.

Calculating the values

9.32 When calculating these metrics, we propose that non-SNI firms use their total gross assets, total gross trading book assets and the total gross market value of their derivatives business. They must be calculated on an individual (solo entity) basis.

9.33 We suggest that any amounts in foreign currencies must be converted into Sterling using the relevant conversion rate determined by reference to an appropriate market rate. This could be the relevant daily spot exchange rate against Sterling published by the Bank of England.

9.34 We propose that the value used for the on- and off-balance sheet assets be a simple average of the assets over the preceding 4 years. Using this average would mitigate the risk that a firm close to the threshold needs to repeatedly move between the 2 categories of non-SNIs due to relatively minor fluctuations.

Notifications

9.35 For a non-SNI firm to move from extended to standard remuneration requirements, we propose that the necessary thresholds should have been met continuously for 6 months. A firm must notify us when this is the case.

9.36 Where a firm subject to standard remuneration requirements no longer meets the necessary thresholds, we propose that the firm must notify us promptly. The firm must then comply with the extended remuneration requirements within 12 months of having first exceeded the relevant threshold.

9.37 For both types of notification, firms should use the Notification Form on which we are consulting as part of this CP. We set out our general approach to notifications under the IFPR in Chapter 15.

Ongoing monitoring

9.38 Following implementation of the proposed thresholds, we would monitor any unintended impacts of these on the market. We would look in particular for trends in firms restructuring, changes in the employment market or competition impacts.

Application in particular circumstances

Application to subsidiaries established in third countries

9.39 We have carefully considered whether it would be appropriate to apply the MIFIDPRU Remuneration Code to entities in third countries that are part of an FCA investment firm group to which prudential consolidation applies.

9.40 A number of firms and trade bodies expressed concerns in their responses to DP20/2 that applying UK remuneration rules to entities in third countries creates practical challenges. This is because they must comply with both the UK rules and the rules of the third country. Firms argued that this can result in contradictory or excessively burdensome requirements relative to the aims of the policy, with adverse consequences for recruitment and retention.

9.41 We have listened to this feedback. We are proposing to apply the remuneration rules only to the material risk takers (MRTs) of group entities in third countries who oversee or are responsible for business activities that take place in the UK. We consider this will reduce the compliance burden without increasing the prudential or conduct risks in relation to the consolidation group or its UK business activities.

FCA investment firm groups

9.42 If we have granted permission to an investment firm group to use the group capital test (see Chapter 3 of CP20/24 for details), then no prudential consolidation is required. Each FCA investment firm in the group would need to apply the basic, standard or extended remuneration rules on an individual entity basis.

9.43 Where prudential consolidation applies, then the relevant remuneration rules (basic, standard or extended requirements) should be applied at both individual entity and consolidated level. The UK parent undertaking should ensure the correct implementation at consolidated level.

9.44 Where entities within a consolidation group are subject to different remuneration requirements, the way these apply will differ depending on the rules that apply. This could be because:

- The entities are subject to different levels of requirements within the MIFIDPRU Remuneration Code, for example all are non-SNI firms but some are subject to the standard requirements, others to the extended requirements.
- The entities are subject to different remuneration codes, for example the group contains FCA investment firms (subject to the MIFIDPRU Remuneration Code) and AIFMs without MiFID permissions (subject to the AIFM Remuneration Code).

9.45 In these instances, we propose that:

- firms must apply the stricter of the requirements (for example longer deferral periods) to any MRT who has a material impact:
  - on the risk profile of another entity in the group (or of the assets it manages) that is subject to the stricter requirements or remuneration code, or

  - on the risk profile of the group as a whole (or of the assets it manages)
- firms may apply the requirements applicable to the individual entity (and not the group) to any other MRT.

Groups with credit institutions or PRA-designated investment firms

9.46 Our proposed approach to FCA investment firm groups is consistent with our approach to groups in scope of the Dual-regulated firms Remuneration Code (SYSC 19D), which we set out in PS20/16 'Updating the Dual-regulated firms Remuneration Code to reflect CRD V' (December 2020).

9.47 We set out in Chapter 3 of CP20/24 that groups containing both a PRA-designated investment firm and an FCA investment firm, but no credit institution, will be subject to prudential consolidation under both the UK CRR and the IFPR. This means the group must satisfy the consolidated requirements of both SYSC 19D and SYSC 19G. We propose that firms apply these remuneration requirements in the same way as FCA investment firm groups.

Application to collective portfolio management investment firms

9.48 Collective portfolio management investment firms (CPMIs) are authorised as full-scope AIFMs or UCITS management firms. They are also permitted to undertake discretionary client-by-client portfolio management and provide certain investment services. These investment services would usually require authorisation under MiFID but, under our current rules, none of our remuneration codes apply to this 'MiFID business'.

9.49 In line with our broader approach to CPMIs under the IFPR, we consider that the potential for harm to customers and markets is the same for these additional investment services regardless of what type of firm is carrying them out.

9.50 For this reason, we propose that the MIFIDPRU Remuneration Code should apply to the MiFID business of CPMIs. This means that CPMIs will need to apply 2 different remuneration codes, as their non-MiFID business is already subject to the AIFM or UCITS Remuneration Codes.

9.51 Where an MRT of a CPMI has responsibilities for just MiFID or just non-MiFID business, the firm should apply the relevant remuneration code. Where an MRT has responsibilities for both MiFID and non-MiFID business, we propose that the firm must apply the stricter of the requirements (for example any longer deferral periods) to the individual.

Scope and application to individuals

Material risk takers

9.52 The basic remuneration requirements are general principles so apply to all staff in all FCA investment firms. The additional rules to be applied by non-SNIs are applicable only to those individuals identified as MRTs. This is because of the higher impact MRTs can have on the risk profile of the firm and the assets it manages, and the need to apply further requirements to their pay to ensure alignment of risk and reward.

Identifying material risk takers

9.53 We propose to require all non-SNIs to identify the MRTs in relation to their firm on an annual basis. The aim is to identify all those individuals whose professional activities can have a material impact on the risk profile of the firm or the assets it manages. In conducting this exercise, an FCA investment firm should consider all types of risks involved in its professional activities. These may include prudential, operational, market, conduct and reputational risks.

9.54 The term 'staff' should be interpreted broadly so as to include all relevant individuals. These should include employees of the firm itself, partners or members (in the case of partnership structures), employees of other entities in the group, employees of joint service companies, and secondees.

9.55 It is important that firms consider all types of roles that may have a material impact on the firm's risk profile or on the assets it manages. To assist with this, we are proposing a list of categories of staff that we consider should always be deemed MRTs due to the responsibilities inherent in the roles.

9.56 We propose that a staff member must be identified as an MRT if they:

- are a member of the management body (in its management or supervisory function) or of senior management
- have managerial responsibilities for the activities of a control function or for the prevention of money laundering and terrorist financing
- have managerial responsibility for a business unit that is carrying on at least one of the following regulated activities:
  - arranging (bringing about) deals in investments
  - dealing in investments as agent
  - dealing in investments as principal
  - managing investments
  - making investments with a view to transactions in investments
  - advising on investments, except P2P agreements
  - operating an organised trading facility
- work for a firm with permission to carry on any of the regulated activities mentioned in the above point, and are responsible for managing any of the following:
  - information technology
  - information security
  - the outsourcing arrangements of critical or important functions
- are responsible for managing a material risk or risk management policies
- have authority to take decisions approving or vetoing the introduction of new products

9.57 For the purpose of these categories, we propose defining 'managerial responsibilities', 'control function' and 'business unit' as set out in the proposed changes to the Handbook Glossary.

9.58 These categories of staff are intended to be a starting point only. We would expect firms to develop their own additional criteria to identify further individuals based on the specific types of activities and risks relevant to the FCA investment firm. To assist with this, we include in SYSC 19G.5 some examples of other roles we have seen firms include as MRTs. We also include guidance on the sorts of factors which firms may find useful to consider.

9.59 We are not proposing to require firms to identify individuals based solely on the level of their remuneration because we do not view this as a reliable indicator of the level of risk involved in a role in an FCA investment firm.

Material risk takers at consolidated level

9.60 If a non-SNI firm is part of an FCA investment firm group to which prudential consolidation applies, then MRTs should be identified at both solo and consolidated level. We propose that the UK parent undertaking should be responsible for the MRT identification process at a consolidated level.

9.61 The UK parent undertaking should assess which individuals have a material impact on the risk profile of the investment firm group. It may also be helpful for the UK parent undertaking to play a role in coordinating the identification process across the group entities.

Relationship with the Senior Managers Regime (SMR)

9.62 Some respondents to DP20/2 told us they are unsure about the relationship between SMFs under the SMR and MRTs. A small number suggested these categories could be combined into a single set of individuals.

9.63 We acknowledge there are overlaps between these categories. For example, in line with the criteria we are proposing above, a Money Laundering Reporting Officer (SMF17) would usually also be identified as an MRT.

9.64 Nevertheless, we would remind firms that identifying MRTs and assigning accountability to SMFs have separate and distinct purposes.

9.65 SMFs identified under the SMR are intended to cover only the most senior individuals at a firm who need to be approved by the FCA. By contrast, MRTs must be identified by firms to cover a wider range of risk-taking roles, so it is not possible to combine them.

Exemption for certain individuals

9.66 Similarly to our existing remuneration codes, we propose to exempt those MRTs who earn below a certain amount from some remuneration requirements.

9.67 These are the same requirements from which non-SNIs subject to the standard remuneration rules would be exempt. The rules are those on:

- deferral of a portion of variable remuneration
- pay-out of a portion of variable remuneration in shares, instruments or alternative arrangements
- the holding and retention periods for discretionary pension benefits when an MRT leaves the firm

9.68 We do not consider it proportionate for these remuneration requirements to apply to individuals with lower levels of variable remuneration. Lower levels of variable remuneration are less likely to incentivise inappropriate risk-taking. Applying the rules listed above would be unlikely to substantially further the objective of promoting effective risk management.

Threshold for exemption

9.69 It is not possible to say with certainty whether a particular amount of variable remuneration is likely to incentivise MRTs to take inappropriate risks. Similarly, it is difficult to pinpoint at what percentage of the total remuneration an individual's behaviour or decision-making may be more decisively influenced by their potential variable remuneration. Decisions are influenced by many factors and the behaviour of individuals differs from person to person.

9.70 We surveyed a representative sample of FCA investment firms to obtain data on how much variable and total remuneration their MRTs earn. The data revealed that MRTs' earnings vary greatly with a broadly equal distribution across earnings categories. It did not provide any clear indication of where it might be appropriate to set the threshold.

9.71 In our existing remuneration codes for IFPRU and BIPRU firms, AIFMs and UCITS management companies, we set out in guidance that we that we do not generally consider it necessary for firms to apply certain rules to individuals whose total remuneration is £500,000 or less and whose variable remuneration represents a maximum of 33% of their total remuneration. This means it is possible for an individual to benefit from proportionality if they receive variable remuneration of up to £166,667 (provided the total remuneration does not exceed £500,000).

9.72 This guidance has been applied by many investment firms for over 10 years and we have not found evidence to suggest it should be set at a higher or lower level.

9.73 For these reasons, we propose to incorporate our current approach into the new MIFIDPRU Remuneration Code as rules with 2 modifications:

- **Change the reference point from £500,000 of total remuneration to £167,000 of variable remuneration**. This means there would be no maximum total remuneration. We consider this approach to be more appropriate because it is not the amount of the total remuneration that can incentivise inappropriate risk-taking. Instead, it is the variable component and the ratio between the variable and fixed components that are relevant.
- **Change the percentage of the total remuneration which can be variable from 33% to one-third (33.3%)**. This would align the approach with that applicable to banks, building societies and designated investment firms in SYSC 19D. We would expect this to simplify the application of the rules for FCA investment firms in CRR groups.

9.74 With these modifications, our proposals mean that an MRT would need to meet 2 criteria to qualify for the exemption.

- have variable remuneration of £167,000 or less
- have variable remuneration which makes up one-third or less of their total remuneration

9.75 Individuals who do not meet these exemption criteria must still be identified as MRTs.

9.76 We would be interested to hear from stakeholders who have data or other evidence which may help us determine appropriate thresholds for this exemption. We will carefully consider any further information we receive before finalising our rules. We may also revisit the finalised criteria at a later date in light of new evidence or subsequent developments that may change our view of this, including those regarding EU market access.

Part-year material risk takers

9.77 The proposed threshold of £167,000 is based on an MRT who is in role for a full performance year of 12 months. In practice, an individual may take on an MRT role at any point during the performance year, either from a non-MRT role within the firm or as an external hire.

9.78 We propose to set out in a rule that:

- FCA investment firms must apply the full £167,000 variable remuneration threshold to part-year MRTs
- the requirement that the variable remuneration must not be more than one-third of the MRT's total remuneration needs to be applied to the relevant portion of the total remuneration paid for the part-year period they were in role
- any guaranteed variable remuneration, for example a 'sign-on bonus', must be treated as part of the variable remuneration for the part-year concerned

9.79 We also include in SYSC 19G.5 a worked example.

Q17: **Do you agree with our proposal for firms to apply the new MIFIDPRU Remuneration Code from the start of their next performance year beginning on or after 1 January 2022?**

Q18: **Do you agree that SNI firms should be subject to the 'basic remuneration requirements'? If not, please explain why not.**

Q19: **Do you agree that only certain non-SNI firms should be required to apply the remuneration rules on deferral, pay-out in instruments and discretionary pension benefits? Do you have any comments on the thresholds we propose?**

Q20: **Do you have any comments on our proposed approach to identifying material risk takers?**

Q21: **Do you agree with our proposals for exempting certain individuals from the rules on deferral, pay-out in instruments and discretionary pension benefits? Do you have any evidence that may assist us in defining the scope of the exemption?**

Q22: **Do you have any other comments on the proposed scope and application of the remuneration rules?**

10 MIFIDPRU Remuneration Code: basic remuneration requirements

10.1 In this chapter, we set out the basic remuneration requirements we propose to apply to all FCA investment firms and in relation to all staff. They focus on ensuring that firms have remuneration policies and practices meeting minimum standards and are subject to sound governance.

Table 4: Overview of basic remuneration requirements

Basic remuneration requirements	
Firm's **remuneration policy** must: • be proportionate to the size, internal organisation and nature, as well as to the scope and complexity, of its activities • be gender-neutral • be consistent with, and promote, sound and effective risk management • be in line with the firm's business strategy and objectives, and take into account long term effects of investment decisions taken • contain measures to avoid conflicts of interest, encourage responsible business conduct and promote risk awareness and prudent risk-taking	**Governance and oversight:** • Management body must adopt and periodically review the remuneration policy, and have responsibility for overseeing its implementation. • Staff with control functions must be independent from the business units they oversee, and be remunerated according to objectives linked to their functions. • Remuneration of senior staff in risk management and compliance functions must be directly overseen by the remuneration committee or management body.
Fixed and variable remuneration: • The remuneration policy must make a clear distinction between the criteria applied to determine fixed and variable remuneration. • The fixed and variable components of the total remuneration must be appropriately balanced. • When assessing individual performance, both financial and non-financial criteria must be taken into account.	**Restrictions on variable remuneration:** • Variable remuneration must not affect the firm's ability to ensure a sound capital base. • A firm which benefits from extraordinary public financial support must not pay any variable remuneration to members of the management body.

Remuneration policy design

10.2 We propose that all FCA investment firms should have a remuneration policy in place for all staff. We would expect it to cover all components of remuneration covered in our proposed MIFIDPRU Remuneration Code.

Aligning risk and reward

10.3 The central objective of every remuneration policy must be that it is consistent with, and promotes, sound and effective risk management by aligning risk and reward.

10.4 To achieve this objective, we propose that an FCA investment firm's remuneration policy should reflect its business strategy and objectives. These cover the FCA investment firm's risk appetite and risk strategy, including with regard to environmental, social and governance (ESG) risk factors, and also extend to its culture and values.

10.5 The remuneration policy should also contain measures to avoid conflicts of interest, encourage responsible business conduct, and promote risk awareness and prudent risk taking.

Proportionality

10.6 Overall, an FCA investment firm's remuneration policy should be proportionate to the size, internal organisation and nature, as well as to the scope and complexity, of the firm's activities.

10.7 This means that the content and level of detail of the remuneration policy may depend on a number of factors. These include the number of staff it employs, the different types of roles, the activities it carries out, and whether or not the FCA investment firm is part of a group with a group-wide remuneration policy.

Gender neutrality

10.8 We propose to introduce a requirement for FCA investment firms' remuneration policies and practices to be gender neutral.

10.9 We would use the definition of 'gender neutral remuneration policy' which we added to our Handbook Glossary in 2020 when we introduced this requirement for credit institutions and designated investment firms. The definition requires a remuneration policy to be 'based on equal pay for male and female workers for equal work or work of equal value'.

10.10 This is in line with the Equality Act 2010, which imposes this legal requirement on all employers in the UK. It includes equality in pay and all other contractual terms, for example variable remuneration.

10.11 A small number of respondents to DP20/2 questioned the value of including in our rules a requirement which already exists in statute. We propose to include it because it would:

- support and reaffirm our aim to drive healthy purposeful cultures in firms, which includes developing an inclusive and diverse workplace
- support us in supervising the extent to which FCA investment firms are meeting this standard and in holding their management body and, where they exist, chairs of remuneration committees, to account if they fail to do so
- further our commitment to upholding our Public Sector Equality Duty, and support our actions as a regulator in helping to eliminate poor conduct prohibited by the Equality Act

10.12 We do not anticipate that the addition of this requirement would impose any additional burden on FCA investment firms. As the Equality Act has been in place for many years, we would expect firms to already be actively taking steps to ensure their remuneration policies reflect the required standards, in line with the Conduct Rule on observing proper standards of market conduct.

10.13 The Equality Act also prohibits discrimination on the basis of an individual's protected characteristics, including in the context of employment. It lists the following as protected characteristics: age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex, and sexual orientation.

10.14 Against this background, we propose to supplement our suggested rule on gender neutrality with a guidance provision. It would remind firms of their existing obligations as employers to ensure their remuneration policies and practices do not discriminate against applicants and employees on the grounds of any of the protected characteristics. This includes when assessing performance for the purpose of awarding variable remuneration.

Governance and oversight

10.15 The effectiveness of remuneration policies and practices is dependent on the governance and oversight around their development, review and implementation.

10.16 We propose that every FCA investment firm should ensure the management body in its supervisory function adopts and periodically reviews its remuneration policy. The management body should also be responsible for overseeing the implementation of the policy and ensuring its compliance with our remuneration rules. If the FCA investment firm has a remuneration committee, it must also play a role in the oversight.

10.17 We propose to include guidance in our Handbook which clarifies:

- It is for each FCA investment firm to assess the most appropriate frequency for the periodic review, taking into account all relevant factors.
- The development and review of the remuneration policy should be supported by the control functions, including (where they exist) risk management, compliance, internal audit and human resources, and by business units.
- The processes and decision-making around the development, review and amendment of remuneration policies and practices are subject to our general record-keeping requirements.

10.18 At present, we provide on our website templates for Remuneration Policy Statements (RPS) which IFPRU and BIPRU firms may use to record how their remuneration policies and practices comply with the relevant rules. We intend to review and amend these templates to align them with the final MIFIDPRU Remuneration Code.

10.19 To mitigate the risk of conflicts of interest arising, our proposals are:

- No variable remuneration should be awarded to members of the management body who do not perform any executive function in the firm.

- The remuneration of senior staff in risk management and compliance functions is directly overseen by the management body in its supervisory function or, where one exists, the remuneration committee.
- All staff with control functions are independent from the business units they oversee, have appropriate authority, and are remunerated according to objectives linked to their functions (independent of the performance of the business areas they control).

Fixed and variable remuneration

Distinguishing between fixed and variable remuneration

10.20 We propose a rule requiring all FCA investment firms to have remuneration policies which make a clear distinction between fixed and variable remuneration. This should include the criteria on which the award of any variable remuneration is based.

10.21 The distinction should result in a clear allocation of all components of remuneration to either fixed or variable remuneration. There is no third or hybrid category. In allocating individual components, it is the quality and purpose of the component that is decisive, not the label applied to it.

10.22 To guide firms in their allocations, we suggest:

- Fixed remuneration should be permanent, pre-determined, non-discretionary, non-revocable and not dependent on performance.
- Variable remuneration should be based on performance or, in exceptional cases, other conditions; it includes discretionary pension benefits.

Appropriate balance

10.23 Remuneration can directly and indirectly influence behaviour. It can incentivise certain behaviours and discourage others. Under our proposals, all FCA investment firms would need to ensure that the fixed and variable components of an individual's total remuneration are appropriately balanced.

10.24 This means the fixed remuneration must represent an amount and a proportion of the total which is sufficiently high to enable the variable remuneration policy to be fully flexible. This flexibility should include the possibility of paying no variable remuneration at all.

10.25 The purpose of this is to ensure that no individual is dependent on variable remuneration to an extent likely to encourage them to take risks outside the risk appetite of the firm.

10.26 All relevant circumstances should be considered when determining what constitutes an 'appropriate balance'. These should include the FCA investment firm's business activities, and the role of the individual and their exposure to risk. We would expect an FCA investment firm to be able to explain why it considers a particular split of fixed and variable remuneration appropriate.

10.27 Our proposal does not mean that every staff member must be able to earn variable remuneration. In may be appropriate for some categories of staff to receive only fixed remuneration which would not have an incentivising effect. But it would not be an appropriate balance for any individual to receive only variable remuneration.

Remuneration and profit-sharing

10.28 In many situations, all or most payments received from a firm by an individual such as an employee or contractor are remuneration for work and/or services. Where the individual is a partner in a partnership or a member of a limited liability partnership (LLP) and also works in the business, the distinction may be less clear. (For ease, we refer to both as 'partnerships' and 'partners'.)

10.29 As part of this CP, we are consulting on guidance provisions in SYSC 19G.4 to assist partnerships in determining which types of payments to partners should be treated as remuneration for the purposes of the MIFIDPRU Remuneration Code, and which as a return on equity (not in scope of our rules).

10.30 Our proposed guidance suggests that FCA investment firms consider how a partner currently receives their profit share and the rationale for the payment. The nature of the payment is decisive, not the label attached to it. Alternatively, or in combination with the above approach, a firm could use a benchmarking approach.

10.31 We also set out in our draft guidance that we would expect a reasonable portion of a partner's profit share to be considered as remuneration.

Co-investment and carried interest

10.32 Staff at FCA investment firms, in particular investment managers, often participate in co-investment and carried interest arrangements. We propose guidance in SYSC 19G.4 to help firms distinguish between them.

10.33 In summary, we would not usually consider returns made by staff on co-investment arrangements to constitute remuneration for the purposes of our rules. We would, however, usually consider carried interest as remuneration.

Financial and non-financial criteria

10.34 Poor performance can pose significant risks for firms. These may be financial, such as poor investment decisions or poor risk management leading to financial losses. But they may also be non-financial, for example behaviours contrary to the firm's values resulting in misconduct, mis-selling and reputational damage.

10.35 We propose that all FCA investment firms must take into account both financial and non-financial criteria when assessing the individual performance of their staff. This aims not only to discourage inappropriate behaviours but also to incentivise and reward behaviour that promotes positive non-financial outcomes for the firm.

10.36 To ensure the overall outcome of the individual performance assessment is appropriate, there should be a balance between financial and non-financial criteria. We propose guidance that an equal split between financial and non-financial criteria will be appropriate for some investment firms, while a slightly different split may better suit others.

10.37 To help FCA investment firms to identify and apply appropriate non-financial criteria, we propose to include guidance in SYSC 19G.6 around our expectations as well as a non-exhaustive list of examples of non-financial criteria.

Restrictions on variable remuneration

10.38 We propose that variable remuneration must not be awarded, paid out or allowed to vest if it would affect the ability of an FCA investment firm to ensure a sound capital base. This would help to ensure that it does not endanger the prudential soundness of the individual FCA investment firm or the investment firm group.

10.39 In line with this approach, we also propose that an FCA investment firm which benefits from extraordinary public financial support (for example, a government bail-out) must not pay any variable remuneration to members of its management body.

10.40 An FCA investment firm may pay variable remuneration to other staff. But if doing so would be inconsistent with maintaining a sound capital base and would compromise the firm's timely exit from extraordinary public financial support, then the variable remuneration must be limited to a portion of the firm's net revenue.

Q23: **Do you have any comments on the specific remuneration rules which we propose to apply to all FCA investment firms ('basic remuneration requirements')?**

11 MIFIDPRU Remuneration Code: standard remuneration requirements

11.1 In this chapter, we set out the standard remuneration requirements that would apply to all non-SNI firms in addition to the basic requirements in Chapter 10.

11.2 Of particular significance is the requirement on all non-SNI firms to identify their MRTs (see Chapter 9 above). Unlike the basic remuneration requirements, which apply to all staff, the additional rules that make up the standard requirements apply only to MRTs. However, we would encourage firms to consider applying them to wider categories of staff where this would contribute to sound risk management and/or a healthy firm culture.

Table 5: Overview of standard remuneration requirements

Standard remuneration requirements	
• Basic remuneration requirements	
Performance assessment: • Performance-related variable remuneration of MRTs must be based on a combination of the performance of the individual, the relevant business unit and the firm overall • Performance assessment must be based on a multi-year period	**Restrictions on non-performance-related variable remuneration of MRTs:** • Guaranteed variable remuneration • Retention awards • Buy-out awards • Severance pay
Ex ante and ex post risk adjustment • Firms must take into account all types of current and future risks when: – measuring performance to calculate bonus pools – awarding and allocating bonuses • Firms must: – have in-year adjustments, malus and clawback arrangements in place – set minimum malus and clawback periods – determine triggers for malus and clawback	**Other requirements on firms:** • Set a ratio between variable and fixed remuneration • Ensure remuneration policy is subject to an annual review by control functions • Discretionary pension benefits must be in line with business strategy, objectives, values and long term interests of the firm • Take all reasonable steps to ensure MRTs do not undermine the remuneration rules • Must not pay variable remuneration through vehicles or methods that facilitate non-compliance

Setting a ratio between variable and fixed remuneration

11.3 We do not consider it would be appropriate for us to set a single maximum ratio between variable and fixed remuneration (often referred to as a 'bonus cap').

11.4 Instead, we propose that non-SNI firms should set their own ratios for MRTs as part of their remuneration policies. This is to ensure firms actively monitor and manage the risks arising from high ratios of variable to fixed remuneration. This would be in addition to the basic requirement that all FCA investment firms should ensure an appropriate balance between fixed and variable remuneration for all staff.

11.5 When setting ratios, a firm should consider the impact that different categories of MRTs have on the risk profile of the firm or the assets it manages. For this reason, different ratios can be set for different categories of staff.

11.6 Ratios may also differ from one performance year to the next as a firm's risks, strategies and priorities shift.

Performance assessment

11.7 We propose that non-SNI firms should ensure that the total performance-related variable remuneration of an MRT is based on a combination of the assessment of the performance of the individual, of the relevant business unit and the firm overall.

11.8 The performance assessment must also be based on a multi-year period which takes into account the business cycle of the firm and its risks. This ensures that the assessment is based on longer-term performance and that the payment of the variable remuneration is spread over an appropriate period.

Ex-ante risk adjustment

11.9 Risk adjustment is an important element of measuring performance for the purpose of setting variable remuneration and requires the use of sound judgement. When measuring performance to calculate pools of variable remuneration, we propose to require non-SNI firms to take into account all types of current and future risks as well as the cost of the capital and liquidity required.

11.10 We also propose that a non-SNI firm must ensure that its total variable remuneration is generally considerably contracted, including through malus or clawback arrangements, where the financial performance of the firm is subdued or negative.

11.11 The variable remuneration awarded and allocated within the firm should also consider all types of current and future risks. We propose that non-SNI firms include both financial risks (for example economic profit or economic capital) and non-financial risks (such as reputation, conduct and customer outcomes, values and strategy).

11.12 We would expect a non-SNI firm to be able to provide us with details of all adjustments made, including clear explanations of how they have been quantified or discretion exercised.

Ex-post risk adjustment

11.13 Ex-post risk adjustment refers to the process and mechanisms by which a firm adjusts an individual's variable remuneration to take account of a specific crystallised risk or adverse performance outcome, including those relating to misconduct.

11.14 Under our proposals, all non-SNI firms would be required to have in place ex-post risk adjustment mechanisms as part of their remuneration policies. These should include at least in-year adjustments, malus and clawback to enable the firm to reduce or cancel cash awards, the number or value of shares and other non-cash instruments, as appropriate. They should enable an MRT's variable remuneration to be reduced by up to 100%.

11.15 As we intend to require only some non-SNI firms to apply deferral (see Chapter 12), some will not be able to use malus if there is no deferred remuneration that can be adjusted.

11.16 We propose that non-SNIs subject to the standard remuneration requirements would still need to put in place clawback mechanisms so these can be applied as needed. Alternatively, it remains open to these firms to reduce expected current year awards or use deferral periods, which would then enable the use of malus too.

Minimum periods of application

11.17 We propose that firms should set malus and clawback periods to allow sufficient time for any potential risks to crystallise and for adjustments to be made. This may mean that they differ for different categories of MRTs.

11.18 To ensure a consistent minimum standard, we propose to require non-SNI firms to:

- ensure that malus can be applied until the award has vested in its entirety
- ensure that the clawback period spans at least the combined length of the deferral and retention periods (where they exist)

Criteria for application

11.19 We consider that it is appropriate for us to set out only high-level situations in which malus and/or clawback must be applied. It should be for an FCA investment firm to determine the criteria or 'triggers' it considers appropriate for the types of risk it is exposed to or might pose to others. This may include differing criteria for the application of malus and clawback.

11.20 We propose that the criteria or 'triggers' must, as a minimum, cover situations in which:

- the MRT in question participated in or was responsible for conduct which resulted in significant losses to the non-SNI firm, or
- the MRT in question failed to meet appropriate standards of fitness and propriety.

11.21 Furthermore, we consider that malus should be applied where:

- there is reasonable evidence of employee misbehaviour or material error, or
- the firm or the relevant business unit suffers a material downturn in its financial performance, or
- the firm or the relevant business unit suffers a material failure of risk management.

11.22 Clawback should always be applied in cases of fraud or other conduct with intent or severe negligence which led to significant losses.

Non-Handbook guidance

11.23 Many industry stakeholders commented in their feedback to DP20/2 that they would find it useful if we were to issue more detailed guidance on how we would expect non-SNI firms to comply with our proposed rules on ex-post risk adjustment.

11.24 Our existing General guidance on the application of ex-post risk adjustment to variable remuneration provides further detail of our expectations on malus and clawback, including on how they should be invoked in an effective, timely, consistent and transparent way. The guidance currently applies only to firms in scope of our Dual-regulated firms Remuneration Code (SYSC 19D).

11.25 We are consulting as part of this CP on extending the scope of the existing guidance to also make it applicable to FCA investment firms. The content continues to reflect our expectations, so the substance would remain unchanged.

11.26 The proposed guidance can be found in Appendix 2.

Non-performance-related variable remuneration

11.27 If a firm were to make extensive use of non-performance-related variable remuneration, the positive effects of aligning risk and reward for individuals could be significantly weakened.

11.28 For this reason, we propose to include in the MIFIDPRU Remuneration Code rules and guidance about the use of guaranteed variable remuneration, retention awards, buy-out awards and severance pay for MRTs.

11.29 The use of such awards would need to be appropriate in each instance they are used. As forms of variable remuneration, they would also be subject to the same requirements, such as deferral and ex post risk adjustment.

Guaranteed variable remuneration

11.30 Guaranteed variable remuneration is sometimes referred to as a 'sign-on bonus' or 'golden handshake'. These awards are often used as a way of compensating new employees in cases where they have lost the opportunity to receive variable remuneration by leaving their previous employment during the performance year.

11.31 We propose that guaranteed remuneration should be awarded to MRTs by non-SNIs only:

- rarely and not as common practice
- in the context of hiring new MRTs
- in the first year of service
- where the firm has a strong capital base

Retention awards

11.32 Retention awards are bonuses which are dependent on an MRT remaining in role until a defined event or at a specified point in time. For example, retention bonuses may be used under restructurings, in wind-down or in the context of specific projects within a firm.

11.33 To ensure a level playing field in the recruitment and retention of key staff, we consider it is appropriate to permit retention awards. However, as for guaranteed variable remuneration, we propose that they should not be used as a matter of course but instead are used only rarely. We also propose that they should be awarded only after the event or time period has ended.

Buy-out awards

11.34 Buy-out awards involve a firm compensating a new employee, or 'buying out' their previous contract with another employer, where the deferred variable remuneration of the staff member was reduced, revoked or cancelled by the previous employer. This may be because they terminated their contract or because the individual has to pay back some money, for example where the employer has paid for a training course or qualification for the individual that was attached to a retention clause.

11.35 In these situations, we propose to require non-SNIs to ensure the buy-out award:

- is aligned with the long-term interests of the firm
- remains subject to the same pay-out terms required by the previous employer, for example by following the same deferral and vesting schedule, and being subject to the same malus and/or clawback provisions, if applicable

Severance pay

11.36 We also propose to place some requirements on payments made to MRTs by non-SNIs relating to the early termination of an employment contract. This is sometimes called 'severance pay'.

11.37 We propose that:

- the ability to make severance payments, and any maximum amount or criteria for determining the amount, should be set out in the firm's remuneration policy
- all severance payments:
  - must reflect the individual's performance over time
  - must not reward failure or misconduct

Other requirements

Annual review of remuneration policy by control functions

11.38 We propose that a non-SNI firm should ensure that the design, implementation and effects of its remuneration policy are subject to an independent, internal review by staff engaged in control functions at least annually.

11.39 The review should be conducted by the internal audit function, where one exists. We would expect the results of the review and the actions taken to remedy any findings to be appropriately documented.

Discretionary pension benefits

11.40 Discretionary pension benefits are a form of variable remuneration. We do not consider pension benefits to be discretionary if they are consistently granted to a category of staff and are not linked to performance.

11.41 Under our proposals, all non-SNIs would be required to:

- ensure that all discretionary pension benefits are in line with the business strategy, objectives, values and long-term interests of the firm
- award the full amount in shares, instruments or within any alternative arrangements we have approved
- apply malus and clawback to discretionary pension benefits in the same way as to other elements of variable remuneration

Non-compliance

11.42 We propose to include rules which aim to prevent non-SNI firms and their MRTs from undermining the objectives of the MIFIDPRU Remuneration Code.

11.43 We propose that non-SNI firms should take all reasonable steps to ensure that MRTs do not transfer the downside risks of variable remuneration to another party by using personal hedging strategies or remuneration- and liability-related insurance. Examples of actions a firm might take include requesting an undertaking or declaration from its MRTs, and implementing policies regarding dealing in financial instruments.

11.44 We also propose a rule that requires non-SNI firms to ensure variable remuneration is not paid through vehicles or methods that facilitate non-compliance with our remuneration rules or the MIFIDPRU sourcebook.

11.45 We would emphasise that we would expect all firms to comply not only with the letter but also the spirit of the remuneration rules we are proposing. We consider that our rules and firms' remuneration policies will be most effective when firms embed them in their wider prudential, risk management and conduct frameworks.

Q24: Do you have any comments on the specific remuneration rules we are proposing to apply to all non-SNI firms ('standard remuneration rules')?

Q25: Do you agree with our proposal to extend the existing non-Handbook guidance on ex post risk adjustment to FCA investment firms?

12 MIFIDPRU Remuneration Code: extended remuneration requirements

12.1 In this chapter, we set out the remuneration rules that would apply to the largest non-SNI firms in addition to the basic and standard remuneration requirements set out in Chapters 10 and 11. We call them the extended remuneration requirements.

Table 6: Overview of extended remuneration requirements

<table>
<tr><th colspan="2">Extended remuneration requirements</th></tr>
<tr><td colspan="2">• Basic remuneration requirements</td></tr>
<tr><td colspan="2">• Standard remuneration requirements</td></tr>
<tr><td>Pay-out of variable remuneration:
• At least 50% to be paid out in shares, instruments or using alternative arrangements approved by the FCA
• Must be subject to an appropriate retention policy</td><td>Deferral and vesting:
• At least 40% of variable remuneration to be deferred for at least 3 years
• At least 60% to be deferred where the variable remuneration is a particularly high amount, and always where it is £500,000 or more
• Must not vest faster than pro rata</td></tr>
<tr><td>Discretionary pension benefits:
• Where MRT leaves the firm before retirement, firm must hold the pension benefits for 5 years
• Where MRT retires, the firm must pay out the pensions benefits and MRT must retain them for 5 years</td><td>Remuneration committees:
• Chair and at least 50% of members must be non-executive members of the management body (where legal structure of firm permits)
• Modification of requirement possible for group level committees</td></tr>
</table>

Pay-out in shares, other instruments or using alternative arrangements

12.2 By linking the value of variable remuneration to the credit quality of the firm, the financial interests of the individual are aligned with those of the firm. In particular, the individual will participate in any losses that result in a deterioration of the credit quality.

Types of instruments

12.3 We propose to require non-SNI firms subject to extended remuneration requirements to pay at least 50% of an MRT's variable remuneration in shares or other instruments.

12.4 To reflect the diverse structures and activities of investment firms and to minimise the administrative burden, we propose to permit the use of a broad range of instruments:

- shares (or equivalent ownership interests)
- share-linked instruments (or equivalent non-cash instruments)

- Additional Tier 1 (AT1) instruments, Tier 2 instruments or other instruments which can be fully converted to Common Equity Tier 1 instruments, or written down, and that adequately reflect the firm's credit quality
- non-cash instruments which reflect the instruments of the portfolios managed

12.5 To meet the objectives of this proposed rule, the instruments used by firms need to be appropriate for use in variable remuneration. They must appropriately reflect the credit quality of the firm as a going concern. This is inherent in shares, share-linked instruments and non-cash instruments which reflect the instruments of the portfolios managed by the firm.

12.6 To ensure this for AT1, Tier 2 and other convertible or write-down instruments, we propose to define the general requirements which must be met. These include (but are not limited to):

- The instrument must be issued by the FCA investment firm.
- The instrument must not be secured or subject to a guarantee that enhances the seniority of the claims of its holder in insolvency.
- The instrument must be either a convertible or a write-down instrument.
- Any right to redeem, call or repurchase the instrument must be exercisable only at the sole discretion of the firm.

12.7 We also propose some additional requirements specifically for convertible instruments and some specifically for write-down instruments.

12.8 Our full proposals can be found in the Annex to SYSC 19G. We would welcome feedback from stakeholders on whether they strike the right balance between flexibility and clarity.

Alternative arrangements

12.9 We recognise that some non-SNI firms do not issue the types of instruments mentioned above. This may be because their legal structure prevents them from doing so, for example partnerships and LLPs. There may also be cases where it would not be proportionate to issue instruments purely for use in variable remuneration, for example when a firm could instead use instruments issued by other entities within the FCA investment firm.

12.10 We propose that firms in these situations – and only these firms – should apply to us for a modification of the rule on pay-out in shares and other instruments. In its application, an FCA investment firm should put forward detailed proposals for an alternative arrangement that it considers would also meet the objectives of the rule.

12.11 Firms should use our standard waivers and modifications form for their applications, and consider the guidance we are proposing in SYSC 19G.6. Our general approach to applications in the IFPR is in Chapter 15.

Deferral and vesting

12.12 We propose that non-SNI firms subject to the extended remuneration requirements must ensure:

- at least 40% of the variable remuneration awarded to an MRT is deferred for at least 3 years
- where the variable remuneration is a particularly high amount, and in any case where it is £500,000 or more, at least 60% is deferred
- the deferred variable remuneration does not vest faster than on a pro rata basis

12.13 The requirement that variable remuneration may not vest faster than pro rata means that if £60,000 is deferred over 3 years, then no more than £20,000 may vest each year. The first deferred portion must not vest sooner than a year after the start of the deferral period.

12.14 The aim is to enable an appropriate portion of the variable remuneration to be adjusted for risk outcomes over an appropriate period. We propose guidance in SYSC 19G.6 which sets out the criteria it may be useful for firms to consider when deciding how to structure the deferral schedule.

Proportion and length of deferral

12.15 We propose to include in SYSC 19G.6 guidance on our expectations of how firms should determine the proportion to be deferred and the deferral period. This includes:

- **Length of deferral period:** We would expect the variable remuneration of MRTs whose roles and responsibilities mean they have a considerable impact on the risk profile of the firm or the funds it manages (for example members of the management body or senior management), to be subject to a deferral period longer than the 3-year minimum.
- **'A particularly high amount':** It may be appropriate in certain circumstances for amounts below £500,000 to be considered 'particularly high' in the context of pay arrangements at the firm concerned, so subject to 60% deferral.

Deferred and non-deferred payments

12.16 Both payments in cash and in shares/instruments can be deferred. We propose to require non-SNI firms to pay out at least 50% of the deferred portion of the variable remuneration in shares, instruments or by using alternative arrangements.

12.17 We also clarify in guidance that we consider it good practice for the deferred portion of variable remuneration to contain a higher proportion of shares/instruments than the non-deferred (upfront) portion.

Interest and dividends

12.18 Since the firm remains the legal owner of any deferred shares or instrument until the remuneration vests, any interest and dividends paid on the shares or instrument during the deferral period are received and owned by the firm. They must not be paid to the MRT either during or after the deferral period.

Taxation of partners

12.19 We set out in DP20/2 that under partnership tax rules, partners of partnerships and members of LLPs are taxed on their profit shares in the year the profits arise. This may result in a tax liability in respect of variable remuneration which is deferred (so-called 'dry' tax charge).

12.20 A small number of respondents to our DP asked us to consider giving firms the possibility of deferring variable remuneration on a net of tax basis to prevent a 'dry' tax charge from arising. However, the tax implications of deferral are not within our remit.

12.21 Specific tax provisions already exist for deferred variable remuneration and partnerships which are AIFMs. We are continuing to engage with HM Treasury and HM Revenue & Customs, who are responsible for taxation policy.

Retention

12.22 We propose that FCA investment firms must ensure all shares and instruments issued for variable remuneration are subject to an appropriate retention policy. This means they cannot be sold or accessed by the MRT for an appropriate period of time after the date on which they vest.

12.23 What is an appropriate period varies depending on a number of factors. We suggest in guidance that firms should consider at least:

- the length of the deferral period
- the length of the business cycle
- the types of risks relevant to the role of the MRT
- how long it could take for the risks underlying the performance to crystallise

12.24 As a guide, the greater the impact of the MRT on the risk profile of the firm and/or the funds managed, the longer the retention period should be.

Discretionary pension benefits

12.25 Where an MRT leaves the firm before retirement age, we propose that the FCA investment firm must hold the pension benefits for 5 years in the form of shares, instruments or within any alternative arrangements.

12.26 Where an MRT leaves the FCA investment firm upon reaching retirement age, the firm must pay out the pensions benefits in shares, instruments or by means of any alternative arrangements. We propose that they be retained by the MRT for 5 years.

Remuneration committees

12.27 We propose that a non-SNI firm subject to the extended remuneration requirements must establish a remuneration committee. We provide further details of our proposals in Chapter 8.

12.28 We do not consider it would be proportionate to require all non-SNI firms to establish remuneration committees. However, we would encourage non-SNI firms not subject to this requirement to consider whether establishing or maintaining one might contribute to the better alignment of risk and individual reward across the firm.

Q26: Do you agree with our proposals for rules on paying out variable remuneration in shares, other instruments or using alternative arrangements?

Q27: Do you have any comments on our proposals on deferral, vesting and retention?

13 Regulatory reporting

13.1 In this chapter, we set out further proposals for regulatory reporting under the IFPR (beyond those consulted upon in CP20/24). Our proposals for MIFIDPRU reporting are based on the information that FCA investment firms should already have available as management information, or already need to record as part of our proposals for the requirements to which they relate.

13.2 Our intention is to collect an appropriate amount of data that will let us supervise FCA investment firms, including CPMIs, against the requirements of the IFPR. We will collect any additional information or clarification required on an ad hoc basis. The amount of data requested is proportionate to the size and complexity of the FCA investment firm.

13.3 We have published the proposed reporting templates. To ensure the consistency and comparability of the data FCA investment firms submit, we are also consulting on draft instructions on how to complete the templates, including key definitions of the terms used.

13.4 This chapter includes our proposals for reporting on:

- the liquid asset requirement
- the ICARA process
- remuneration, and
- updating FIN067 additional reporting for CPMIs

13.5 We are still considering any additional information we need on securitisations and intend to consult on amending or replacing FSA046 and FSA058 at a later date, possibly after the IFPR is introduced.

13.6 Our proposals for calculating the values that should be reported on are in:

- Chapter 6 of this CP for the liquid asset requirement (MIFIDPRU 6)
- Chapter 7 of this CP for the ICARA process (MIFIDPRU 7)
- Chapters 9 to 12 of this CP for remuneration requirements (SYSC 19G)

13.7 Our approach to the FIN067 return will remain substantially the same, but we are also taking this opportunity to simplify the form and reduce the amount of information that we collect from CPMIs.

13.8 We will be providing detail on feedback we received to our first set of proposals on regulatory reporting in CP20/24, and how we will be implementing those proposals, in the related policy statement.

Liquid asset requirement reporting (MIF002)

13.9 This CP contains our proposals for the type of liquid assets that FCA investment firms should hold and how to calculate their basic liquid asset requirement. These are in found in MIFIDPRU 6. We are also consulting on our proposals on how FCA investment firms should calculate any additional liquid asset requirement. These are found in MIFIDPRU 7.

13.10 As a result, we now propose a slightly amended liquid asset reporting form (MIF002), building on our original proposed form in CP20/24, to reflect some of the new terminology that is in line with these proposals. This return will apply to all FCA investment firms and should be completed quarterly.

ICARA process reporting – The ICARA Questionnaire (MIF007)

13.11 This CP contains our proposals on how the ICARA process applies to FCA investment firms (see Chapter 7). So that we get a snapshot of the results of the ICARA process, we are proposing a new reporting form that will apply to all FCA investment firms that should be submitted annually. This form, The ICARA Questionnaire will replace the current FSA019 for FCA investment firms. FSA019 will still be relevant for UCITS depositories that are subject to IPRU-INV chapter 5 requirements.

13.12 This form will provide us with additional information on the results of an FCA investment firm's review of its ICARA process including where additional harms have been identified. It will include any additional own funds and liquid assets that the firm has identified through their ICARA process that they should hold. More detail on how the ICARA Questionnaire fits into the ICARA process is provided in Chapter 7.

13.13 We also propose to ask for some detail about business models. The activities and services set out in MiFID do not all map neatly to regulated activities under FSMA. In addition, not all the services provided by FCA investment firms, such as corporate finance or venture capital, can necessarily be ascertained by the permissions held. Asking for this information annually will ensure that we are updated as to any changes in an FCA investment firm's business model where no changes in permission are needed.

13.14 FCA investment firms will be required to notify us of the date on which they will submit MIF007. They can subsequently notify us to amend this date as long as there are not more than 12 months between submissions.

13.15 In certain circumstances, a firm may review its ICARA process more frequently than annually. This may occur where the activities carried on by the firm are significant in their nature, scale or complexity and the firm concludes that it is appropriate to conduct a more regular review. In that case, we propose that the firm must submit MIF007 after each review and must notify us of the submission dates for each.

13.16 A firm may also need to carry out a review of its ICARA process after a significant change in its business or operating model. In that case, we propose that the firm must submit MIF007 within 20 business days of its governing body having approved the outcome of that review. The firm will not be required to notify us in advance of the submission date in these circumstances. This will ensure that we have up-to-date information on the firm's business.

Reporting requirements for CPMIs

13.17 CPMIs currently complete either FIN067 or FIN068 as a supplemental return, depending on whether they are subject to BIPRU or IFPRU. The IFPR will replace both of those existing regimes. To simplify matters we are proposing to ask all CPMIs to complete a revised FIN067 and we will retire FIN068. The FIN067 return will continue to be a supplemental report that applies in addition to the applicable "MIF00" reports in MIFIDPRU 9. We propose to align the submission dates of the FIN067 return with the submission dates for MIF001 and MIF002, so that CPMI firms can provide the supplemental data in FIN067 alongside the standard data on their capital in MIF001 and their liquid assets in MIF002.

13.18 CPMIs should note that from 1 January 2022, FOR should be calculated as set out in MIFIDPRU 4 for the whole business (see Chapter 4 of this CP)

13.19 We have also taken this opportunity to propose changes to the information that we collect in FIN067, including no longer requiring granular information about the PII policies that CPMIs hold.

Remuneration reporting

13.20 This CP contains our proposals for a new MIFIDPRU Remuneration Code that will apply to all FCA investment firms (see Chapters 9 to 12). To support this, we are proposing to introduce a new MIFIDPRU Remuneration Report (MIF008) and retire the existing Remuneration Benchmarking Information Report (REP004) and High Earners Report (REP005).

13.21 We propose to tailor the reporting requirements depending on whether a firm is subject to basic, standard or extended remuneration requirements:

- SNI firms would report to us only basic information about the total number of staff they have, and how much total fixed and variable remuneration they awarded in the relevant year.
- Non-SNI firms would need to split this information between material risk takers (MRTs) and non-MRTs, and also provide information on the ex-post adjustments made to variable remuneration.
- Non-SNIs subject to extended remuneration requirements would need to provide the above as well as information on the remuneration awarded to their highest 3 earners.

13.22 We do not propose as part of this CP to require FCA investment firms to report on diversity-related pay gaps, for example gender and/or ethnicity. We will consider the potential use of reporting on diversity-related data as part of our broader work on diversity and inclusion later this year.

13.23 Our proposals mean that an FCA investment firm which is not part of a consolidation group under the IFPR would complete the remuneration report on a solo basis. This includes firms which are part of a group subject to the group capital test. But an FCA investment firm which is part of an FCA consolidation group would instead complete the report on a consolidated basis. The group may submit a single report to satisfy the reporting requirements of all FCA investment firms in the group.

13.24 As is the case for our current remuneration reports, we propose that the new report be submitted annually within 4 months of a firm's accounting reference date.

Q28: Do you have any feedback on our reporting proposals? Please particularly provide details of any areas where you consider additional guidance on how to complete them is needed.

14 Interaction of MIFIDPRU with other prudential sourcebooks

14.1 In this chapter we set out how MIFIDPRU is intended to interact with other prudential sourcebooks in our Handbook. This will mainly be relevant to FCA investment firms that also carry out non-MiFID regulated business and so may currently be subject to more than one prudential sourcebook at the same time.

14.2 The other key prudential sourcebooks that are affected by the introduction of MIFIDPRU are:

- GENPRU – General Prudential sourcebook
- BIPRU – Prudential sourcebook for Banks, Building Societies and Investment Firms
- IFPRU – Prudential sourcebook for Investment Firms
- MIPRU – Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries
- IPRU-INV – Interim Prudential sourcebook for Investment Business

14.3 In this CP, we also propose amendments to the Glossary of definitions that are necessary to explain how our relevant prudential sourcebooks will apply alongside MIFIDPRU.

14.4 We also propose a three-year transitional provision to give former exempt-CAD firms time to comply with any new professional indemnity insurance requirements in MIPRU 3.2 as a result of undertaking non-MiFID activities such as insurance distribution.

14.5 We intend to consult on the remaining consequential changes in a subsequent consultation paper. That will include:

- consequential changes to the chapters of prudential sourcebooks not covered in this consultation;
- consequential changes to non-prudential sourcebooks; and
- the remaining consequential changes to the Glossary.

14.6 We know that our Handbook currently requires an investment firm to be a 'full-scope' IFPRU investment firm before it can meet the eligibility criteria for depositaries in FUND 3.11.10R(2). We are minded to allow an FCA investment firm to act as a depositary under the IFPR without the need for dealing on own account, whilst ensuring that the underlying prudential requirements that currently apply to such depositaries continue to apply. We intend to consult on the relevant changes to FUND 3.11, and corollary changes to COLL 6.6B, in a subsequent consultation paper.

Our overall approach

14.7 Our overall approach in this CP to other prudential sourcebooks affected by the introduction of MIFIDPRU is to make only the consequential amendments that are needed to:

- delete provisions that are no longer required
- ensure that the interactions between them and MIFIDPRU work in practice

For example, there will no longer be a need for provisions that refer to various categories of MiFID investment firm (eg 'exempt-CAD'), where we proposed in CP1 that IFPR will apply to all MiFID investment firms prudentially regulated by us.

14.8 We do not propose any material changes in underlying policy now as part of our initial implementation of MIFIDPRU. However, we know that some of the contents of other prudential sourcebooks could be updated and their interactions with MIFIDPRU be improved further. Our broad intention is to review the remaining prudential sourcebooks over the coming years and, where appropriate, to make them more consistent with the concepts in the IFPR. This will also reflect the aim of our Mission in that greater focus will be put on the potential harm that FCA regulated firms can cause to others.

General approach to cross-references

14.9 Where appropriate, we have updated cross-references so that they refer to MIFIDPRU instead of the UK CRR or deleted prudential sourcebooks. For example, IPRU-INV 11.6.1G currently explains that CPMI firms are subject to IPRU-INV 11 in parallel with the requirements for MiFID investment firms in GENPRU, BIPRU or IFPRU. We have updated this provision so that it refers to MIFIDPRU, without otherwise changing the policy approach that CPMI firms are required to comply with the prudential requirements for their MiFID and non-MiFID activities in parallel.

14.10 However, in other cases we have not updated cross-references in this way. This is to avoid making material changes to the underlying policy for non-MIFID prudential sourcebooks. Instead, we have either copied out the underlying material being cross-referred to, or we have fixed the cross-reference in time to the day before the IFPR is implemented. For example, in IPRU-INV 11 and parts of IPRU-INV 5, the definition of 'own funds' is currently set by cross-reference to the UK CRR. We have fixed this cross-reference in time to the day before the IFPR is implemented, so that it will not be affected by changes made by the IFPR or CRR2.

GENPRU

14.11 We propose to delete GENPRU 2, and other parts of GENPRU that relate to GENPRU 2. BIPRU firms currently subject to GENPRU 2 will become subject to MIFIDPRU.

14.12 We will consult on amendments to GENPRU 3 (Cross sector groups) and related provisions in a subsequent publication.

BIPRU

14.13 We propose to delete BIPRU in its entirety. BIPRU firms will become subject to MIFIDPRU.

14.14 The few existing provisions that refer to BIPRU in other prudential sourcebooks will either be written into those other sourcebooks or cross reference will be made to the version of BIPRU that exists on the day before the IFPR is implemented.

IFPRU

14.15 We propose to delete all of IFPRU, except for IFPRU 11. IFPRU firms will become subject to MIFIDPRU.

14.16 The Treasury consulted on the application of the UK resolution regime to FCA investment firms in February 2021. We intend to consult on our approach to the requirements in IFPRU 11 (which supplement the UK resolution regime) in a subsequent consultation, once the outcome of the Treasury's consultation is clear.

MIPRU

14.17 We propose to amend MIPRU 1.3 to remove references to BIPRU. As explained above, any standards that need to be kept (eg on the valuation of residential property) will be brought into MIPRU (see proposed guidance in MIPRU 1.3.3A).

14.18 We will amend the following sections of MIPRU:

- 3 (professional indemnity insurance
- 4.1 (application and purpose (of capital resources))
- 4.2 (capital resource requirements)
- 4.4 (calculation of capital resources)

to remove references to types of firm or (parts of) prudential sourcebooks that will no longer exist, or to update references to MIFIDPRU.

14.19 We also propose to clarify that MIPRU 4 does not apply to a MiFID investment firm that has been designated for prudential supervision by the PRA. The PRA is responsible for setting the prudential requirements for these firms.

Former exempt-CAD firms and professional indemnity insurance under MIPRU

14.20 Exempt CAD firms that carry on activities in scope of MIPRU 3.2 (eg insurance distribution activity) are currently exempt from the requirements in MIPRU 3.2, on the basis that they are currently subject to similar professional indemnity insurance requirements in Chapters 9 or 13 of IPRU-INV.

14.21 As the category of an exempt-CAD firm will cease to exist once the IFPR is implemented (see Chapter 1 of CP20/24) these firms will no longer be subject to IPRU-INV. Instead they will become subject to prudential requirements in MIFIDPRU. MIFIDPRU does not require the holding of professional indemnity insurance.

14.22 Former exempt-CAD firms that carry on activities in scope of MIPRU 3.2 will therefore have to comply with the requirement to hold professional indemnity insurance in MIPRU 3.2 for the first time, consistent with other investment firms that have always had to comply with MIPRU 3.2.

14.23 As a result, we propose a transitional provision (set out in MIPRU TP 2) to give former exempt-CAD firms time to comply with any new requirements in MIPRU 3.2. Our proposal is to allow such firms to continue to comply with relevant provisions for professional indemnity insurance in IPRU-INV Chapters 9 or 13, for a period of three years, upon implementation of the IFPR.

14.24 In particular, former-exempt CAD firms should note that:

- the minimum limit of indemnity for claims in aggregate can be higher under MIPRU 3.2.7R(2)(b) than under the relevant provisions in IPRU-INV
- MIPRU 3.2 also contains material relating to excess levels that differs from the material in IPRU-INV
- MIPRU 3.2 does not make provision for exclusions in the same way as IPRU-INV 13

14.25 We expect former exempt-CAD firms to have regard to the requirements in MIPRU 3.2 when renewing their professional indemnity insurance whilst our proposed transitional applies.

IPRU-INV (except IPRU-INV 11)

14.26 We propose to delete Chapter 9 (financial resources requirements for an exempt-CAD firm) and Chapter 13.1A (Capital resources and professional indemnity insurance requirements for an exempt CAD firm). Exempt CAD firms and local firms will become subject to MIFIDPRU, and will no longer be subject to IPRU-INV.

14.27 We also propose to remove exempt BIPRU and exempt IPRU commodities firms from the scope of IPRU-INV 3. These firms are MiFID investment firms and will become subject to MIFIDPRU.

14.28 We propose to make consequential amendments reflecting the changes above to the following chapters of IPRU-INV:

- 1 (Application and general provisions)
- 2 (Authorised professional firms)
- 3 (Financial resources for securities and future firms which are not MiFID investment firms)
- 4 (Lloyd's firms)
- 5 (Financial resources for investment management firms)
- 13 (Financial resources requirements for personal investment firms)
- 14 (Consolidated supervision for investment businesses)

14.29 We will also make minor consequential amendments to Appendix 1 and Annex A.

14.30 We are proposing to amend cross-references to GENPRU, BIPRU, IFPRU and the UK CRR in line with the general approach to cross-references outlined above.

14.31 In Chapter 14 of IPRU-INV we propose to update the circumstances under which this chapter will not apply to include situations where the firm is part of a group that contains an FCA investment firm and is included within a prudential consolidation under MIFIDPRU 2.5 or a group capital test under MIFIDPRU 2.6.

14.32 We have also taken the opportunity to correct an inaccurate cross-reference in IPRU-INV 14.5.2R.

14.33 We will publish our proposals for consequential changes to IPRU-INV Annex D (required forms) in a subsequent consultation.

IPRU-INV 11

14.34 As explained in the "general approach to cross-references" section, we have amended IPRU-INV 11 so that it explains that CPMI firms will be subject to MIFIDPRU in parallel with IPRU-INV 11. This is consistent with our existing approach. For example, a CPMI firm will need to comply with the base requirement in IPRU-INV 11 in parallel with the permanent minimum requirement (PMR) in MIFIDPRU (see Chapter 5 of CP20/24 for details on the PMR).

14.35 We have not updated the definition of 'own funds' in IPRU-INV 11 to refer to MIFIDPRU. Instead, we have fixed the cross-reference to the UK CRR in time. As a result, CPM firms will not be affected by the changes to the meaning of "own funds" in MIFIDPRU 3. For CPMI firms, this means that the definition of "own funds" will differ between MIFIDPRU and IPRU-INV 11.

14.36 We explain our proposals for a basic liquid assets requirement in MIFIDPRU 6. CPMI firms, as MIFIDPRU investment firms, will become subject to this requirement in parallel with the liquid assets requirement in IPRU-INV 11.2.1R(3). CPMI firms should note that there is a different definition of 'liquid asset' in each chapter.

14.37 CPM firms and CPMI firms are both subject to a fixed overheads requirement in IPRU-INV 11. This currently cross-refers to the fixed overheads requirement in Article 97 of the CRR. We propose to cross-refer instead to the methodology for calculating fixed overheads in MIFIDPRU 4 (see Chapter 4 of this CP for details). The provisions that are currently in Article 97 of the UK CRR will be deleted in that regulation once the IFPR is implemented, as they are not applicable to banks or PRA designated investment firms. This is consistent with the EU's changes in Articles 60 and 61 of the Investment Firms Directive.

14.38 We have also explained that a CPMI firm is not required to include its collective portfolio management activities when calculating its K-factor metrics under MIFIDPRU 4.

Glossary

14.39 We propose to make consequential amendments to a small number of defined terms in our Handbook Glossary that are necessary to be consistent with our other consequential amendments.

14.40 These include adding specific reference to 'dormant account fund operators' in several definitions where references to 'BIPRU' will be deleted, which is necessary so as to leave undisturbed the prudential requirements that apply to a firm conducting this permitted activity.

Q29: **Do you agree with our proposals for consequential changes to our other prudential sourcebooks? If not, please identify which specific provisions you believe are not consequential changes that are needed.**

Q30: **Do you agree with our proposal for a three-year transitional provision (set out in MIPRU TP 2) to give former exempt-CAD firms time to comply with any new requirements in MIPRU 3.2? If not, what alternative proposal would you suggest?**

Q31: **Have you identified any specific cross-references that we may have missed where a consequential amendment could be needed to ensure the relevant provision still operates once IFPR is implemented? If so, please provide details.**

15 Applications and notifications

15.1 In this chapter we explain our approach to applications and notifications under MIFIDPRU.

15.2 We are also consulting on the proposed forms for applications and notifications.

15.3 Once finalised, the forms will be available via Connect, our online application and notification system. We expect to open the gateway for draft IFPR applications and notifications in the summer of 2021.

15.4 This chapter also:

- indicates for which applications we are likely to charge a fee
- explains what is happening with existing UK CRR permissions
- sets out our proposed approach to publishing information on the Financial Services Register for permissions granted under MIFIDPRU
- highlights where transitional provisions mean that FCA investment firms do not need to make an application or notification

15.5 The applications and notifications referred to in this chapter cover the material consulted on in CP20/24 and in this CP. In the case of cross-references to material published in CP20/24, cross-references to MIFIDPRU are to the version that we will publish in our forthcoming policy statement. In that statement, we intend to introduce some additional material explaining how UK CRR market risk permissions and notifications will work under MIFIDPRU.

15.6 We will place the relevant forms in Annexes at the end of each chapter of MIFIDPRU handbook text. In our final IFPR policy statement we will provide a complete list of IFPR applications and notifications.

MIFIDPRU applications and notifications

15.7 MIFIDPRU contains several instances where FCA investment firms or UK parent entities will have to apply to seek our permission to do something or to make a formal notification to us about a particular event. Tables 7 and 8 list all the MIFIDPRU permissions and notifications.

15.8 We have designed a specific form for each of the application and notification requirements listed in Table 7 and Table 8. This is to make it clear to applicant firms the information that we expect them to provide us with to support their application, or the level of detail needed for notifications. The content in each form is based on the specific requirements set out in our rules. We think this is an improvement on the current generic notification form and CRR permission forms. It should make it easier for applicant firms to submit complete applications and notifications. This should also make it easier and more cost-effective for us to process permissions and notifications.

15.9 In some application forms, we propose to request that applicant firms attach specific supporting information or documentation. This is to help us judge that they meet the relevant standards or conditions for the permission they are applying for. For example, in the K-CMG permission forms we propose to require that firms attach a copy of the agreement with their clearing member concerning the margin model and collateral used.

15.10 Other application forms request that applicant firms provide supporting information or documentation to demonstrate they meet certain requirements without being overly prescriptive. For example, investment firm groups wishing to apply for the group capital test are requested to attach supporting information to demonstrate that their structure is sufficiently simple.

Common sections for all forms

15.11 As we propose to receive applications through Connect, applicant firms should not need to re-enter all their basic information when submitting these forms. However, we are proposing to ask for details of the Senior Manager responsible for an application/notification.

15.12 Where an application or notification is submitted in the context of a group, we also propose to ask for confirmation of the group entities involved.

15.13 Each form will also require that our standard declaration is signed electronically before being submitted to us via Connect.

Applications and notifications to be made before 1 January 2022

15.14 Table 7 lists all MIFIDPRU permissions for which FCA investment firms or UK parent entities must formally apply to us.

15.15 We would encourage all firms to submit their applications as early as possible to ensure we can determine them in time, especially where an applicant firm wishes to rely on it from the point at which new rules come into effect on 1 January 2022.

15.16 Due to their nature, some permissions apply to a specific event and will only be relevant once the IFPR has been in operation.

15.17 Where an existing UK CRR permission may carry across it does not require anything to be done for the start of the IFPR. However, some firms not in currently scope of the existing UK CRR permissions may want to apply for these permissions for the first time under IFPR.

15.18 We would encourage FCA investment firms to state explicitly in their feedback which of these permissions, if any, they are thinking of applying for to help us gauge the potential volumes of applications we are likely to receive. We would also encourage trade bodies to gauge interest amongst their members. Based on that information, we will confirm in the subsequent PS by when we would expect firms to submit their applications. Any indications of interest are not binding, and we will treat them as confidential, subject to our ordinary legal obligations.

Table 7: MIFIDPRU permissions

Permission	Handbook Ref
Individual exemption from disclosure requirements	2.3.1R
Individual exemption from liquidity requirements where the firm is included in consolidated supervision	2.3.2R
Permission to use group capital test (See note 1)	2.4.17R
Exemption from liquidity requirements on a consolidated basis	2.5.19R
Permission to offset positions within a prudential consolidation group for calculating K-NPR	2.5.34R
K-CMG permission to include a portfolio of a designated investment firm in a consolidated K-CMG requirement	2.5.40R
K-CMG permission to include a portfolio of a third country entity in a consolidated K-CMG requirement	2.5.41R
Permission to include interim or year-end profits in CET1 capital	3.3.2R
Permission to include capital instruments issued by a firm as CET1 capital instruments (see note 2)	3.3.3R
Permission to reduce own funds, where none of the conditions in MIFIDPRU 3.6.4R apply	3.6.2R
Permission to rebase fixed overheads requirement to a lower amount where firm's projected relevant expenditure decreases by a material amount	4.5.9R
Permission to exclude from net open currency positions, positions deliberately taken in order to hedge against the adverse effect of the exchange rate on: (a) the firm's own funds requirement; or (b) an item which the firm has deducted from its own capital.	4.11.8R
Permission to use advanced internal models for the calculation of K-NPR	4.12.4R
Permission to make a material change or a material extension to the use of an advanced internal model	4.12.6R
Permission to use sensitivity models to calculate interest rate risk on derivative instruments	4.12.66R
Permission to apply K-CMG to a portfolio	4.13.9R
Permission to exclude transactions with certain counterparties from the calculation of firm's K-TCD requirement	4.14.6R

Note 1: We remind investment firm groups that are intending to apply to use the group capital test that we need to have received their application by 31 January 2022 if they want to take advantage of being able to apply the group capital test on a temporary basis, as set out in MIFIDPRU TP3.

Note 2: Firms that were not previously subject to the UK CRR definition of capital do not have to apply for permission to include as CET1 capital instruments that they have already issued provided that the instruments meet the necessary conditions for such capital in MIFIDPRU 3. They should refer to the section on transitional provisions for own funds permissions at the end of this chapter.

15.19 Table 8 lists all IFPR related notifications. We encourage FCA investment firms to notify us as soon as they can if they want to rely on having complied with a notification requirement, for example from the point at which the new rules come into effect on 1 January 2022.

15.20 In some cases, notifications need to be submitted to us within a specified timeframe. For example, firms who intend to issue AT1 or T2 instruments need to notify us of their intention at least 20 business days before the intended issuance date.

Table 8: MIFIDPRU notifications

Notification	Handbook Ref
Notifications of the use of the alternative approach to measure AUM and/or COH for the purpose of determining if a firm can be classified as an SNI firm	1.2.4R
Notification of the use of an end-of-day value for CMH as a result a qualifying error	1.2.7R
Notification that a non-SNI investment firm qualifies to be reclassified as an SNI investment firm	1.2.13R
Notification that a firm no longer qualifies to be classified as an SNI investment firm	1.2.16R
Notification of the intended use of proportional consolidation in respect of a relevant financial undertaking	2.5.17R
Notification of issuance of additional capital instruments in a class that has already been approved as CET1 instruments (See note 1)	3.3.3R
Notification of the intended reduction in own funds instruments where either of the conditions in MIFIDPRU 3.6.4R apply (See note 2)	3.6.3R
Notification of the intention to issue AT1 or T2 instruments (See note 3)	3.6.5R
Notification of the intended non-material change or extension to the use of an internal model	4.12.7R
Notification of the intended use of own delta estimates in K-NPR (standardised approach for options) or K-TCD	4.12.10R 4.14.20R
Notification that a firm no longer satisfies all the conditions of a K-CMG permission previously granted for a portfolio	4.13.10R
Notification to cancel a K-CMG permission for a portfolio and calculate K-NPR instead	4.13.20R
Notification that the concentration risk soft limit has been exceeded	5.6.3R
Notification of the concentration risk hard limit breach	5.9.3R
Notifications for the exemption from the K-CON requirement for commodity and emission allowance dealers	5.11.2R
Notification by non SNIs of meeting or no longer meeting conditions for exemption from requirements to establish certain committees and from additional remuneration requirements. (See note 4)	7.1.9R and 7.1.12R
Notification of own funds falling below certain level	7.6.11R
Notification of liquid assets falling below certain level	7.7.14R
Notification of a revised ICARA assessment questionnaire (MIF007) submission date(s)	7.8.5R
Notification of the intended treatment of instruments which were issued and met the conditions to be classified as AT1 instruments in accordance with the UK CRR before MIFIDPRU sourcebook application date (See note 5)	TP 1.8R
Notification that the instruments issued by a former non-CRR firm, its UK parent entity or parent undertaking before MIFIDPRU comes into effect meet the requirements to qualify as own funds under MIFIDPRU	TP 7.4R

Note 1: We must receive the notification at least 20 business days before the day that the CET1 instruments are due to be issued

Note 2: We must receive the notification at least 20 business days before the day that the intended reduction in own funds is due to take effect.

Note 3: We must receive the notification at least 20 business days before the day that the AT1 or T2 instruments are due to be issued

Note 4: This notification requirement is also referred to in SYSC 19G

Note 5: We would prefer to receive this notification before MIFIDPRU takes effect. However, firms have until 1 month after MIFIDPRU comes into force to notify us of the treatment of existing AT1.

Application fees

15.21 We are not proposing to charge fees for the majority of MIFIDPRU applications. However, there are some exceptions where we believe it is fair for us to seek to recover our costs because these costs are likely to be material. The applications we propose to charge a fee for are those requiring a significant level of technical expertise and that will take a substantial amount of time to determine. These include applications to:

- use advanced internal models to calculate the K-NPR (market risk) own funds requirements
- use sensitivity models to calculate interest rate risk on derivative instruments
- exclude from net open currency positions, positions deliberately taken to hedge against the adverse effect of the exchange rate on:
  - the applicant firm's own funds requirement or
  - an item which the applicant firm has deducted from its own funds
- use K-CMG, instead of K-NPR

15.22 The fees we propose to charge will be commensurate with the complexity of a given application type and the resources required to assess it. We expect the fee for internal market risk model approvals to be substantial. We expect that moderate fees will apply in all other cases.

15.23 We intend to put forward our proposals on applicable fee amounts and fee structures in our third IFPR CP, due to be published in Q3 2021.

15.24 As rules on fees for MIFIDPRU permission applications are unlikely to be finalised until later this year, those wishing to submit draft applications before then may not have certainty of the applicable fee. Applicant firms will not be required to pay a fee for draft applications until the requisite rules are in force and once the amount of the fee has been confirmed will be able to withdraw their applications without being liable for any application fees.

Treatment of existing UK CRR permissions

15.25 In DP20/2, A new UK prudential regime for MiFID investment firms, we indicated which CRR-based permissions we expected to continue to be in effect under the IFPR. In CP20/24 we proposed preserving the existing UK CRR market risk regime and introduced transitional provisions for the continuing application of UK CRR permissions for own funds.

15.26 Table 9 summarises how the relevant UK CRR-based permissions that will continue, map onto MIFPIDPRU.

Table 9: UK CRR permissions which carry forward as MIFIDPRU permissions. Existing permissions previously granted will continue to be in effect.

Permission	UK CRR Article	MIFIDPRU Ref
Permission to include interim or year-end profits in CET1 capital	Article 26(2)	3.3.2R
Permission to classify capital instruments issued by a firm as CET1 capital instruments	Article 26(3)	3.3.3R
Permission to use sensitivity models to calculate interest rate risk on derivative instruments (see note 1)	Article 331	4.12.66R

Note 1: We will be explaining our approach to sensitivity model permissions and include the near-final rules on this in PS1.

15.27 Table 10 shows which existing CRR permissions will become notifications under MIFIDPRU.

Table 10: UK CRR permissions which carry forward as notifications

Permission	UK CRR Article	MIFIDPRU Ref
Permission to reduce own funds where one of the conditions in MIFIDPRU 3.6.4R apply	Articles 77 & 78	3.6.3R
Permission to calculate own estimates for delta for the purposes of the standardised approach for options (see note 1)	Articles 329, 352(1) & 358	4.12.10R

Note 1: Existing UK CRR permissions for own estimates of delta will be treated as permanent notifications under the new rules. This means that we will not expect FCA investment firms currently holding these permissions to submit further notifications in the future for the existing models used for these purposes. For new permissions see: https://www.fca.org.uk/publication/documents/option-price-template-for-notification.xlsx.

15.28 Table 11 shows which existing UK CRR permissions will carry forward as MIFIDPRU permissions but we do not expect there to be any active permissions as at 1 January 2022.

Table 11: UK CRR permissions which carry forward as permissions where we do not expect there to be any active permissions at the MIFIDPRU implementation date.

Permission	UK CRR Article	MIFIDPRU Ref
Permission to reduce own funds, where none of the conditions in MIFIDPRU 3.6.4R apply (See note 1)	Articles 77 & 78	3.6.2R
Permission to offset positions held by different group undertakings when applying consolidated market risk requirements	Article 325	2.5.34R
Permission to exclude from net open currency positions, positions deliberately taken in order to hedge against the adverse effect of the exchange rate on: (a) the firm's own funds requirement; or (b) an item which the firm has deducted from its own capital.	Article 352(2)	4.11.8R
Permission to use advanced internal models for the calculation of market risk capital requirement	Article 363	4.12.4R
Permission to make a material change or a material extension to the use of an advanced internal model	Article 363	4.12.6R

Note 1: a reduction permission under UK CRR is a 'point in time' permission and so is not converted into a MIFIDPRU equivalent.

15.29 For the avoidance of doubt, any existing UK CRR permissions which are not listed in Tables 3, 4 and 5 will cease to have effect from 1 January 2022.

Treatment of existing waivers and modifications

15.30 Most existing waivers and modifications of the rules in our current prudential sourcebooks will also cease to apply from 1 January 2022. We noted this expectation in Chapter 16 of DP20/2. Further information about the amendments to other prudential sourcebooks is given in Chapter 14 of this CP.

15.31 The exception to this is the existing waivers and modifications in respect of the committee requirements under IFPRU. FCA investment firms that remain in scope and whose waivers or modifications will not have expired before 1 January 2022 will be able to have them transferred to the MIFIDPRU regime. We include further details with other governance requirements in Chapter 8 of this CP.

FSMA waivers

15.32 Generally, FCA investment firms and UK parent entities wishing to apply for a FSMA waiver or modification in respect of any of the rules related to the IFPR will be expected to use our existing Waiver Application Form.

Publication of MIFIDPRU permissions on the Financial Services (FS) register

15.33 We propose to publish any MIFIDPRU permissions that we grant on the FS register, in line with our current approach to publishing FSMA waivers and modifications, and UK CRR permissions.

15.34 Under this approach most waivers, modifications and CRR permissions that are granted are published in full. In some cases, we publish the information in abridged form or do not publish at all, if we think this is appropriate. In general, we believe that publishing MIFIDPRU permissions ensures consistency with the current approach, while also strengthening transparency and public disclosure.

Transitional provisions for own funds permissions and notifications

FCA investment firms and UK parent entities that have not been subject to the UK CRR definition of capital

15.35 MIFIDPRU TP 7 applies to FCA investment firms and UK parent entities that have not been subject to the UK CRR definition of capital, that is BIPRU firms, exempt CAD firms, locals and exempt commodities firms. This allows these FCA investment firms and parent entities to recognise their existing own funds instruments as own funds under MIFIDPRU where they meet these conditions:

- the own funds instruments were issued before the date that MIFIDPRU began to apply, and

- the instruments meet the conditions in MIFIDPRU 3 to be classed as own funds (excluding any conditions relating to needing to obtain our permission, or to give notification to us before treating them as own funds)

15.36 FCA investment firms and UK parent entities with own funds instruments that meet these criteria do not need to notify, or ask permission from, us in accordance with the normal rules in MIFIDPRU to count these existing instruments as own funds for the purpose of MIFIDPRU 3. This is because the transitional provisions deem the FCA investment firm or UK parent entity to have obtained the relevant permission or to have made the relevant notification under MIFIDPRU. However, these entities do need to notify us, by no later than the date that MIFIDPRU begins to apply, where they intend to count these existing instruments as own funds.

15.37 The transitional provisions also mean that if such an FCA investment firm or UK parent entity subsequently issues further instruments of the same class of existing instruments on substantially the same terms after MIFIDPRU begins to apply, it only needs to comply with the rules that apply to the subsequent issuance.

15.38 For CET1 instruments of an existing class, this means that FCA investment firms must give us advance notice of the subsequent issuance, but they do not require our permission. For AT1 and T2 instruments of an existing class, no further notification is required. However, if an FCA investment firm issues a new class of regulatory capital instruments (or instruments of an existing class on substantially different terms) on or after the date that MIFIDPRU begins to apply, it will need to get our permission (for CET1 instruments) or to notify us (for AT1 or T2 instruments) under the standard rules in MIFIDPRU 3.

FCA investment firms that are currently subject to the UK CRR definition of capital

15.39 FCA investment firms that are currently subject to the UK CRR do not need to rely on the proposed transitional in MIFIDPRU TP7. In CP20/24, we included proposed transitional provisions in MIFIDPRU TP1 that would automatically convert existing UK CRR CET1 permissions into their equivalent MIFIDPRU permission. In this consultation, we propose to add additional provisions to MIFIDPRU TP1 to clarify that we will deem notifications made under IFPRU for existing AT1 or T2 instruments issued by IFPRU investment firms equivalent notifications under MIFIDPRU. This means that where former CRR firms are issuing further instruments of pre-existing classes of regulatory capital instruments on substantially similar terms after MIFIDPRU begins to apply, they only need to comply with the rules that apply to subsequent issuances of an existing class.

15.40 However, current IFPRU investment firms should note that this does not mean that the underlying instruments will automatically satisfy the criteria in MIFIDPRU 3 to qualify as regulatory capital instruments. It is the firm's responsibility to ensure that those criteria are met if it intends to include existing instruments in its own funds under MIFIDPRU. We remind FCA investment firms that the criteria to recognise instruments as AT1 capital under MIFIDPRU 3 are different from those under the current UK CRR.

15.41 Current IFPRU investment firms that have issued existing AT1 instruments should also note that under our proposals in CP20/24, there is a separate requirement in MIFIDPRU TP1 to notify us of whether those instruments meet the updated AT1 conditions in MIFIDPRU 3.If they do not, the FCA investment firm is required to notify us of the approach that it intends to take in relation to such instruments. That notification must be submitted no later than one month after MIFIDPRU begins to apply.

15.42 The above summary of the transitional provisions in MIFIDPRU TP1 and TP 7 is a very high-level summary of eligibility criteria and the operation of the provisions. FCA investment firms should refer to the rules in those annexes in the draft legal instrument for more detailed information. This includes how we propose to apply an equivalent approach to that outlined above for existing UK parent undertakings that will be required to hold regulatory capital in accordance with MIFIDPRU 3 when IFPR begins to apply.

Q32: **Do you have any feedback on the applications and notifications forms covered in this chapter, including our proposals for any supporting information or documentation? Please indicate the specific form or forms your feedback relates to.**

Q33: **If you think you might want to apply for any of the permissions that need to be determined before 1 January 2022, please indicate which ones.**

Q34: **Do you agree it is fair and appropriate that we charge fees for the applications in certain circumstances where we have deemed it justifiable to do so? Please suggest what you believe would be an appropriate charge for the applications we have listed in section 11.19. Please indicate which permissions from that list you might be applying for.**

Q35: **Do you agree with our proposed approach to publishing MIFIDPRU permissions on the FS Register?**

16 Our approach to the Financial Services Bill and compatibility with our duties and principles

16.1 When we consult on new rules, the Financial Services and Markets Act 2000 (FSMA) requires that we must advance at least 1 of our operational objectives. We are also required to have regard to regulatory principles.

16.2 As explained in CP 20/24, the Financial Services Bill (FS Bill), as currently drafted, sets out additional duties, new 'have regards to' considerations, and public accountability requirements we must comply with in our rulemaking for the IFPR.

16.3 We intend to meet the new obligations set out in the FS Bill ahead of the Bill coming into force. The current draft of the FS Bill permits this to enable us to consult stakeholders before implementing these new prudential requirements.

16.4 The drafting of the FS Bill may change as it is debated and considered by Parliament. Nonetheless we believe consulting now is preferable to waiting until the Bill comes into force. This ensures the timely introduction of the IFPR while giving firms sufficient time to prepare for it. We are monitoring the FS Bill's passage through Parliament and will consider whether any changes to its provisions require us to take any further steps before we introduce the new regime.

16.5 The scope of the secondary legislation that the Treasury makes using the proposed regulation-making powers in the Bill will affect our powers to introduce the IFPR. Again, we will closely monitor the content of those regulations and will reflect their effect in subsequent consultations if needed.

16.6 The FS Bill, as introduced to Parliament in October 2020, will place a duty on the FCA to make rules for investment firms, using our existing rulemaking powers, to impose the following prudential requirements:

- the types and amounts of capital and liquid assets they must hold
- the management of risks arising from the strength of firms' relationship with, or exposure to, clients
- regulatory reporting
- governance arrangements
- remuneration policies and practices
- public disclosure

16.7 In doing so, the FS Bill will require us to address the risks to:

- consumers arising from investment firms
- the integrity of the UK financial system arising from investment firms
- which FCA investment firms are exposed

16.8 The FS Bill will also impose similar obligations to make prudential rules for authorised parent undertakings of FCA investment firms, and (if we think such rules are necessary or expedient to advance one of our operational objectives) for unauthorised parent undertakings of FCA investment firms.

16.9 The rules the FCA makes to meet these new duties under the FS Bill for the IFPR are referred to in the Bill as 'Part 9C Rules'. The FS Bill sets out that, when making or amending any 'Part 9C Rules', we must have regard to:

- any relevant standards set by an international body
- the likely effect on the relative standing of the UK as a place for internationally active investment firms to be based or to carry on activities
- any other matter specified by the Treasury

16.10 These new considerations are in addition to our existing statutory objectives, our duty to have regard to the regulatory principles in FSMA, and to the importance of taking action to minimise the extent to which it is possible for a business to be used for a purpose connected with financial crime. All of which are considered in the context of the Financial Conduct Authority's new remit letter of 23 March 2021. Unlike these existing obligations, the new considerations in the FS Bill only apply to Part 9C rules.

16.11 The FS Bill will also require us to consider, and consult the Treasury on, the likely effect of the rules on relevant equivalence decisions. The Treasury is responsible for determining what is considered a relevant equivalence decision and must notify us of these in writing.

16.12 The FS Bill also sets out new accountability requirements. When we consult on our draft IFPR rules, we are required to explain:

- the provisions included to address the risks set out above
- the ways in which having regard to the above new considerations has affected the rules

This is in addition to our existing requirements under section 138I of FSMA.

16.13 When we make our proposed rules, we must publish a summary of the purpose of the rules and explanations and a statement on the points above. We are also required to publish a list of the rules we consider Part 9C rules.

How we intend to fulfil our duties

16.14 In this chapter, we set out how we have considered our new duties and have regards obligations set out under the FS Bill, as well as our obligations under FSMA, in relation to the proposals in this CP.

16.15 As set out in CP20/24, we want to provide industry with sufficient time to prepare for the introduction of this new regime. So we have taken a phased approach to consultation. we set out now our draft rules on those areas where we believe industry needs more time to prepare now, rather than waiting until later in 2021 to release a single consultation.

16.16 A consequence is that we will only set out in this CP how we have fulfilled our duties and addressed the risks as required by the FS Bill provisions in the context of the proposals that we are consulting on in this CP. We will explain in our subsequent third consultation how the remaining elements of our proposals further address our duties and the risks set out.

16.17 Our intention is that our final consultation will bring together the elements covered in the preceding consultations as well.

16.18 In this CP, we set out our draft rules to introduce the following chapters, or elements of them, of the new prudential sourcebook for MIFID investment firms and related provisions elsewhere in our rules:

- MIFIDPRU1 – Application (remainder)
- MIFIDPRU4 – Own funds requirements
- MIFIDPRU6 – Liquidity
- MIFIDPRU7 – Risk Management, Governance, ICARA & SREP
- MIFIDPRU9 – Regulatory reporting (remainder)
- MIFIDPRU10 – Clearing firms
- SYSC19G – Remuneration requirements

This CP also contains certain other consequential or non-material amendments that are connected to the above proposals.

16.19 Below we set out how we believe our proposed rules in these chapters help us fulfil our duties and address the risks.

MIFIDPRU1 – Application

16.20 Our duty under the proposed Part 9C of the FS Bill is to make rules for FCA investment firms and certain parent undertakings. In this CP, we propose to include an overall application chapter at the beginning of the new MIFIDPRU sourcebook that identifies the entities to which the rules and guidance in the sourcebook apply.

16.21 Having considered the definition of an FCA investment firm in the FS Bill, we consider that this includes collective portfolio management investment (CPMI) firms. So we are also proposing to add guidance that clarifies that CPMIs must comply with the requirements in MIFIDPRU that are applicable to FCA investment firms, except to the extent that a provision specifically directs otherwise. This will ensure that we meet our obligation to apply Part 9C rules to the required population of firms. More generally, it helps us deliver a more level playing field, and so supports our objective to promote competition.

16.22 The definition of an FCA investment firm in the FS Bill does not include overseas investment firms, including where they operate branches in the UK. Therefore we do not have a duty to make prudential rules that apply to such firms, although we could make rules under our general FSMA rule-making powers if we considered this appropriate.

16.23 Having considered this issue, we have decided that at present, we will consult on excluding overseas firms from the scope of MIFIDPRU. However, when considering whether to authorise a UK branch of an overseas investment firm, we will assess whether the firm is subject to a prudential regime in its home jurisdiction that applies requirements that are broadly equivalent to MIFIDPRU. We think that this is an appropriate approach, having regard to the practical limitations on applying direct prudential supervision on a branch basis and our published approach on authorising branches of overseas firms 'Our Approach to international firms' (Feb 2021).

16.24 In this CP, we are also proposing some amendments to clarify the criteria according to which an FCA investment firm will be assessed as small and non-interconnected (SNI). Most of these amendments do not change the approach that we previously proposed in CP20/24. They are designed to clarify how certain calculations should be performed when assessing whether the criteria are met.

16.25 We also propose to add a new criterion that will prevent a firm from being SNI if it provides clearing services to other users, whether as a direct clearing member of a central counterparty or through indirect clearing arrangements. We think that this is appropriate to reflect the interconnected nature of clearing arrangements and the associated risks within the financial system. In making this amendment we are fulfilling our requirement to address risks to integrity of the UK financial system arising from investment firms.

MIFIDPRU4 – Own funds requirements

16.26 To enable us to deliver our Mission and objectives, we must ensure that FCA investment firms have adequate financial resources and be able to put right any harm that they might cause to others. Reflecting our requirements as set out in the Bill, our rules look to minimise the risk of firm failure. However, our intention is not to introduce a zero-failure regime. We do want to ensure that, if an investment firm does exit the market, this occurs an orderly manner. This helps us address potential harm to consumers and protect the integrity of the financial system.

16.27 In this CP, we propose that the fixed overhead requirement (FOR) will apply to all FCA investment firms. The FOR is one of the factors that determines the level of own funds a firm needs to have (its 'own funds requirement'). It is an amount equal to one quarter of the firm's relevant expenditure during the preceding year. Ensuring a firm has own funds reflecting its FOR plays an important role in making sure it can exit the market in an orderly way.

16.28 We are also consulting on how to calculate the remaining K-factor requirements. These are a mixture of activity- and exposure-based requirements. The K-factors are a fundamental development within the IFPR. They help us assess the level of risk firms pose based on their activities, and the calculations needed to help determine the amount of own funds they need to hold to cover these risks. This creates a direct link between firms' own fund requirements and their business and operational models.

16.29 The additions to MIFIDPRU 4 in this consultation cover the K-factor requirements for MiFID business from:

- portfolio management and investment advice of an on-going nature (K-AUM);
- reception and transmission and execution of client orders (K-COH);
- holding client money (K-CMH); and
- holding client assets (K-ASA).

16.30 These requirements will help to address risks from activities that have the potential to cause material harm to an FCA investment firm's clients, such as operational risks from holding client funds or errors in executing a client's order.

MIFIDPRU6 – Liquidity

16.31 While all FCA-authorised firms are required to hold adequate financial resources to meet their liabilities as they fall due, not all FCA investment firms are currently subject to the detailed liquidity requirements set out in BIPRU 12.

16.32 The IFPR introduces minimum quantitative liquidity requirements for all FCA investment firms, including SNIs. These proposed requirements are designed to ensure that all FCA investment firms have a minimum stock of liquid assets to fund the initial process of a wind down, if it becomes necessary to exit the market. This helps us to address the potential harm to consumers, and the UK financial system more widely, that may otherwise arise from the disorderly failure of FCA investment firms.

16.33 The new basic liquidity requirement will require an FCA investment firm to hold an amount of core liquid assets that is at least equal to the sum of a third of the amount of its fixed overhead requirement and 1.6% of the total amount of any guarantees provided to clients.

16.34 This basic requirement must be met through the most liquid assets, in order to support a wind down. Conversely, for going concern purposes, we are allowing greater flexibility to meet the threshold requirements set out in MIFIDPRU7.

16.35 This should help ensure FCA investment firms can continue to function or otherwise exit the market without disruption, by continuing to fund their relevant expenditure for a given period and without having to rely upon continued income.

MIFIDPRU7- Risk Management, Governance, ICARA & SREP

16.36 With the introduction of the IFPR, we propose to introduce a more proportionate approach to the assessment and setting of prudential requirements. We will achieve this by creating a clearer link, compared to previous regimes, between firms' size, complexity, and harm they pose to consumers and markets.

16.37 FCA investment firms' risk management practices and governance are critical in enabling them to assess the appropriate non-financial and financial resources required to cover the risk of harm they pose, both on an ongoing basis and to exit the market.

16.38 Our proposed rules make clear senior management's responsibilities to deliver effective risk management, including Senior Managers' responsibilities.

16.39 Reflecting the wider duties set out for us, our proposed rules emphasise the requirement for FCA investment firms to identify and mitigate the harm they may cause to consumers and the market throughout the economic cycle. This means that an FCA investment firm should consider as part of its ICARA process how the risk of harm may develop in future, including in the event of a disorderly wind-down, rather than focussing on a static assessment based on current circumstances.

16.40 These proposals will also allow us to re-orientate our prudential supervisory approach to a more sectoral and risk-based approach, concentrating on areas where harm is most likely to arise. This will help us fulfil our duty to mitigate the risks to consumers and the market arising from FCA investment firms, as well as to reduce those risks that firms themselves may be exposed to.

MIFIDPRU9- Regulatory reporting

16.41 In this CP, we are consulting on the proposed reporting forms on an FCA investment firm's ICARA process and on remuneration requirements. We are also consulting on amendments to the liquidity reporting forms we proposed in CP20/24 to take into account the proposed rules on the liquid assets requirement, and on amendments to the existing reporting forms for CPMIs to account for changes introduced by the IFPR.

16.42 As set out in our first CP, we need relevant and timely data on the risk profile of individual firms, to enable us to identify trends that point to potential risks to their financial resilience. So effective reporting of liquidity, the outcome of firm's ICARA assessments, and remuneration requirements, are essential to enable us to deliver on our requirements for the IFPR.

16.43 Our proposed approach is to streamline existing reporting requirements and focus on information that will support a more agile supervisory approach. This relies on having access to more relevant and timely data. The level of detail we propose to collect from FCA investment firms will depend on the complexity of their business model and size.

MIFIDPRU10 – Clearing firms

16.44 As part of our engagement with industry participants, we have identified that certain FCA investment firms may provide clearing services, either as direct clearing members of central counterparties or through providing indirect clearing arrangements. These activities may be important, particularly in certain specialist markets where they may increase competition and widen access to clearing services. However, clearing services may also involve additional risks, particularly due to their interconnected nature within the broader financial system.

16.45 Reflecting our requirement to address the integrity of the UK financial system arising from investment firms we propose to apply certain additional requirements to clearing firms. These will include requiring cleared transactions to be included within the calculation of a firm's daily trading flow (DTF), which will therefore contribute towards its K-DTF requirement. However, where a firm is both executing and clearing the same trade and the value has already been included in the firm's calculation of COH or DTF due to the execution activity, we propose that the firm does not need to include the value in DTF again for the clearing activity. We think that this is a proportionate approach to addressing the relevant risks.

16.46 Firms that are direct clearing members of a central counterparty are often required to make pre-funded contributions to the central counterparty's default fund. The current UK CRR requires firms to treat these pre-funded contributions as exposures when a CRR firm is calculating its counterparty credit risk requirement. We propose to adopt a similar approach in our rules by requiring firms to include pre-funded contributions to the default fund of a central counterparty within their K-TCD requirement. This will help to address the risks from the firm's potential financial liability if the central counterparty defaults on its obligations.

Remuneration requirements

16.47 We designed the proposed remuneration rules included in this CP to be consistent with an FCA investment firm's size and complexity. For example, we propose to apply only basic requirements to SNIs. Non-SNIs will have to meet more detailed standard rules, including identifying material risk-takers (MRTs), guaranteed variable remuneration, severance pay, performance measurement, and malus/clawback. The largest non-SNIs will also need to comply with rules on deferral, retention, and paying a proportion of variable remuneration in non-cash.

16.48 The overall aim behind our proposals is for firms' remuneration policies and practices to promote healthy cultures and to help us prevent behaviour that could lead to harm to consumers or markets and that promote effective risk management. This, in turn, should help us mitigate the risks to consumers and the market from FCA investment firms' activities.

Summary

16.49 As set out previously, we consider the impact of our proposals will be to reduce the risks to consumers to which FCA investment firms are exposed (including because of their relationship with their parent undertaking), reduce the risks they pose to clients and counterparties, and to support the integrity of the financial system.

16.50 In so doing, these proposals are part of the fulfilment of our duties under the FS Bill to impose the following requirements on FCA investment firms and their parent undertakings:

- the types and amounts of capital they must hold
- the management of risks arising from the strength of firms' relationships with, or exposure to, clients
- regulatory reporting
- governance arrangements
- remuneration policies and practices
- public disclosure

Advancing our objectives

16.51 The proposals in this CP are intended to advance our objectives to enhance the integrity of the UK financial system, to protect consumers and to promote effective competition in the interests of consumers.

16.52 We consider these proposals compatible with our strategic objective of ensuring that the relevant markets function well. They are intended to refocus prudential requirements away from solely looking at the risks to firms' balance sheet, to also consider and look to mitigate the potential for harm the firm may pose to others, to their clients and markets.

16.53 For example, the proposed K-factor approach to determine minimum own funds requirements for non-SNIs seeks to capture activity and exposure-based risks that are specific to each firm. FCA investment firms will only have to apply the K-factors that are relevant to their business model. We believe that aligning standards with different categories of risks should help us reduce the potential harm to consumers, therefore improving confidence in the integrity of the market.

16.54 Likewise, by requiring that FCA firms have adequate stress-testing and wind-down plans as part of their ICARA process, we are ensuring that firms are taking the necessary steps to avoid a disorderly failure. This, in turn, should help improve the stability of the financial sector overall.

16.55 This should also grant greater protection to consumers, by ensuring the FCA investment firms they deal with have robust governance procedures to monitor risk and adequate financial resources.

16.56 Our proposals will also mean that there will be 1 overarching regime for all FCA investment firms. There is proportionality according to the type of activities they undertake and their size. This will be a significant improvement on the 11 regimes that are currently in place for these firms. FCA investment firms with similar business models will now have similar prudential requirements, rather than markedly different ones due to historical quirks. This will help to improve competition between existing FCA investment firms as well as simplifying prudential requirements for new entrants.

How we have taken account of our 'have regard to' considerations in developing the draft rules

Relevant standards set by an international body (as proposed by the FS Bill)

16.57 For the purpose of the MIFIDPRU chapters included in this and our previous CP, we have identified 1 relevant international standard for investment firms: IOSCO's 'Core Principle 30.' This sets out that: 'there should be an initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.'

16.58 We consider that the proposals included in this CP are consistent with this standard. As set out in CP20/24, our proposed rules amend the current levels of initial capital required for authorisation as an investment firm. These are set based on the regulated activity being undertaken, and we proposed to update them to reflect changes to the affected firms in terms of size and business model. Our proposed K-Factor and FOR requirements help ensure that prudential requirements are aligned with FCA investment firms' business model, their size and complexity. The ICARA proposals we set out in this consultation further develop this by requiring the firm to establish systems to identify and monitor risks of harm posed by the firm's activities and business model and strategy. And to mitigate them through controls and/or financial resources.

16.59 Furthermore, we have had regards to relevant standards set by an international body in relation to our remuneration proposals. For example, the Financial Stability Board's (FSB) Principles and Standards for Sound Compensation Practices (P&S) are high-level standards which seek to align firms' remuneration policies and practices with prudent risk management and the long-term interests of the firm. They cover key areas such as effective governance by the firm's management body, risk adjustment, pay-out of variable remuneration in shares or share-linked instruments, deferral, clawback, and restrictions on guaranteed variable remuneration.

16.60 Reflecting the FSB's focus on global financial stability, the P&S were initially intended primarily for large, systemically relevant financial institutions. But their areas of focus are also relevant to investment firms, as emphasised by the FSB's growing interest in the implementation of the P&S for the investment and insurance sectors in member jurisdictions.

16.61 We consider that our remuneration proposals in this CP are consistent with the FSB P&S. This applies not only to the overarching objectives but also to the more detailed elements of the P&S, for example that deferral periods should be not less than 3 years. At the same time, we are mindful that the P&S are aimed particularly at systemically relevant firms such as banks. We have ensured our proposals for FCA investment firms are proportionate to the risks posed by these firms. We do this by requiring only the larger investment firms to apply details rules on deferral and pay-out in instruments. We also allow exemptions for MRTs earning smaller amounts of variable remuneration. We have taken care to ensure that FCA investment firms have sufficient flexibility to establish remuneration policies and practices which are appropriate to the risks associated with their diverse activities, size, complexity and legal structure.

16.62 The revised G20/OECD Principles of Corporate Governance from 2015 apply to financial and non-financial listed companies. Although only a small proportion of FCA investment firms are listed, ie have shares that are publicly traded, some of the principles are relevant to good governance more broadly. This is particularly the case where the responsibilities of the management board are concerned.

16.63 To the extent they are relevant to non-listed investment firms, we have taken these principles into account. We consider our proposals on general governance are consistent with them. Examples include monitoring and managing conflicts of interest, ensuring adequate systems and controls, and setting up risk, remuneration and nomination committees, where appropriate.

The relative standing of the UK (as proposed by the FS Bill)

16.64 In CP20/24, we described how, when considering the new 'have regard to' duty as set out in the FS Bill, we first have to establish a baseline of where the UK stands before the proposed rules come into force. The UK is the world's largest or second largest financial centre by most measures and has the highest number of domestic and international investment firms operating in Europe.

16.65 As such, we consider the UK has a strong relative standing as a place for international investment firms to establish and conduct business. This is confirmed in discussions we have with firms and industry bodies. They confirm that the deep pool of skilled labour, deep capital markets, time zone, and strong, informed and consistent regulatory approach are all positive drivers.

16.66 For the purposes of our IFPR rulemaking, the most relevant other country or territory where in our opinion internationally active investment firms could choose to be based or carry on activities jurisdiction is the EU. It is the other major jurisdiction currently introducing a prudential regime for investment firms, shares broadly the same time zone, has deep capital markets, and a labour pool with the relevant financial services skill set.

16.67 We are adopting the same approach as we did for CP20/24, by using the EU's IFR/IFD as the baseline for the UK's IFPR. As we mentioned in that CP, our intention is to achieve the same overall prudential outcomes with IFPR as that of the IFR/IFD. This, in part, reflects the level of input we had on the design of the EU's regime. This approach, we believe, will have a positive impact on the relative standing of the UK in the eyes of internationally active investment firms.

16.68 There are specific areas where having regard to the UK's relative standing has affected the choices made in our rules in this CP, to ensure they are aligned with the needs of the UK market and take into account the business models of firms located here. These are:

MIFIDPRU6 – Our approach to assessing basic liquidity requirements

16.69 We propose that firms meet the basic liquidity requirement using a narrower range of assets than the more detailed provisions under the CRR that the EU's regime cross-refers to in its rules.

16.70 The assets that we propose can meet these basic liquidity requirements are those we would reasonably expect all FCA investment firms to hold. They do not require any reduction (or 'haircut') given their certainty of value.

16.71 When drafting this rule, we were conscious that by setting out a narrower range of permitted assets, we were taking a stricter approach than the EU, and that this in isolation could have an impact on international firms' views of the UK.

16.72 We do not consider high standards to be necessarily detrimental to internationally active firms. In many cases it can be the contrary. In this specific case, our proposals were driven by two considerations:

- **i.** Under our proposals the basic liquid assets requirement is a baseline that firms must always hold to ensure that they can start to wind-down in an orderly way, should that be necessary. Having a narrower band of the most liquid assets provides us, and the wider market, with greater confidence that this will be the case.
- **ii.** We believe strong market stability to be an important consideration for internationally active investment firms.

16.73 We are also conscious of a key objective of our IFPR proposals – to simplify the regime, particularly for the benefit of smaller and less well-resourced firms. This supports our competition objective.

16.74 Our proposals have achieved this by removing the need for cross-referring to detailed CRR provisions (delegated regulations) on liquid assets applicable to banks. These permit various types of assets (eg covered bonds, securitisation positions) subject to very prescriptive and complex conditions. Our aim is to simplify these requirements, while ensuring they remain prudentially sound.

16.75 Overall, we believe that maintaining a strong and robust regulatory and supervisory system, and our commitment to achieving the highest international standards, go hand-in-hand with the UK's competitiveness as a global financial centre.

MIFIDPRU10 – Categorisation of clearing firms

16.76 We are proposing that FCA investment firms providing clearing services (either as direct clearing members of a CCP, or as indirect clearing members through other clearing members) should automatically be treated as non-SNI. In our view, this reflects the fact that, given the nature of clearing activities, these firms are interconnected with other firms and the broader financial system.

16.77 Where an investment firm group is subject to prudential consolidation and contains one or more clearing firms, the UK parent entity of that group would need to comply with our rules on the basis that it is a non-SNI investment firm on a consolidated basis. These requirements will apply equally to self-clearers, ie firms that provide clearing services for their own trades.

16.78 Our approach to firms providing clearing services is designed to meet the specific needs of the UK market. Specialist non-bank clearing firms provide important services in specific markets (such as interest rate or commodity derivatives) within the UK, where larger bank clearing firms may be unwilling to provide these services or may only do so at uncompetitive rates.

16.79 In the EU, some of these firms may be designated as systemically important and therefore, may be subject to the CRR/CRD. However, our discussions with industry have led us to conclude that subjecting these smaller, non-bank clearing firms to the CRR/CRD would be disproportionate. In our view, the IFPR is a more proportionate regime to regulate these firms as our proposed standards are specifically designed with their needs in mind.

16.80 We are also proposing some additional capital requirements for clearing activities that go beyond those that would apply under the EU regime. In our view, these additional requirements are appropriate to address additional risks that may arise from the provision of clearing services. They are based on existing requirements in the UK CRR, but have been adapted to fit into the IFPR framework proportionately.

16.81 Our proposed rules should reflect the needs of the UK market, and therefore have regard to its relative standing, by ensuring our requirements account for the specific nature of activities and the business models of firms based in the UK.

Remuneration requirements

16.82 SYSC 19G - We are proposing to introduce a single Remuneration Code for all FCA investment firms, the MIFIDPRU Remuneration Code. This will replace the IFPRU Remuneration Code and the BIPRU Remuneration Code.

16.83 Our proposed rules are designed to account for the specifics of the UK market and ensure that our regime remains internationally competitive.

16.84 For example, in Chapter 9 of our CP, we set out our proposals to apply our MIFIDPRU Remuneration Code to firms in a proportionate manner. The EU's IFD does not apply any remuneration requirements to EU SNI firms, whereas we propose SNI firms comply with a small number of remuneration rules, the 'basic remuneration requirements' (see Chapter 10). As these rules are principles-based requirements there is a high degree of discretion in how to comply with them.

16.85 We have reflected on the impact of the UK's relative standing in making this proposal. If we did not apply at least these basic remuneration requirements it could have a negative impact upon the standing of the UK investment firm sector, both in prudential and conduct terms. This is particularly the case given many SNI firms are currently in scope of the IFPRU or BIPRU Remuneration Codes that are more detailed than our proposals under the IFPR. We conclude that continuing to promote effective risk management and alignment between risk and individual reward in all FCA investment firms (see Chapter 9) may broaden the UK's appeal as a destination for international firms to operate.

Likely effect on equivalence decisions (as proposed by the FS Bill)

16.86 As part of the process of drafting our rules in this CP, we have discussed with the Treasury the likely effect on equivalence decisions. We are not expected under our new public accountability requirements to provide further detail on this.

The need to use our resources in the most efficient and economical way

16.87 We have had regard to the need to use our resources in the most efficient and economical way as we developed our proposed rules. There are 2 areas where we have applied this principle in particular: our reporting requirements (MIFIDPRU9) and our rules around firms' risk, governance management and ICARA (MIFIDPRU7).

16.88 As set out previously, we have designed our rules to be proportionate and to ensure there is a clearer link between our requirements and the outcomes we are seeking. We have also sought to align these with FCA investment firms' size and complexity. This shift should make it less onerous to comply with our rules and enable us to be more efficient in how we undertake our supervisory work.

16.89 Our intention is to move our supervisory focus away from cyclical Supervisory Review and Evaluation Process (SREPs) for our larger firms, to concentrate our resources on those firms that pose the highest potential for harm, and to undertake sectoral analysis. While we intend to maintain a supervisory focus on the larger and more complex firms, we will assess the determinations and actions made as part of an FCA investment firm's ICARA process through a data-led, benchmarking-based intervention approach.

16.90 Our decision to do this reflects our desire to make best use of our supervisory resources. Undertaking a SREPs is a resource-intensive exercise. Our current approach of cyclical SREPs is not harm-led, but reflects requirements set out by the European Banking Authority designed for banking regulators. By making this proposal we aim to re-allocate resources to better deliver against our objectives.

16.91 Due to the number of FCA investment firms we regulate, we have focused on requesting the key information that supervisors need to make their assessment of harm. To support this, we have consulted on our proposals to retire the existing FSA019 form and replace it with a new, more streamlined ICARA questionnaire that all firms should complete.

16.92 Under our proposed approach, we ask focused questions which allow us to understand firms' activities and help us establish intervention points for firms to monitor against for their own funds and liquid asset resources. We set out when we expect firms to take actions, and the types of actions we expect. We also set out the types of actions we are likely to take.

16.93 Where we identify issues, we will be clear on the actions we will have expected the firms to take, as set out in our rules and in the firm's ICARA. We will have expected firms to act promptly on that basis.

16.94 This principle also applies to our proposed remuneration reporting requirements. In drafting our rules, we have determined which data items on remuneration are necessary for us to assess the effectiveness of firms' remuneration policies, while also being mindful of the need to ensure our supervisory resources are used in the most efficient and economical way.

The principle that a burden or restriction should be proportionate to the benefits

16.95 One of the underlying objectives of the IFPR is to ensure that prudential requirements are well aligned with FCA investment firms' business and operating models, and the potential harms that they may pose to consumers and markets in carrying specific activities.

16.96 In introducing the IFPR, we are departing from regimes that do not have this link to risks of harm posed by FCA investment firms built-in, for example the CRR/CRD, which was designed for systemically important banks. Currently, different investment firms of varying size and complexity operate under regimes that potentially place disproportionate requirements on them for the activities they carry out, or which do not capture all the potential risks they posed to their clients and the market.

16.97 The following examples highlight 3 areas where having regards to this principle has particularly influenced the design of our proposed rules:

MiFIDPRU4 – K-factor own funds requirements

16.98 As discussed in Chapter 4 of this CP, the K-factors are a mixture of activity and exposure-based requirements. Only non-SNIs will be required to calculate them. The K-factors that apply to each firm will depend on the nature of their activities and services.

16.99 The K-factors are one component that is used to determine the minimum own funds requirements for a non-SNI FCA investment firm. The information needed to calculate these has been designed with business metrics in mind. The more straight-forward formulae to calculate the requirement should, in principle, reduce the need for FCA investment firms to require external support.

16.100 We believe the K-factors to be one of the most important innovations of the IFPR. This is because the risk categories they aim to cover better reflect the potential harm that an FCA investment firm can pose to consumers and markets.

16.101 However, we recognise this approach will require considerable initial effort and resources on behalf of FCA investment firms to get things right. For some firms, their requirements will be higher than in the previous regime. However, as explained previously, we will be providing transitional relief in some areas and additional guidance, to ensure the costs associated with compliance are reduced as far as reasonably possible.

16.102 Overall, we believe the potential additional initial burden placed on firms needing to comply with our new rules is proportionate to the benefits that will be delivered with time by the regime. This is because it will lead to a more prudentially sound set of requirements based on the potential risks arising from FCA investment firms' specific activities.

MIFIDPRU6 – Liquidity

16.103 As set out previously, this is the first time that all FCA investment firms will have to comply with a basic liquidity requirement.

16.104 Our proposed rules are therefore likely to raise the requirements for a number of firms. However, we believe these requirements deliver considerable benefits, including that all firms should now have a ring-fenced pool of liquid assets, which gives both their counterparties and the market confidence.

16.105 In this CP, we have consulted on introducing greater granularity in the types of liquid assets firms need to hold. We are proposing that for the purpose of fulfilling their basic liquidity requirements, each FCA investment firms should be self-sufficient in terms of the amount of 'core' liquid assets they hold.

16.106 The basic requirement is based on a proportion of each firm's fixed overhead requirements and any guarantees provided by clients. A firm may need to hold additional liquid assets if determined as part of its ICARA process.

16.107 However, we have introduced flexibility in our approach to account for circumstances in which it may be appropriate for FCA investment firms to rely on liquidity by other entities in the group. Where firms are subject to prudential consolidation, they may apply for an exemption from the application of liquidity requirements on an individual basis.

16.108 Overall, we believe that the potential costs of complying with our proposed liquidity requirement are outweighed by the benefits they are designed to deliver. While the standards are being raised for some firms, overall these are proportionate to their size and complexity.

MiFIDPRU7 – Risk Management, Governance, ICARA & SREP

16.109 Our MIFIDPRU7 rules are designed to help both firms and us identify where harm may arise and put in place the measures necessary to mitigate this.

16.110 We expect all firms through the ICARA process to undertake business model planning, forecasting, stress-testing, recovery planning and wind-down planning. This is likely to be the first time that some FCA investment firms have completed such a detailed risk, governance and management assessment.

16.111 However, we believe the benefits outweigh the costs. Through the process firms will be better positioned to mitigate risks that they face and harms they pose to consumers and markets. The data that results from this provided in ICARA questionnaire will allow us to move to a more data-led and less SREP-reliant approach to supervision. The ICARA itself will allow us to have a more comprehensive conversation with FCA investment firms about what constitutes adequate financial resources given their operating and business model and their risk appetite.

16.112 Our approach is designed to be proportionate to firms' size and complexity. We also set out comprehensive guidance for larger or more complex firms to ensure the process is not too cumbersome. For example, when it comes to smaller, less complex FCA investment firms we only expect the ICARA process to be reviewed every 12 months (as opposed to 6 months, which may be appropriate for larger or for more complex FCA investment firms). We also set out much lighter expectations for stress and scenario testing, including that we do not expect non-complex firms to undertake reverse stress-testing. Equally, we do not expect FCA investment firms to undertake the same level of analysis on the sources of harm not covered by the basic requirements.

16.113 Overall, we expect our proposed rules to lead to a more resilient and prudentially sound regime, as it will ensure FCA investment firms conduct a thorough assessment of the specific harms that they are exposed to, as well as those they pose to their clients and the market.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

16.114 Given FCA investment firms' importance to the functioning of the UK and global economy, it is important that they are held to prudential standards that are proportionate to the risks they pose to clients, other firms and the market.

16.115 We have consulted on a set of prudential requirements which we believe to be proportionate to the risks they pose, based on each FCA investment firm's business and operating model. Our proposals are designed to support their resilience and therefore promote greater confidence in the industry's stability.

16.116 For example, our own funds requirements ensure that FCA investment firms have to protect themselves from external shocks and can continue operating in times of stress They also ensure that they avoid harm to their clients and the wider market by holding resources that can support an orderly wind down.

16.117 We have also consulted on rules that set new requirements around firms' systems and controls to prevent risks from materialising, by establishing a comprehensive ICARA framework. Our proposed approach would require firms to set out in detail the steps they are taking to reduce potential harm.

16.118 Also set out in our proposed ICARA rules – we expect all FCA investment firms to undertake stress testing based on realistic forecasts to support risk mitigation and to enable them to better plan for the future. We believe this will, we believe, support sustainable growth as firms use their findings to make realistic and appropriate strategic growth decisions.

16.119 We believe these measures support sustainable economic growth, as they minimise the disruption that FCA investment firms may pose to the wider economy during times of financial stress.

The general principle that consumers should take responsibility for their decisions

16.120 The proposals are primarily prudential and about reducing the potential harm that an FCA investment firm may cause to its clients and markets. Consumers typically do not have any influence over these.

The responsibilities of senior management

16.121 Under the IFPR, we are proposing to draw a clearer obligation for senior management to take responsibility for the oversight and sign-off of FCA investment firms' risk management and governance procedures.

16.122 As discussed in Chapter 7 of this CP, we are proposing that all FCA investment firms are responsible for recognising, monitoring, controlling and mitigating the risks to which they are exposed and potential for harm their activities pose to consumers and markets.

16.123 The ICARA process makes sure that each firm's assessment and the necessary steps to mitigate harm are well documented. Because we view the ICARA process as a key requirement of the regulatory system for investment firms, we expect that Senior Managers will take an active role in contributing to the required analysis, embedding the requirements in their business areas and approving the conclusion.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation

16.124 Our proposals are designed to support the resilience of FCA investment firms, many of which operate on a global scale and play an important role in the efficient allocation of capital, which is key to economic growth.

16.125 We have discussed throughout this CP, and previously, the specific characteristics of the regime that means it is more appropriate for FCA investment firms and proposes prudential and risk management obligations that are proportionate to the size and complexity of each firm.

16.126 For example, in CP 20/24 we set out how we consider the differentiation between SNIs and non-SNIs should ensure that smaller firms are not subject to requirements that are disproportionate to their size and the risks that they pose.

16.127 Below, we set out the areas where having regards to the differences in the types of business carried out by investment firms has particularly influenced our proposed rules:

MIFIDPRU4 – Own funds requirements

16.128 We are proposing to introduce K-factor requirements that apply to all non-SNIs and which are based on the specific activities that firms carry out. The amount of own-funds requirements for each non-SNI firm will therefore vary depending on the level of risk they pose-and are exposed to-because of their business model.

MIFIDPRU6 – Liquidity

16.129 We are proposing that all FCA investment firms should be self-sufficient in terms of holding liquid assets to meet the liquid assets requirement on an individual basis. However, we understand there are circumstances in which it may be appropriate for firms that are subject to prudential consolidation to apply for an exemption.

16.130 We are also proposing to provide transitional relief of up 5 years to meet this requirement for commodity and emission allowance dealers, to account for their business model and needs, given the specialised nature of this sector.

16.131 In addition, as the liquid assets requirement is determined by reference to the FOR, other types of firm that benefit from transitional relief limiting their FOR will also have their basic liquid assets requirement correspondingly reduced during the transitional period.

16.132 The flexibility in our approach to these proposed liquidity requirements is therefore based on the recognition of the different needs of businesses based on their size and complexity.

MIFIDPRU7 – Risk Management, Governance, ICARA & SREP

16.133 As set out previously in this chapter, the rules in MIFIDPRU7 address FCA investment firms' approach to internal governance and risk management. It sets out the expectations and requirements we have of firms, our expectations for the ICARA, and how we will assess firms against this.

16.134 Under our proposed rules we make a clear distinction between our expectations for firms based on their size or complexity. Our proposed rules contain a set of core requirements that we expect of every FCA investment firm, but also set out additional guidance and requirements for larger or more complex firms.

MIFIDPRU9 – Reporting requirements

16.135 We propose to reduce the quantity of data points that firms are required to provide as part of their reporting under the IFPR, focussing only on data which helps supervisors understand firm-specific harms, perform portfolio and sectoral analysis and ensure compliance with our new rules.

16.136 The amount and type of data we request from each FCA investment firm will therefore depend on their size and activities, with added proportionality for SNIs.

16.137 For example, in Chapter 13 of this CP, we have set out our proposals to tailor reporting requirements depending on a firm's size and whether it is subject to basic, standard or extended remuneration requirements.

16.138 Under our proposals, SNIs would only report to us basic information about the total number of staff they have and how much fixed and variable remuneration they awarded in the relevant year. In contrast, small non-SNI firms subject to standard remuneration requirements would need to split this information between material risk takers (MRTs) and non-MRTs and provide information on ex-post adjustments made to variable remuneration.

16.139 The largest non-SNI firms subject to extended remuneration requirements would need to provide the above information as well as the remuneration awarded to their highest 3 earners.

The desirability of publishing information relating to persons subject to requirements imposed under FSMA, or requiring them to publish information

16.140 Information about FCA investment firm authorisation status will generally be published on the FS register, except for when that information is particularly sensitive. This includes where a firm is using an alternative treatment (such as K-CMG, rather than K-NPR) or has been granted a waiver. The purpose of this is to ensure there is full disclosure of firms' status, to promote transparency and trust in the market.

The principle that we should exercise our functions as transparently as possible

16.141 Our consultation processes are intended to transparently set out the thinking behind our proposals and clearly explain what we expect to achieve. We will continue to engage with industry and other stakeholders to get feedback during the consultation process to ensure transparency and clarity in our approach.

16.142 In formulating these proposals, we have had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s. 1B(5)(b) FSMA). We do not consider this relevant to our proposals.

Annex 1
Questions in this paper

Q1: **Do you agree that CPMIs should apply MIFIDPRU requirements to their MiFID business? If not, please provide details of an appropriate prudential regime for the MiFID business of a CPMI.**

Q2: **Do you have any specific comments on our proposed approach to the calculation of the fixed overheads requirement (FOR) and the specific items of expenditure that may be deducted from total expenses? If yes, what items would you suggest are/are not deducted, and why?**

Q3: **Do you agree with our proposals for calculating K-ASA and that this should address the potential risk of harm from an FCA investment firm's direct safeguarding responsibilities, including where it is safeguarding assets delegated to it by another entity ASA? If you disagree, please explain why.**

Q4: **Are our proposals on the calculation of K-CMH, especially when amounts of CMH should be treated as being in a segregated account, sufficiently clear? If not, what specific suggestions do you have for improvement?**

Q5: **Do you agree with our proposals on how the value of assets should be calculated, and for when formal delegation takes place, when calculating K-AUM? If not, please explain any alternative suggestions you may have.**

Q6: **Do you agree with our proposals for calculating K-COH? Especially for measuring the value of cash trades, and for when certain transactions may be excluded from the measurement of COH? If not, please explain why and provide evidence to support any alternative suggested treatments.**

Q7: **Are our proposals that cover the interaction between K-AUM and K-COH clear and prudent? If not, what specific suggestions do you have to improve this?**

Q8: **Do you foresee any issues with our proposals for how to calculate an adjusted coefficient for use in times of stressed market conditions? If so, how might we address them, or what alternative practical suggestions do you have for achieving the desired outcome without unnecessary complexity?**

Q9: **Do you agree with our proposed treatment of FCA investment firms when acting as clearing members and indirect clearing firms? If not, what alternatives could be used to calculate the own funds requirements for such activity? Are there any other circumstances in which FCA investment firms may have exposures to a CCP that should be captured by K-TCD?**

Q10: **Do you agree with our proposals for a basic liquid asset requirement, to be met by holding core liquid assets? If not, please explain what alternative proposal you would suggest and why.**

Q11: **Are our expectations of firms regarding the ICARA and meeting the OFAR sufficiently clear? If not, which areas would benefit from further clarification?**

Q12: **Is the rationale for and explanation of the own funds and liquid assets wind-down trigger sufficiently clear? If not, which areas would benefit from further clarification?**

Q13: **Do you agree with our proposal to use an early warning indicator?**

Q14: **Do you agree with our proposed approach to the ICARA for firms forming part of a group?**

Q15: **Do you have any comments on our proposals for high-level rules on internal governance and controls?**

Q16: **Do you agree with our proposals to require certain non-SNI firms to have a risk committee, remuneration committee and nomination committee?**

Q17: **Do you agree with our proposal for firms to apply the new MIFIDPRU Remuneration Code from the start of their next performance year beginning on or after 1 January 2022?**

Q18: **Do you agree that SNI firms should be subject to the 'basic remuneration requirements'? If not, please explain why not.**

Q19: **Do you agree that only certain non-SNI firms should be required to apply the remuneration rules on deferral, pay-out in instruments and discretionary pension benefits? Do you have any comments on the thresholds we propose?**

Q20: **Do you have any comments on our proposed approach to identifying material risk takers?**

Q21: **Do you agree with our proposals for exempting certain individuals from the rules on deferral, pay-out in instruments and discretionary pension benefits? Do you have any evidence that may assist us in defining the scope of the exemption?**

Q22: **Do you have any other comments on the proposed scope and application of the remuneration rules?**

Q23: **Do you have any comments on the specific remuneration rules which we propose to apply to all FCA investment firms ('basic remuneration requirements')?**

Q24: **Do you have any comments on the specific remuneration rules we are proposing to apply to all non-SNI firms ('standard remuneration rules')?**

Q25: **Do you agree with our proposal to extend the existing non-Handbook guidance on ex post risk adjustment to FCA investment firms?**

Q26: **Do you agree with our proposals for rules on paying out variable remuneration in shares, other instruments or using alternative arrangements?**

Q27: **Do you have any comments on our proposals on deferral, vesting and retention?**

Q28: **Do you have any feedback on our reporting proposals? Please particularly provide details of any areas where you consider additional guidance on how to complete them is needed.**

Q29: **Do you agree with our proposals for consequential changes to our other prudential sourcebooks? If not, please identify which specific provisions you believe are not consequential changes that are needed.**

Q30: **Do you agree with our proposal for a three-year transitional provision (set out in MIPRU TP 2) to give former exempt-CAD firms time to comply with any new requirements in MIPRU 3.2? If not, what alternative proposal would you suggest?**

Q31: **Have you identified any specific cross-references that we may have missed where a consequential amendment could be needed to ensure the relevant provision still operates once IFPR is implemented? If so, please provide details.**

Q32: **Do you have any feedback on the applications and notifications forms covered in this chapter, including our proposals for any supporting information or documentation? Please indicate the specific form or forms your feedback relates to.**

Q33: **If you think you might want to apply for any of the permissions that need to be determined before 1 January 2022, please indicate which ones.**

Q34: **Do you agree it is fair and appropriate that we charge fees for the applications in certain circumstances where we have deemed it justifiable to do so? Please suggest what you believe would be an appropriate charge for the applications we have listed in section 11.19. Please indicate which permissions from that list you might be applying for.**

Q35: **Do you agree with our proposed approach to publishing MIFIDPRU permissions on the FS Register?**

Annex 2
Cost benefit analysis

Introduction

1. FSMA, as amended by the Financial Services Act 2012, requires us to publish a CBA of our proposed rules. Specifically, section 138I requires us to publish a cost benefit analysis (CBA) of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made and an estimate of those costs and those benefits'.

2. This analysis presents estimates of the significant impacts of our proposal. We provide monetary values for the impacts where we believe it is reasonably practicable to do so. For others, we provide estimates of outcomes in other ways.

3. The scope of this CP and corresponding CBA focus on a subset of own funds requirements (namely the Fixed Overheads Requirement (FOR), the Permanent Minimum Capital Requirement (PMR) and those K-factor requirements (KFR) not covered in CP20/24), liquidity, the ICARA process, Remuneration/Governance, and Reporting. A subsequent, third consultation will cover the remaining elements of the Investment Firm Prudential Regime (IFPR) and will include a relevant CBA. We intend in the third consultation to present our view on the overall impact of our rules over all three consultations. This ensures the total costs and benefits are considered in their entirety given the interlinked nature of many of the requirements which have been considered separately over CP20/24, this CP and our third CP.

4. This CBA has the following structure:

a. Section 1 outlines the problem and rationale for our proposed intervention.
b. Section 2 presents our baseline and key assumptions.
c. Section 3 lays out our estimates and analysis of the costs and benefits.

Problem and rationale for proposed intervention

5. FCA investment firms are an important element of a well-functioning economy. They help ensure capital is allocated efficiently and appropriately to help individuals make the most of their savings and investments. If FCA investment firms are not financially resilient, their failure, if it occurs in a disorderly manner, could bring disruption to clients or the markets in which they operate. This means it is necessary for such firms to be held to appropriate prudential standards.

6. Furthermore, decisions and choices of individual market participants can lead to negative externalities. These are side effects on third parties, such as consumers, other firms, the taxpayer, or the wider economy, that are not necessarily considered by individual market participants. This can lead to a suboptimal (low) level of capital held.

Where FCA investment firms fail, this can have knock-on effects on the markets or the economy, for example higher FSCS levies.

7. Our proposed intervention aims to achieve a better balance between avoiding the excessive social cost from firm failure and ensuring that excess costs are not ultimately paid by end-consumers. The proposed regime is expected to generate benefits to FCA investment firms and the market. We expect that firms subject to the proposed regime would find the new prudential framework more appropriate and proportionate to their business model and less burdensome than the current requirements. Prudential requirements that better align with an FCA investment firm's business model should also help improve the financial stability in the sector overall. This should have positive implications for consumer protection and particularly for clients of these firms, either because it reduces the potential for firm failure itself, or because it reduces the potential for disorderly failure if a firm does fail, increasing the likelihood of restoring consumers back into the position they should have been in. The proposed changes should help reduce costs and distress associated with discontinuity of service and economic losses in drawn-out insolvency proceedings; as well as placing less reliance on investor compensation schemes, avoiding consequent impacts on other firms to top-up these schemes to handle pay-outs. Overall confidence, investor sentiment and market stability should also benefit.[1]

8. The proposed regime will be closely aligned with the new EU regime – the IFD/IFR, while taking into consideration the specifics of the UK market. The details of the EU's new prudential regime for investment firms can be found in our June 2020 Discussion Paper – DP20/2.[2]

Baseline and key assumptions

Baseline – current regulatory regime

9. It is necessary to establish a baseline against which to assess the costs and benefits of an intervention to ensure that only those attributable to the intervention are considered.

10. The EU's framework legislation for its new prudential regime for investment firms was published at the end of 2019. This has been supplemented by additional technical standards published by the European Banking Authority, in consultation with the European Securities and Markets Authority. As the UK is no longer a member of the EU, we are not obliged to implement the EU's rules. We will instead be subject to an obligation to implement a domestic regime under the FS Bill currently in Parliament. As set out in both CP20/24 and this CP we believe that for our 'have regard' to the relative standing of the UK, the EU's IFD/IFR is the baseline for the IFPR. Nevertheless, recognising that parts of the overall regime are still based upon the UK CRR, we consider that it is sensible to go beyond and consider the existing levels of regulatory requirements and the current market conditions as an appropriate baseline for the purposes of our CBA.

1 EU impact assessment of the IFPR
2 DP20/2 - A new UK prudential regime for MiFID investment firms

11. We will compare our proposals against the current prudential framework that either specifies direct requirements for UK investment firms or defines the scope of the FCA's discretion to apply other prudential requirements i.e., the on-shored CRDIV and the CRR regime.[3] Where an IFPR requirement impacts a firm in a materially different way to these regimes this will be set out in this analysis. Where our proposals will be aligned with the EU, we will also consider any case made by the EU in making its proposals where we consider it relevant to do so.

Scope and affected firms

12. This CBA will only assess costs and direct benefits of proposals covered by this consultation. The IFPR will apply to a maximum of around 3,600 investment firms regulated by the FCA. This is based on the number of firms with relevant permissions on the FCA Services Register. However, we recognise that some Exempt-CAD firms may decide not to opt-in to MIFID and thus not become subject to the IFPR. For the purposes of the CBA, we have still used the upper bound of 3,600 investment firms for our costings.

13. As in CP20/24 we have defined categories of investment firms for the purpose of this CBA to calculate the costs and benefits. This current CP is covering a wide range of IFPR elements (part of own funds requirements, liquidity, the ICARA process, Remuneration and Governance, and further reporting aspects). The existing baseline for each of these elements can vary considerably because the firms in scope of the relevant existing rules (and how the existing rules may apply to them) differs for each element. For example, the ICARA process is akin to the ICAAP that currently applies to IFPRU and BIPRU firms only, whereas only a few firms are currently subject to any quantitative liquid assets requirement (under BIPRU 12). Equally, IFPRU and BIPRU firms are subject to different Remuneration Codes.

14. To provide as accurate an analysis of the costs and benefits as possible of each IFPR element consulted on in CP2 we have applied different categorisations to different IFPR elements. We outline below how we have done this.

Own Funds Requirements; Liquidity; and Reporting

15. In CP20/24 we divided investment firms into 3 categories. These were Small, Medium and Large. Large firms were those designated for prudential supervision by the PRA and so are not subject to any of the rules proposed in this CP. Since our first consultation, firms' responses to our data survey mean that we have been able to refine our estimates for the number of small and medium firms and in our third consultation, where we will present our view on the overall impact of our IFPR rules over all three consultations, we will take account of any refinement in numbers.

16. For the purposes of analysing: i) own funds requirements; ii) the basic liquid assets requirement; and iii) the reporting proposals, in this CP we make the distinction between SNI and non-SNI FCA investment firms. We estimate that the total FCA investment firm population would break down by around 70% SNIs and 30% Non-SNIs (provided that all existing investment firms remained under MiFID).

3 References to the "CRR" in this CBA are to the on-shored version of the CRR as it applies in UK domestic law by virtue of the European Union (Withdrawal) Act 2018 (as amended) and any subordinate legislation.

17. The following explains how the own funds requirements, liquidity standards and reporting proposals apply to SNI and non-SNIs.

18. **SNIs** – The own funds requirement of these firms will be driven by either the PMR or the FOR. The basic liquidity requirement is a new prudential standard for all IFPR firms irrespective of size.

19. All FCA investment firms will be required to submit regulatory returns under IFPR, although we would expect SNIs not to have to report some of the information. We assess the impact of our streamlined reporting proposals based on whether a firm is SNI or Non-SNI.

20. **Non-SNIs** – The own funds requirement of these firms will be the higher of the PMR, FOR and KFR. For many, it is expected that it will be the K-factors that drive own funds requirements (not the PMR or FOR).

21. The KFR, although applicable for all non-SNI firms when calculating own funds requirements, is not expected to be greater than the FOR or PMR for smaller non-SNIs. This is because some smaller firms will be categorised as non-SNI investment firms, due only to breaching one or more of the SNI thresholds by a small amount or because they have permission to deal on own account.

22. As explained above, the basic quantitative liquidity requirement is a new prudential standard for all IFPR firms irrespective of size; and all firms will be required to submit regulatory reporting to help monitor their compliance with the regime.

The ICARA process

23. We have defined four categories of investment firm for the purposes of the ICARA process. First, we have categorised firms based on whether they have been subject to the existing 'Pillar '2 approach or not. Pillar 2 is essentially where a firm is required to assess the adequacy of its financial resources and following our supervisory review many be required to hold additional own funds (or liquidity, or be subject to other measures).

24. Firms that have been subject to Pillar 2 will already be familiar with a lot of the concepts in the ICARA process and are likely to have existing processes in place that can be relatively easily repurposed to the ICARA process. This will be existing IFPRU and BIPRU firms.

25. All other firms subject to IFPRU will be new to the requirements in the ICARA process, and so the implementation costs will be relatively higher. Although many of these will be SNIs with smaller, less complex business models.

26. We have further split each of those two categories into SNI and non-SNI. This reflects the fact that the ICARA process includes some proportionality when firms undertake their ICARA assessment.

27. Based on these criteria we determine the percentage of firms in each of the four categories as:

	SNI	Non-SNI
Firm subject to existing Pillar 2 approach	36%	28%
Firm not subject to existing Pillar 2 approach	33%	3%
Total	**69%**	**31%**

Remuneration/Governance

28. We have defined six categories of investment firm for the purposes of the implementation of our remuneration proposals. First, we have categorised firms based on whether they are subject to an existing Remuneration Code. Firms subject to existing Remuneration Codes are IFPRU and BIPRU firms. CPMI firms already apply the AIFM Remuneration Code or the UCITS Remuneration Code to the non-MiFID parts of their businesses.

29. All other IFPR firms will be newer to remuneration requirements, though many already comply with the principle-based requirements on the remuneration of sales staff and advisers (SYSC 19F) and so will be familiar with establishing and implementing remuneration policies. The implementation costs will be relatively higher for these firms.

30. We have further split each of those two categories into three cohorts based on the proportionality provisions in our proposed remuneration rules. For example, many of the more detailed provisions on variable remuneration would not apply to SNIs.

31. Furthermore, the provisions on deferral and pay-out in shares or instruments would apply only to the largest non-SNIs. We are proposing to apply these only to non-SNI firms with:

- total on- and off-balance sheet assets of more than £300m, or
- total on- and off-balance sheet assets of more than £100m but less than £300m, and either trading book business of over £150m, or derivatives book business of over £100m

32. Consequently, we have further allocated firms to categories based on whether they are SNIs and whether they meet these criteria if they are non-SNIs.

33. Using these criteria, we estimate the percentage of firms in each of the six categories to be:

	SNIs	Non-SNIs not subject to deferral and pay-out rules	Non-SNIs subject to deferral and pay-out rules
Firm subject to an existing Remuneration Code	36%	26%	2%
Firm not subject to an existing Remuneration Code	33%	2%	1%
Total	**69%**	**28%**	**3%**

34. The following table brings all the different categorisations together, which we have applied above, to illustrate what percentage of the IFPR firm population are in the different categories.

Firm	SNI	Non-SNI			
		Binding own funds requirement is FOR or PMR		Binding own funds requirement is K-Factor approach	
		Assets < £300m	Assets > £300m	Assets < £300m	Assets > £300m
Firm subject to an existing ICARA or Remuneration Code	36%	15%	1%	10%	1%
Firm not subject to an existing ICARA or Remuneration Code	33%	2%	<1%	<1%	<1%

Data

35. We conducted this analysis of the costs and benefits of the consultation proposals using two sources of data. We used data held by the FCA including data provided through firms' regulatory returns, such as a firms' balance sheet data and liquid assets data.

36. The IFPR includes requirements that rely on non-financial data (e.g. staff numbers and business volumes) and some financial data (e.g. assets under management) that is not routinely reported to us by all firms or in the format required, and which we need to receive to inform our policy making and cost our proposals. Therefore, we separately issued a data request to collect such data from firms to support this, and our later, consultation. We surveyed 2,476 firms, a subset of the population as the data request was not relevant to all investment firms and received a very high response rate (57%). For this CBA we used the Remuneration data to inform the impact of Remuneration policies, and some of the business model metrics to determine which own funds requirement methodology was binding for each firm. We will use more of the survey data for our CP3 CBA.

Costs and Benefits

Summary of costs and benefits

37. In the sections below, we have assessed the implementation costs, the costs arising from the proposed prudential standards and the expected benefits. The following table sets out a summary of the estimated implementation costs, which are one-off costs. We do not include ongoing implementation costs, which are wrapped up within firms' day-to-day activities.

Type of cost	One-off implementation costs
Familiarisation costs	£3.5m
Gap analysis	£25.2m
Costs of changes to the firms' methodology for own funds and liquidity requirements and ICARA and remuneration material	£45.5m
Costs of making changes to the IT systems	£30.1m
Costs of providing staff training/disseminating information about the new rules	£27.3m
Total	***£131.6m***

38. The estimated total one-off implementation costs imply average cost of around £65k and £23k per non-SNI and SNI respectively. The per-firm average estimated values do not represent the costs we expect each firm of a given size or type to incur as a result of the proposals in this CP. Rather, these are averages published for the purposes of transparency for our calculations of the costs of these interventions. As we articulated in the previous section, the categories we have used to try and allocate firms are broad and each encompasses a range of firm sizes and types, which in turn would have a range of compliance costs above or below the averages we have included.

39. We also summarise below what we believe to be the one-off implementation costs, presented by each area of the regime.

40. We stress that all implementation cost estimates have been calculated based on separate teams being set up for each part of the regime. We recognise that in practice firms are likely to set up teams that will implement more than one aspect of the regime concurrently leading to implementation cost synergies. As a result, our approach to estimate implementation costs is likely to overstate the true implementation cost and be an upper bound. Equally, for some IFPR elements, such as Reporting and own funds requirements, where we consulted on rules in CP20/24 as well, we are likely to be duplicating some implementation costs in our estimates in this CBA.

IFPR element	One-off implementation costs
Familiarisation costs (which are not rule area specific)	£3.5m
Own funds requirements	£17.1m
Liquidity	£14.7m
Reporting	£15.3m
ICARA process	£43.3m
Remuneration and Committees	£37.7m
Total	***£113.86***

41. In the tables below we assess how SNI and Non-SNI FCA investment firms will be impacted by the proposed changes to the prudential regime. Each table summarises the net impact of each of the key policy changes according to any categorisation criteria explained above.

Own funds requirements; Liquidity and reporting

Item	Impact on firms	SNI	Non-SNI
Fixed Overheads requirement (FOR) ***Rules, draft MIFIDPRU 4***	Most firms can meet the requirement before the benefit of 5-year transitional provisions. Where this is not the case, SNIs appear less likely to be able to meet the requirement compared to non-SNIs. [see paragraphs 62-71 for details].	Yes	Yes
Permanent Minimum Capital requirement (PMR) ***Rules, draft MIFIDPRU 4***	Most firms can meet the requirement before the benefit of 5-year transitional provisions. The PMR is more relevant for SNIs than for non-SNIs. [see paragraphs 62-71 for details].	Yes	Yes
K-Factor requirements (KFR) ***Rules, draft MIFIDPRU 4***	Just over half the firms can meet the requirement before the benefit of 5-year transitional provisions. [see paragraphs 62-71 for details].	Not applicable	Yes
Basic liquid assets requirement ***Rules, draft MIFIDPRU 6***	Most firms can meet the requirement today. Furthermore, transitional provisions are likely to lessen impacts for some firms that cannot meet the requirement immediately. [see paragraphs 59-61 for details].	Yes	Yes
Reporting requirements ***Rules, draft MIFIDPRU 9 and connected amendments to SUP16.12***	Cost saving to firms due to significant reduction in the number of data items to be reported. [see paragraphs 87-91 for details].	Yes	Yes
Clearing ***Rules, draft MIFIDPRU 10***	Most firms can meet the own funds requirements for clearing. [see paragraphs 92-94 for details].	Not applicable	Yes

The ICARA process

Item	Impact on firms	Firm subject to existing "Pillar 2" approach		Firms new to setting additional requirements	
		SNI	Non-SNI	SNI	Non-SNI
Risk Management, ICARA, SREP ***Rules, draft MIFIDPRU 7***	There will be net implementation costs, particularly for those firms new to setting additional own funds or liquidity requirements. There will be benefits in the short to medium term for all firms through improvements to firms' risk management practices, and a heightened focus on mitigating harms to consumers and markets. [see paragraphs 72-75 for more details].	Yes	Yes	Yes	Yes

Remuneration and Governance

Item	Impact on firms [see paragraphs 76 to 86 for details]	Firms subject to an existing Remuneration Code			Firms not subject to an existing Remuneration Code		
		SNI	Non-SNI below thresholds	Non-SNI above thresholds	SNI	Non-SNI below thresholds	Non-SNI above thresholds
Gender neutrality of remuneration policies and practices *Rules, draft SYSC 19G*	No incremental cost as new rules reflect current legal position in UK	Yes	Yes	Yes	Yes	Yes	Yes
Ex post risk adjustment (malus and clawback) *Rules, draft SYSC 19G*	Net implementation cost as new provision for many firms	No	Yes	Yes	No	Yes	Yes
Identifying MRTs *Rules, draft SYSC 19G*	Net implementation cost for firms new to remuneration rules, and reduction in burden for firms already subject to a Remuneration Code	Yes	Yes	Yes	No	Yes	Yes
Deferral and pay-out in shares or instruments *Rules, draft SYSC 19G*	Net implementation cost for firms as will be new requirements for most firms in scope	No	No	Yes	No	No	Yes
Creating committees *Rules, draft MIFIDPRU 7*	Net implementation cost for firms as will be new requirements for some firms in scope, e.g., firms which are not currently 'significant IFPRU firms'	No	No	Yes (but not if currently significant IFPRU firm)	No	No	Yes

42. In addition, FCA investment firms might be eligible to opt in for a transitional arrangement (contained in the draft MIFIDPRU transitional provision annexes) or a phase-in period, which may last for up to five years. Examples relevant to this CP are the transitional provisions for the FOR and the PMR.[4] These are designed to reduce the immediate impact of the new prudential requirements for (potentially smaller) firms that might find transition challenging and should thus help to mitigate some costs in the short term.

4 Note, the transitional provisions for FOR and PMR were included in CP1 however were not included in the CBA at that time, because the FOR content was not finalised.

43. In summary, the benefits of the proposed rules assessed in this CBA are:

- All investment firms carrying out the same investment activity are treated in a simpler and more consistent manner. This removes any differences within markets and hence competitive distortions created by the existing mix of standards.
- More proportionate regulatory reporting requirements thereby lowering compliance costs.
- The IFPR is creating a tighter alignment and calibration of prudential requirements to business models and the potential for a firm to cause harm to their consumers/clients and the markets they operate in. This should raise awareness that running a business prudently includes assessing the degree to which their activities are posing harm to others and mitigating those harms.
- The linking of requirements to firm's business models and risk of harm should allow FCA supervisors and FCA investment firms, during the ICARA and SREP processes, to focus on mitigating the risks of harm in a way that aligns to how investment firms think about their business. This should also strengthen firm's internal risk management practices.
- By establishing an objective link in the ICARA between the financial resources an investment firm holds under its IFPR requirements, and its threshold conditions we will make it easier for firms to plan for how we expect them to respond in a certain situation, including whether they should commence wind-down.
- The introduction of a minimum liquidity requirement for all investment firms should improve overall confidence in the financial resilience of investment firms among customers, counterparties and, where relevant, shareholders. This should reduce the potential for firm failure itself or reducing the potential for disorderly failure if a firm does fail or exit the market.
- Reducing the social cost of firm failure by reducing the reliance on investor compensation schemes and avoiding consequent impacts on other firms to top-up these schemes to handle pay-outs. Consumers will avoid the distress and search costs of finding a new investment firm to service their business.

44. We do not consider it reasonably practicable to quantify these benefits. We will return to the benefits of the IFPR, including the broader impact of the whole regime on capital requirements and any other potential unintended consequences in our third consultation.

45. We believe that our proposals in this CP will have a net cost in the short to medium term. Most of the costs are one-off implementation costs; while the benefits (such as reducing the potential for disorderly failure) are ongoing and will likely build over time.

Implementation, IT and Training Costs

46. Implementation costs include the time and resources spent by firms familiarising themselves with the proposals and performing a gap analysis to identify necessary changes as a result. Firms may also incur training and IT costs. These costs will be one-off in nature to prepare for the introduction of the IFPR.

47. We use standard assumptions to estimate firm compliance costs based on the standardised costs model, of which further details can be found in the FCA publication

"How we analyse the costs and benefits of our policies".[5] As we explained above, we are introducing a range of different policy areas in this CP which will impact different categories of investment firms differently depending on the rules under consideration. Therefore, for the purposes of the CBA we categorised firms differently depending on which policy area we are analysing. This is so we can factor in longer implementation time and costs for those firms where a particular set of standards are entirely new, and thus provide a more accurate implementation estimate.

48. Given the overlap between some of the policy proposals in this CP and CP20/24, some of the implementation costs associated with the proposals would have already effectively been costed in the previous CP (for example, the own funds calculation methodologies). However, to be prudent we have included an estimate of those costs again.[6]

49. **Familiarisation:** To familiarise themselves with our proposals, we expect that all firms will read the consultation, which contains 167 pages some of which will not be relevant to all firms. We assume that the number of compliance staff who would need to read the consultation will on average be 5 people at a medium firm and 2 at a small firm. We use an average salary of a compliance function and apply these estimates to the different categories of firms we have created for the different sets of policies we are proposing in this CBA.

50. We estimate the total cost of familiarisation to be around £3.5m for the rules consulted on in this CP.

51. **Gap analysis:** To meet the proposed requirements, firms are expected to conduct a gap analysis of the amount of own funds and liquid assets required, among other things, and compare it against the current regime. The standardised cost model assumes it will take 2 and 1 legal and compliance professionals at a medium and a small firm respectively to review 242 pages of legal text, plus 73 pages of different rule specific consultation text, to assess our proposals. For those prudential standards that are entirely new to a firm, such as the additional own funds and liquid assets requirements in the ICARA process, they will require deeper familiarisation to establish firm impacts. Consequently, for those standards and firms where this is the case, we have refined our cost estimates to assume a slightly longer time to review the legal text.

52. We estimate the total cost of the gap analysis to be around £25.2m for the rules consulted on in this CP.

53. **Methodology changes:** Firms are likely to have to make changes to their own funds calculation, introduce a new liquid assets calculation and embed revised (or in the case of some firms new) ICARA processes or remuneration policies and practices (for example firms may need to revise employment contracts for those individuals to whom malus and clawback provisions apply or have to set up a risk, remuneration or nomination committee). These will require firms to have a small project management team and the main costs relate to the opportunity cost of staff time. Our model assumes that a medium firm will spend 14 person days to implement a change, while a small firm will spend 3 person days. We also assume that this change will need to be reviewed by Senior Managers at each firm. Again, for firms where the standards are entirely new, we have factored in a slightly longer time to reflect the deeper implementation required. The total cost of this change is expected to be around £45.5m.

5 How we analyse the costs and benefits of our policies
6 In CP3 we will provide an estimated implementation cost for the whole IFPR regime.

54. **IT changes:** In addition to the costs set out above, firms will need to make some changes to their IT systems to reflect amendments to their own funds calculation methodologies, introduce new liquidity standards and amend or introduce ICARA processes and amended remuneration policies and practices. Firms will also need to update their systems to comply with updated reporting requirements. Our estimates assume that medium firms have an in-house IT capability and will spend 8 person days to implement this change, while small firms are likely to rely on external consultants and spend the equivalent of 4 person days to implement the IT change. Like for other implementation costs we have factored in slightly longer time for those cohorts where particular standards will be entirely new. We expect the total cost of this change to be around £30.1m.

55. **Training:** Finally, we expect firms to incur some training costs especially where the standards are entirely new to a firm. Training will range from formal staff learning through to disseminating information via informal memos and e-mail updates. We assume that a medium firm will brief 10 employees and a small firm will brief 2 employees, comprising of compliance staff and investment advisors. We assume that attending the training, reading any briefings and acting on the information will take a full day for each affected employee, and costed a higher weighting where standards are completely new. Again, we have factored in slightly longer time for those cohorts where particular standards will be entirely new. This would result in a total training cost of £27.3m.

Rule-specific net costs to firms

56. This section covers costs and benefits that firms would incur from each of the rules proposed in this consultation:

- Liquidity – Basic liquid assets requirement
- Own funds requirements – FOR, PMR and K-Factors
- Risk management – The ICARA process
- Remuneration/Committees
- Reporting requirements
- Clearing members
- Interaction with other prudential regimes
- PII policies for exempt-CAD firms also subject to MIPRU

57. Many of the costs associated with the rule-specific proposals are implementation costs. For the avoidance of doubt, where the following rule-specific sections mention implementation costs these costs have already been estimated in the implementation costs section above.

Liquidity – Basic liquid assets requirement

58. The IFPR introduces for the first time minimum quantitative liquidity requirements for all FCA investment firms. The requirement is to hold an amount of core liquid assets equivalent to at least one third of the amount of their FOR. These requirements aim to ensure that investment firms have some resilience to sudden liquidity shocks. This should help them to continue to function or otherwise exit the market without disruption, through funding their overheads for a given period, thus reducing the harm they may cause to consumers and markets.

59. We have compared the most recently reported liquidity position of firms to their expected basic liquid assets requirement, to assess the impact of a quantitative liquidity standard on firms. The findings are below:

Non-SNI		SNI	
% of non-SNI firms with an excess of core liquid assets compared to basic liquid assets requirement	% of Non-SNI firms with a shortfall in core liquid assets compared to basic liquid assets requirement	% of SNI firms with an excess of core liquid assets compared to basic liquid assets requirement	% of SNI firms with a shortfall in core liquid assets compared to basic liquid assets requirement
88%	12%	86%	14%

60. Around 14% of firms (the percentage is very similar for SNIs and non-SNIs) would be unable to meet their basic liquid assets requirement. However, this is a worst-case scenario: these numbers have been calculated assuming a firm's FOR value before the application of any transitional provisions. Equally, we do not know how many SNIs, or Non-SNIs that do not deal on own account, have trade debtors that are due in less than 30 days, a value that can contribute to core liquid assets and thus lower any calculated shortfall. In practice, and as explained below in the own funds requirement section, some of IFPR transitional provisions have been designed to reduce the immediate impact of the FOR on (potentially smaller) firms that might find transition challenging. The metric underlying the Basic liquid assets requirement calculation is the FOR, so where available, FOR transitional provisions should carry over to the liquidity requirements. Transitional provisions provide time to help firms comply, but there will be costs of acquiring liquid assets to remedy any shortfall. We aim to deal with such costs overall in the CBA that will accompany our third consultation paper.

Own funds requirements – FOR, PMR and K-factors

61. In CP20/24 we consulted on different elements of the K-factor requirement for trading firms and the PMR. We explained that it wasn't practicable to prepare a meaningful estimate of the costs or benefits arising from the proposals relating to the PMR. This is because the PMR will not necessarily determine the overall own funds requirements of an FCA investment firm. Instead, we proposed that the PMR will become the operative requirement only where it is higher than the FOR and (for firms that are non-SNIs investment firms) the KFR of the relevant firm.

62. Until we published proposals in this CP specifying the calculation of the FOR and the remaining K-factors (see Chapter 4 of this CP) it wasn't possible to determine the effect of the PMR or FOR or KFR on the population of FCA investment firms.

63. We have now been able to estimate for SNIs which of the PMR or FOR is the binding requirement, and for non-SNIs which of the PMR, FOR and KFR is the binding requirement.

64. The table below illustrates the findings of which own funds requirement calculation is the binding requirement (assuming a firm's PMR and FOR value at the end of any transitional provision).

Firm type	% of firms where the binding requirement is:			Total percentage of firms
	PMR	FOR	KFR	
SNI	31%	38%	Not applicable	69%
Non-SNI	3%	16%	12%	31%
Total	34%	54%	12%	100%

65. The table shows that around 90% of firms that we think will be subject to the IFPR will have a binding requirement that is either the PMR or the FOR at the end of the transitional period.

66. For those firms where the PMR or FOR is the binding requirement we have compared their IFPR own funds requirement (at the end of any transitional period) to their existing level of own funds. This is to assess the worst-case marginal impact of the PMR or FOR on firms. The table below reports the findings:

Firm type	The binding requirement is:	% of firms where own funds > binding requirement (PMR or FOR)	% of firms where own funds < binding requirement (PMR or FOR)	Total
SNI	PMR	24%	11%	35%
	FOR	35%	9%	44%
Non-SNI	PMR	2%	1%	3%
	FOR	15%	3%	18%
Total		76%	24%	100%

67. We find that around 24% of firms have a shortfall in own funds compared to the requirements they would have at the end of the five-year transitional period. In both cases, we find that SNIs are more likely to have a shortfall compared to non-SNIs. Of course, we would expect firms with any shortfall to use the period of any available transitional requirement to build up their own funds from the current level, for example through retention of earnings. There will be costs of raising own funds to remedy any shortfall, but we aim to deal with such transition costs overall in the CBA that will accompany our third consultation paper.

68. For those firms where the KFR is the binding requirement we have compared their IFPR own funds requirement (at the end of any transitional period) to their existing level of own funds. This is to assess the worst-case marginal impact of the KFR. We find that around 56% of firms would have sufficient own funds now to meet their KFR at the end of the five-year transitional period. Again, we would expect investment firms with any initial shortfall to use a transitional period to build up its own funds. And we will aim to deal with such transition costs overall in the CBA that will accompany our third consultation paper.

69. IFPR transitional arrangements (or a phase-in period) such as those consulted on in CP20/24 for the PMR, FOR and KFR are designed to reduce the immediate impact of the IFPR own funds requirements for (potentially smaller) firms that might find transition challenging. These arrangements would give FCA investment firms up to five years to comply after the IFPR's introduction, and so provide a potential benefit. Although above we have identified how many firms may have own funds shortfalls under the new regime compared to the level of FOR, PMR and KFR required at the end of the transitional arrangements, we do not consider it reasonably practicable to give an estimate of the reduction in costs that the transitional arrangement provide firms. This is because there is uncertainty about how many firms will make use of this transitional arrangement given it will ultimately depend upon the specific situation of each firm.

70. The interactions between different parts of the own funds requirements calculations, as well as the transitional provisions, mean that in the third consultation we will present our view on the overall impact of our rules and the basis on which we have drafted them over all three consultations.

Risk Management – the ICARA process

71. The IFPR is introducing the ICARA process as a new requirement for all FCA investment firms. Firms must have processes in place to assess the amount of additional own funds and liquid assets that they should hold to cover the harms they may cause to consumers and markets, and which have not been adequately mitigated for by other risk mitigation tools.

72. Additional own funds and liquid assets requirements due to firm-specific risks are identified by firms themselves through the ICARA process and/or supervisory review process. We do not prescribe a particular quantitative methodology in our rules for these purposes and the resulting requirements will depend upon other factors, such as the systems and controls operated by individual firms to mitigate potential risks. It is therefore not reasonably practicable to quantify the impact of these requirements. As a result, we have not produced an estimate of the costs and benefits of any such firm-specific prudential requirements arising from the ICARA.

73. We envisage that the ICARA process will primarily lead to one-off implementation costs, particularly for those firms that are new to a regime where they must carry out an assessment to determine if they should hold additional own funds and/or liquid assets resources. There will be a large proportion of firms for whom an assessment of residual risks will be something they are used to under an existing prudential regime. And all investment firms should already be aware of FG20/21 when assessing the adequacy of their financial resources. As a result, those firms are likely to already have a notable proportion of the requisite processes in place to pivot to the ICARA process. The exception will be the inclusion of additional liquid assets requirements, which most firms will not have had to carry out previously. The implementation impacts of introducing the ICARA have already costed in the implementation costs section above.

74. In terms of benefits, the ICARA process will establish a clear link between the financial resources an FCA investment firm holds under its IFPR requirements and its threshold conditions. This should strengthen firm's internal risk management practices including a heightened focus on mitigating the harms firms' business models may cause to consumers and the markets in which they operate.

Remuneration/Committees

75. The key direct costs associated with implementing the rules in the new MIFIDPRU Remuneration Code are likely to be implementation costs. The existing IFPRU and BIPRU Remuneration Codes will be replaced by a single Remuneration Code applicable to all MIFIDPRU firms. The marginal impact of the new remuneration provisions is complex to map. This is because some IFPR firms are currently subject to one or two existing Remuneration Codes, while others are subject to none. On top of that, to accommodate the diverse range of business models and activities captured under the IFPR, the proposed MIFIDPRU Remuneration Code contains several proportionality provisions.

76. As a consequence, firms are coming from various starting points (depending on their existing firm classification) and moving to different end points in the MIFIDPRU Remuneration Code depending on whether they are an SNI or not, and their balance sheet size.

77. Given the above, for the purposes of the remuneration aspects of the CBA, we grouped investment firms into six categories (I.e. three categories with two sub-categories each) to try and best understand the marginal impact for each category, and from that try to more accurately estimate the implementation cost for each of the six categories.

78. The key summary impacts for those six categories is below. As these are implementation impacts, we have already costed them in the implementation costs section above.

79. **SNIs:** For those SNIs that have not implemented remuneration rules before, they will incur implementation costs to familiarise themselves with the rules, review and amend their current remuneration policies and practices, provide training to relevant staff and make any consequential changes to IT systems.

80. For those SNIs that are existing IFPRU and BIPRU firms they will be subject to fewer rules than currently, which means there will be a net cost benefit to them. Any changes that these firms decide to make would be their own choice due to them being subject to more flexible rules than in the past.

81. **Non-SNIs not subject to deferral and pay-out rules:** For those non-SNIs that have not implemented remuneration rules before, they will incur implementation costs to familiarise themselves with the rules, review and amend their current remuneration policies and practices, provide training to relevant staff and make any consequential changes to IT systems. In this non-SNI category new firms will also incur the cost of identifying Material Risk Takers (MRTs).

82. For many firms in this category (irrespective of whether they are subject to remuneration rules now or not), there will be the cost of implementing ex post risk adjustment provisions for the first time (e.g. modifying employment contracts for impacted individuals).

83. For firms subject to existing remuneration rules, the new MRT provisions may be a reduced burden compared to status quo.

84. **Non-SNIs subject to deferral and pay-out rules:** For those non-SNIs who have not implemented remuneration rules before, they will incur implementation costs to familiarise themselves with the rules, review and amend their current remuneration policies and practices, provide training to relevant staff and make any consequential changes to IT systems. Clawback and MRT provisions will also apply to this group of firms.

85. There are costs for most firms to implement deferral and pay-out in shares/instruments for the first time. Additionally, there are costs for some firms to establish Remuneration Committees, Risk Committees, Nomination Committees and potentially recruiting additional Non-Executive Directors.

Reporting requirements

86. In CP20/24 we explained that we are proposing to introduce a more proportionate and risk-based reporting regime for FCA investment firms. This will be achieved by:

a. Having a single suite of IFPR reporting forms. Currently, there are different sets of regulatory returns depending on which prudential sourcebook firms fall under and if they are subject to COREP or FINREP. This has proven to be unduly complex for firms to navigate, especially if there is a change in permissions.
b. Reducing the number of data items reported, while maintaining sufficient information to adequately supervise firms.
c. Requiring firms to report information to us with a frequency that is appropriate to the information being requested.

87. The overwhelming majority of reporting form proposals were covered in CP20/24. In this CP we are consulting on the reporting forms that accompany our policy proposals for:

a. Remuneration
b. ICARA
c. and CPMIs.

88. To enable the FCA to effectively supervise firms, we will continue to reserve the right to require firms to provide additional information if required.

89. The reporting requirements that we are consulting on will be a scaled down version of existing reporting requirements, with the added benefit that they will slot into our dedicated single suite of reporting forms making navigating the requirements far easier. Notwithstanding some initial one-off cost in becoming acquainted with what reporting requirements have been removed or clarified, this should be overall beneficial to firms.

90. With the reporting proposals in this CP we have now presented the full suite of reporting templates from CP20/24 and this CP. We will bring together the total costs and benefits of the IFPR reporting obligations compared to the current mix of reporting requirements in our third CP.

Clearing members

91. Since CP20/24, our discussions with stakeholders have shown that some FCA investment firms play a part in the overall provision of clearing services to other FCA investment firms. As a result, in Chapter 10 of this CP we are consulting on proposals for firms that act as clearing members or are indirect clearing firms.

92. Our proposals account for the fact that FCA investment firms may provide clearing services, by incorporating clearing activities into the calculation of capital requirements for counterparty credit risk (by including it in the trading counterparty default (TCD) calculation) and operational risk (by including it in the daily trading flow (DTF) calculation). We also propose to exclude firms who provide clearing services from becoming SNIs because of their inter-connectivity with other investment firms and CCPs. Our approach recognises that FCA investment firms perform vital clearing services for other FCA investment firms, whilst maintaining prudential standards in a proportionate manner. There are only a small number of IFPR investment firms that act as clearers.

93. The benefits arise in terms of maintaining lower market access/transaction costs – when FCA investment firms are clearing they are providing this service for other smaller FCA investment firms competitively (compared to the charges large clearing banks might potentially quote otherwise to smaller clients) – especially in specialised product sectors. In terms of regulatory capital, we would not expect the total requirements proposed under IFPR to be materially different from what the UK CRR requires currently from the same firms acting as clearers. We ask that firms that may be impacted by these proposals respond to the consultation and provide further details on how they believe they may be impacted.

Interaction with other prudential sourcebooks

94. In this CP we have set out how MIFIDPRU is intended to interact with other prudential sourcebooks in our Handbook. This will mainly be relevant to FCA investment firms that also carry out non-MiFID regulated business and so may currently be subject to more than one prudential sourcebook at the same time. Our overall approach in this CP to other prudential sourcebooks affected by the introduction of MIFIDPRU is to make only the consequential amendments that are needed to: i) delete provisions that are no longer required; and ii) ensure that the interactions between them and MIFIDPRU work in practice We have not proposed any material changes in underlying policy now as part of our initial implementation of MIFIDPRU. As a result, we have not included this in our CBA analysis.

PII policies

95. One consequence of the removal of the existing prudential category of exempt-CAD firm is where any such firms are also conducting insurance distribution or home finance business in addition to their MiFID investment business. Where this is the case, such firms will become subject to the provisions of MIPRU 3 (rather than either IPRU INV 9 or 13) for holding professional indemnity insurance (PII).

96. The PII provisions of MIPRU 3 contain more detailed requirements on PII than IPRU INV. As a result, we propose a three-year transitional provision, during which those firms concerned may continue to meet their PII requirements as long as they comply with the relevant parts of IPRU INV 9 and 13. We believe the impact of this transitional will be minimal, allowing any firms concerned time to adjust their policies to the terms of MIPRU 3.

Benefits

97. As for the CBA in CP1 we believe that the benefits of our proposals will be delivered in the form of improved consumer protection and particularly for clients of FCA investment firms, either because it reduces the potential for firm failure itself, or because it reduces the potential for disorderly failure in the event that a firm does fail. The proposed changes should help reduce economic losses in drawn out insolvency proceedings or reduce social costs through lessening reliance on investor compensation schemes, and thus avoiding consequent impacts on other firms to top-up these schemes to handle pay-outs. Consequently, over confidence, investor sentiment and market stability should also benefit. Consumers are also saved the costs and distress of having to find alternative investment firms to conduct business with.

98. FCA investment firms will benefit from more proportionate, simpler, risk-based reporting that is available in a single suite of forms. This is expected to considerably reduce their administrative and compliance burdens. Furthermore, these reporting forms will not change if there is a change in MIFID permissions reducing complexity further.

99. All investment firms carrying out the same investment activity are treated in a simpler and more consistent manner. This removes any differences within markets and hence competitive distortions created by the existing mix of standards.

100. We are establishing, in the ICARA process, an objective link between the financial resources an investment firm holds under its IFPR requirements, and its threshold conditions. This is supported by specific guidance and clear intervention points detailing what we expect of firms when they run into difficulties, and what they can expect from us. This will make it easier for firms to plan for how we expect them to respond in a certain situation, including whether they should commence wind-down.

101. We are introducing a minimum liquidity requirement for all investment firms. This should improve overall confidence in the financial resilience of investment firms among customers, counterparties and, where relevant, shareholders. This should also reduce the potential for firm failure itself or reducing the potential for disorderly failure if a firm does fail.

102. Remuneration is a key driver of behaviour for all firms and individuals. Appropriate remuneration policies and practices help to support prudential soundness and risk management in firms. But they also ensure appropriate outcomes for customers and markets, and so reduce the likelihood of harm. In this way, our remuneration rules for FCA investment firms have both prudential and conduct-related objectives. Our approach aims to: promote effective risk management in the long-term interests of the firms and its customers; ensure alignment between risk and individual reward; support positive behaviours and healthy firm cultures; and discourage behaviours that can lead to misconduct and poor customer outcomes.

103. The IFPR is creating a tighter alignment and calibration of prudential requirements to business models and the potential for a firm to cause harm to their consumers/clients and the markets they operate in. The aim is to ensure that firms are more aware that running a business prudently includes assessing the degree to which their activities are posing harm to others and mitigating those harms.

104. This alignment between prudential requirements and harms to consumers and markets is further strengthened through the new ICARA process. Firms must embed risk management practices to focus on mitigating the risks of harm to consumers and markets, identify how to mitigate those harms if they are not adequately captured through our basic requirements and apply additional own funds and liquid assets requirements where those harm mitigation mechanisms are insufficient. In so doing the IFPR is creating a better alignment between regulatory prudential requirements, business model risk and management strategy. This should also raise the standard of risk management in FCA investment firms.

105. Also, the linking of requirements between business model and risk of harm will allow FCA supervisors and FCA investment firms to focus during the ICARA and SREP processes on mitigating the risks of harm in a way that aligns to how investment firms think about their business and strengthens their internal risk management practices for the benefits of their consumers and the markets they interact with.

106. Finally, the ICARA is heightening awareness of firms having credible and accountable wind-down planning. We consider this to be an important feature of investment firms internal risk management processes so that they can embed and implement credible wind-down actions sooner were they to get into difficulty.

107. We will look at all the benefits again as part of our consolidated CBA in CP3.

Annex 3
The own funds threshold requirement and intervention points

Introduction

1. In this annex we illustrate how FCA investment firms will assess the own funds threshold requirement necessary to meet the overall financial adequacy rule (OFAR). We also illustrate the calculation of the early warning indicator and the wind-down trigger. The early warning indicator, a breach of the own funds threshold requirement and the wind-down trigger are levels of own funds that let us know the FCA investment firm, and/or the FCA, may need to act.

2. Further information on everything in this annex is in Chapter 7 of this CP. The relevant rules are in MIFIDPRU 7.

Intervention points

Early warning indicator

3. The early warning indicator will ordinarily be 110% of an FCA investment firm's own funds threshold requirement. We reserve the right to set this at a higher level.

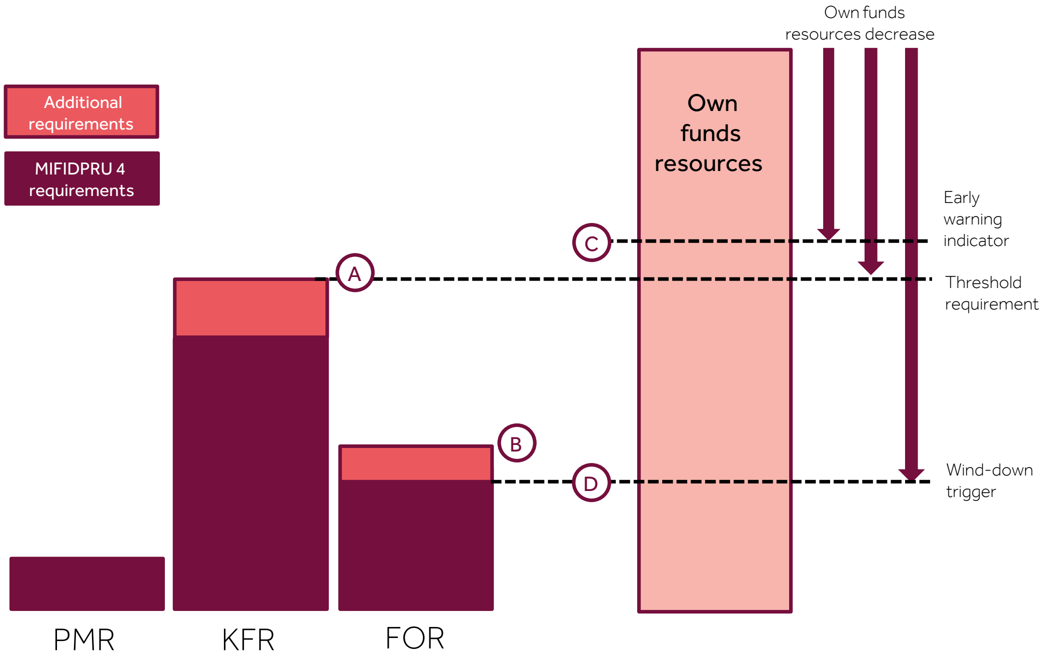
Own funds threshold requirement breach

4. FCA investment firms will set their own funds threshold requirement as the higher of the i) PMR, ii) own funds needed to cover risks from ongoing business operations, or iii) own funds needed for wind-down. Diagram x in Chapter 7 of this CP shows the process for calculating the own funds threshold requirement. We reserve the right to set this at a higher level.

Wind-down trigger

5. The wind-down trigger is the level of own funds an FCA investment firm will need for an orderly wind-down.

Example 1 – Non-SNI firm



Example 1 – Non-SNI firm

6. An FCA investment firm has determined that its K-factor requirement (KFR) is not enough to cover all the risks of harm posed by its ongoing operations. It is holding additional own funds to meet the OFAR. Total own funds to cover the risks from ongoing operations is (A).

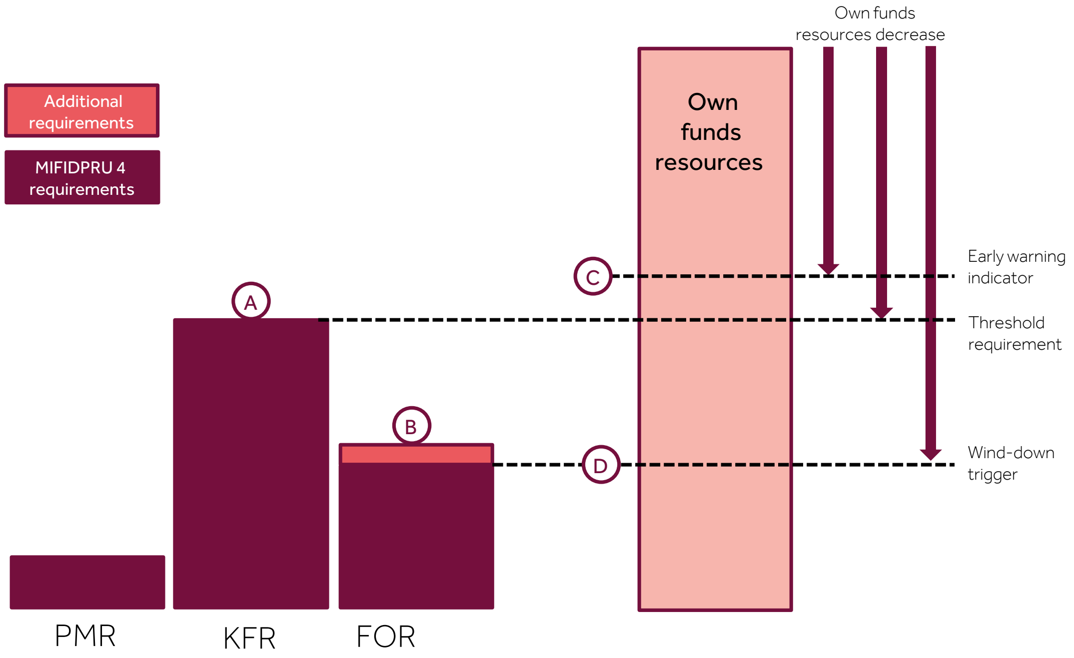
7. It has also determined that it will need additional own funds to its FOR to allow for an orderly wind-down. Total own funds for wind-down is (B). The KFR plus the additional own funds required (A) is more than both the PMR and (B).

8. (A) becomes its own funds threshold requirement.

9. (C) is 110% of its threshold requirement and becomes its early warning trigger.

10. (D) is its wind-down trigger and is equal to its FOR.

Example 2 – Non-SNI firm



Example 2 – Non-SNI firm

11. An FCA investment firm has determined that its KFR is enough to cover all the risks of harm posed by its ongoing operations (A).

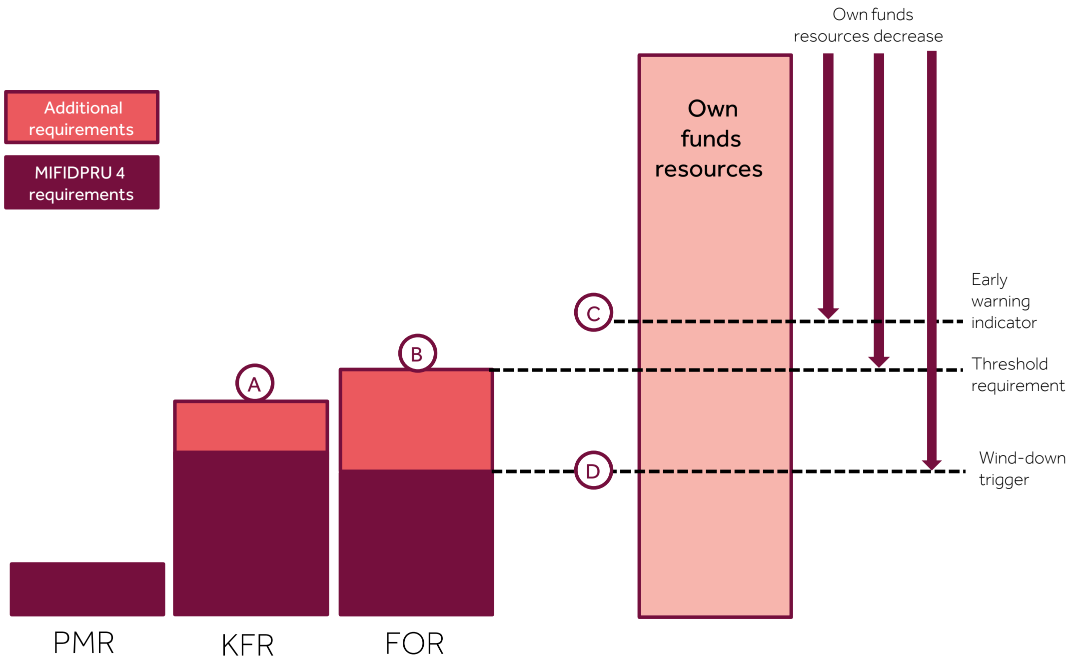
12. It has determined that it will need additional own funds to its FOR to allow for an orderly wind-down. The total own funds required for wind-down is (B). The KFR (A) is more than both the PMR and (B).

13. (A) becomes its own funds threshold requirement.

14. (C) is 110% of its threshold requirement and becomes its early warning trigger.

15. (D) is its wind-down trigger and is equal to its FOR.

Example 3 – Non-SNI firm



Example 3 – Non-SNI firm

16. An FCA investment firm has determined that its K-factor requirement (KFR) is not enough to cover all the risks of harm posed by its ongoing operations. It is holding additional own funds to mitigate this. Total own funds to cover the risks from ongoing operations is (A).

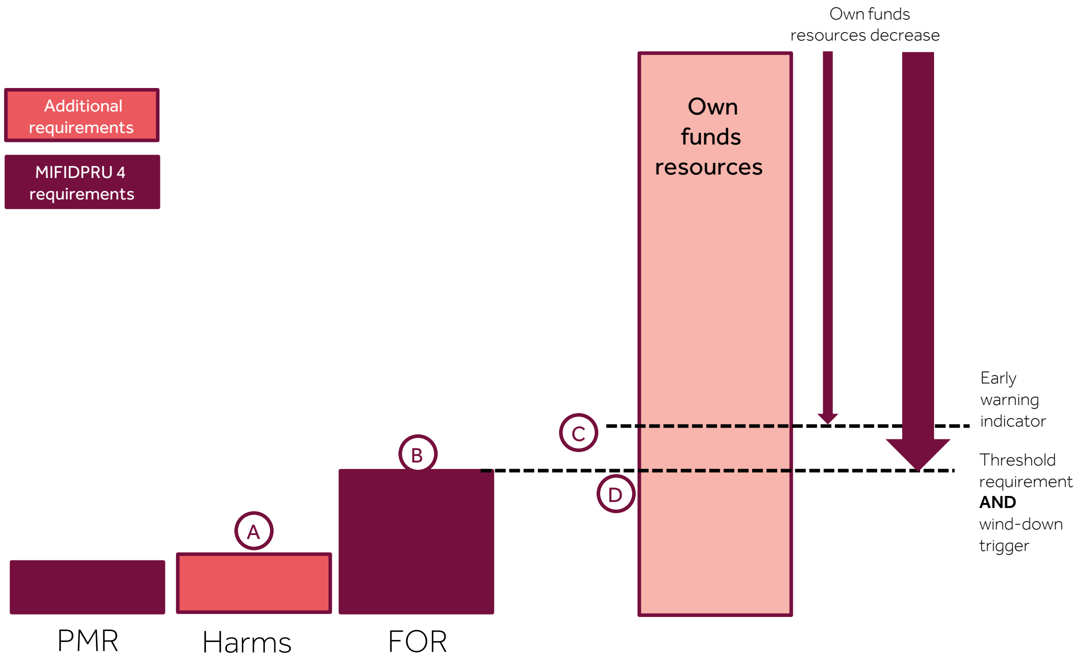
17. It has also determined that it will need a significant amount of additional own funds beyond the FOR to allow for an orderly wind-down. The total own funds required for wind-down is (B). In this case the KFR plus the additional own funds (A) is lower than the FOR plus additional own funds (B).

18. (B), the wind-down amount, becomes its own funds threshold requirement.

19. (C) is 110% of its threshold requirement and becomes its early warning trigger.

20. (D) is its wind-down trigger and is equal to its FOR.

Example 4 – SNI firm



Example 4 – SNI firm

21. An FCA investment firm has determined there is a proportion of risk from harm from its ongoing operations that it is only able to mitigate through financial means. It has determined that (A) is the appropriate amount of additional own funds to hold to mitigate this harm.

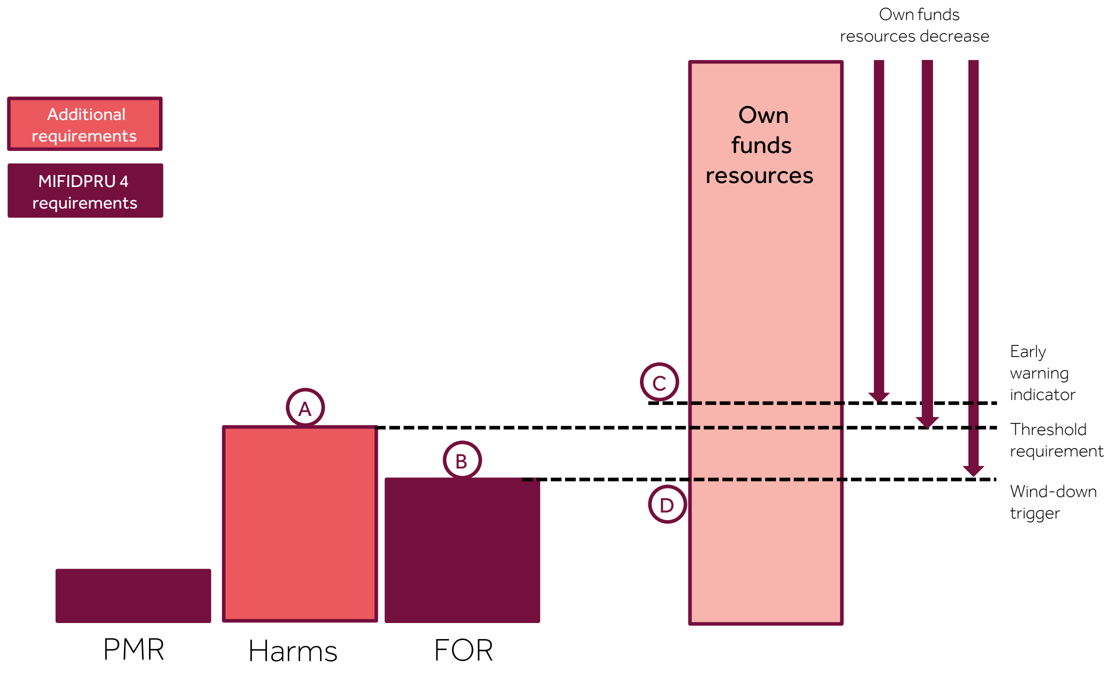
22. It has also determined that its FOR is enough to allow for an orderly wind-down (B). Its FOR is more than both the PMR and the 'Harms' own funds requirements (A)

23. (B) becomes its own funds threshold requirement.

24. (C) is 110% of its threshold requirement and becomes its early warning trigger.

25. (D) is its wind-down trigger. In this case it is the same as (B) as the wind-down trigger is always equal to the FOR, unless we specify a higher amount.

Example 5 – SNI firm



Example 5 – SNI firm

26. An FCA investment firm has determined there is a proportion of risk from harm from its ongoing operations that it is only able to mitigate through financial means. It has determined that (A) is the appropriate amount of additional own funds to hold to mitigate this harm.

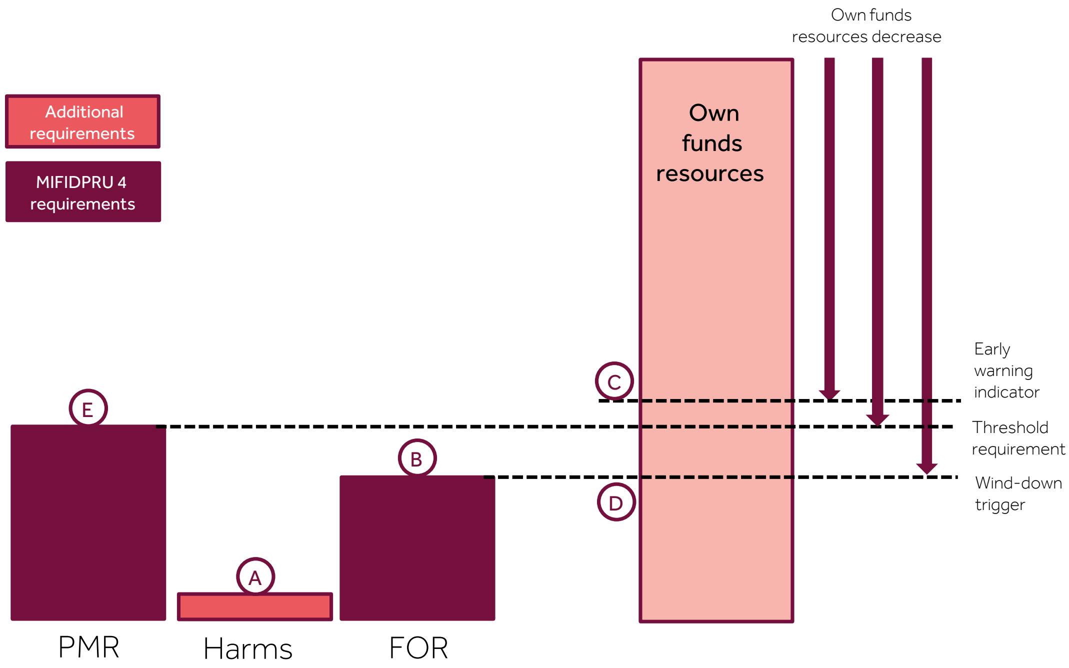
27. It has also determined that its FOR is enough to allow for an orderly wind-down (B). The 'Harms' own fund requirement (A) is greater than both the PMR and the FOR.

28. (A) becomes its own funds threshold requirement.

29. (C) is 110% of its threshold requirement and becomes its early warning trigger.

30. (D) is its wind-down trigger and is equal to its FOR.

Example 6 – SNI firm



Example 6 – SNI firm

31. An FCA investment firm has determined there is a only a minimal amount of risk from harm from its ongoing operations that it is only able to mitigate through financial means (A).

32. It has also determined that its FOR is enough to allow for an orderly wind-down (B).

33. Its PMR (E) is higher than its FOR (B).

34. (E) becomes its own funds threshold requirement.

35. (C) is 110% of its threshold requirement and becomes its early warning trigger.

36. (D) is its wind-down trigger. In this case it is the same as (B) as the wind-down trigger is always equal to the FOR, unless we specify a higher amount.

Annex 4
The liquid assets threshold requirement and intervention points

Introduction

1. In this annex we illustrate how FCA investment firms will assess the liquid assets threshold requirement necessary to meet the overall financial adequacy rule (OFAR). A breach of the liquid asset threshold requirement or the wind-down trigger are levels of liquid assets that let us know the FCA investment firm, and/or the FCA, may need to act.

2. FCA investment firms can only use core liquid assets to meet the basic liquid asset requirement. They can use a mixture of core and non-core liquid assets to meet the additional amount of liquid assets needed to meet the liquid assets threshold requirement.

3. Further information on everything in this annex is in Chapter 7 of this CP. The relevant rules are in MIFIDPRU 7.

Intervention points

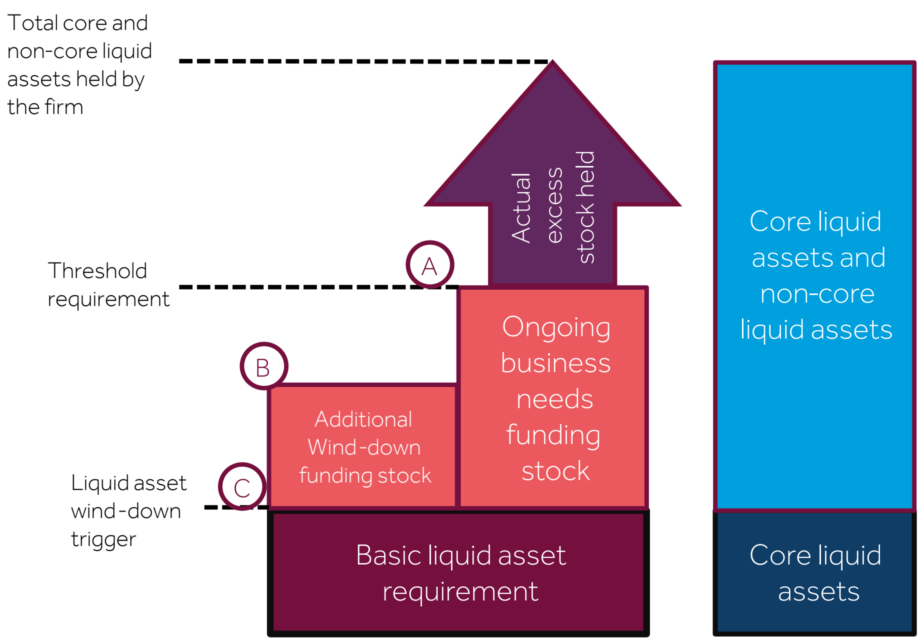
Liquid assets threshold requirement breach

4. FCA investment firms will set their liquid assets threshold requirement as the higher of the liquid assets needed to i) wind-down, or ii) liquid assets needed for ongoing business needs. Diagram x in Chapter 7 of this CP shows the process for calculating the liquid assets threshold requirement. We reserve the right to set this at a higher level.

Wind-down trigger

5. The wind-down trigger is the same as the basic liquid asset requirement.

Example 1 – ongoing business needs funding exceed additional wind-down funding



Example 1 – Ongoing business needs funding exceeds additional wind-down funding

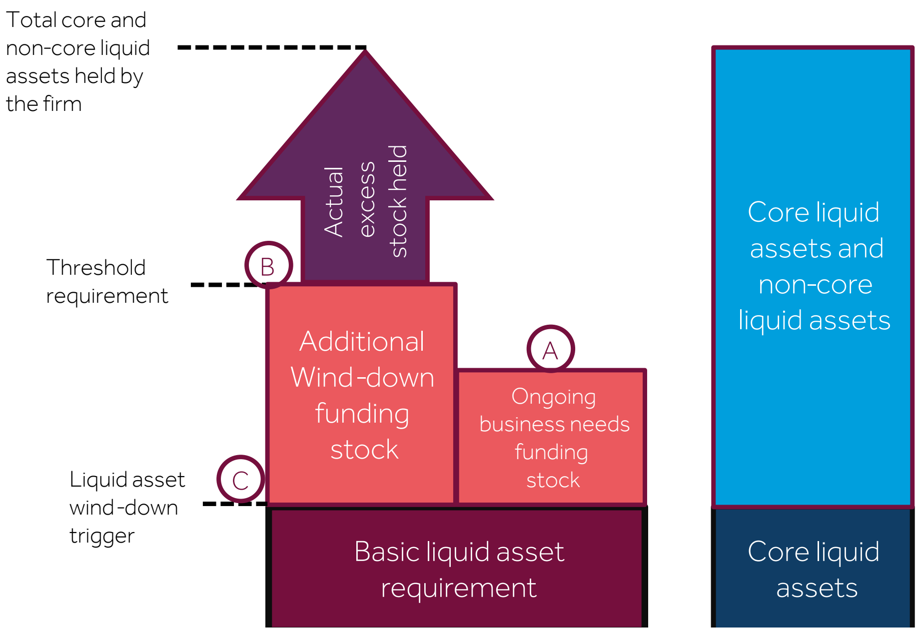
6. An FCA investment firm has assessed the total liquid assets it needs for ongoing business (A) and the total liquid assets required for starting to wind-down (B).

7. In this case (A) is greater than (B).

8. (A) becomes its liquid asset threshold requirement.

9. (C), the basic liquid asset requirement is its liquid asset wind-down trigger.

Example 2 – additional wind down funding needs exceeds the ongoing business funding needs



Example 2 – additional wind down funding needs exceeds the ongoing business funding needs

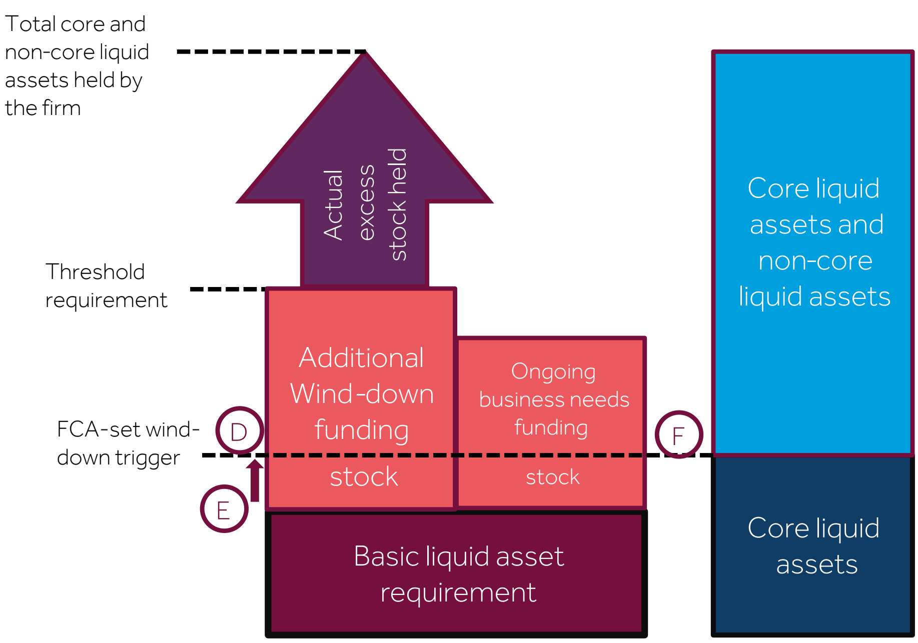
10. An FCA investment firm has assessed the total liquid assets it needs for ongoing business needs (A) and the total liquid assets needed for starting to wind-down (B).

11. In this case (B) is greater than (A).

12. (B) becomes its liquid asset threshold requirement.

13. (C), the basic liquid asset requirement is its liquid asset wind-down trigger.

Example 3 – the FCA has set a higher liquid assets wind-down trigger



Example 3 – the FCA has set a higher liquid assets wind-down trigger

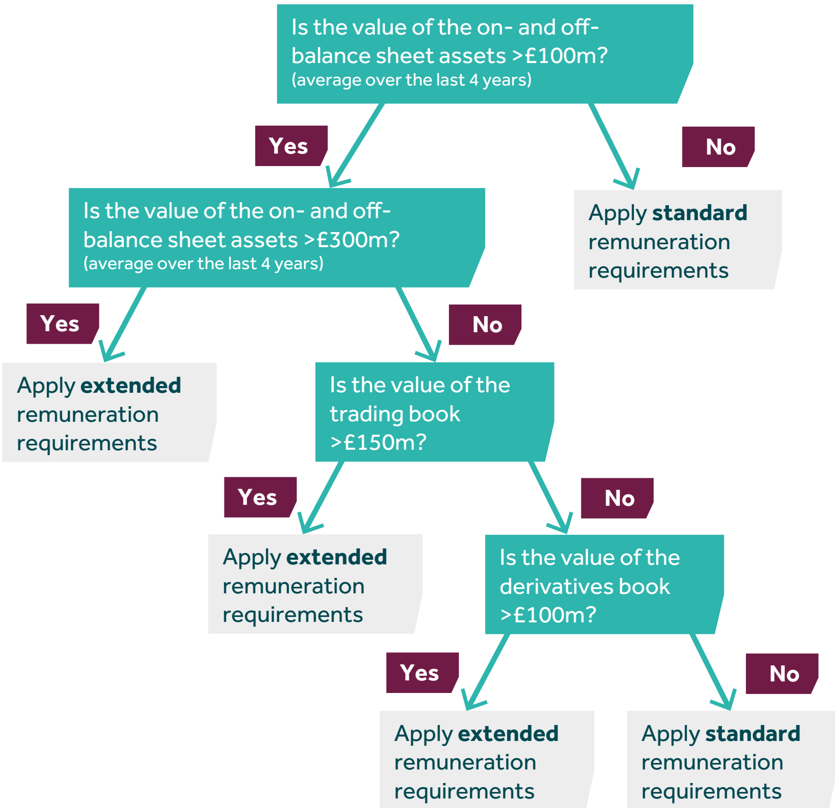
14. An FCA investment firm has assessed the total liquid assets it needs for ongoing business and the total liquid assets required for starting wind-down.

15. The FCA has set it a liquid assets wind-down trigger (D) that is higher than the basic liquidity requirement (E).

16. (D) can only be met with core liquid assets (F).

Annex 5
Application of remuneration requirements

Criteria for application of standard / extended remuneration requirements



Annex 6
Compatibility statement

Expected effect on mutual societies

1. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies.

Equality and diversity

2. We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, to and foster good relations between people who share a protected characteristic and those who do not.

3. As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. The outcome of our consideration in relation to these matters in this case is stated in paragraph 2.11 of this Consultation Paper.

Legislative and Regulatory Reform Act 2006 (LRRA)

4. We have had regard to the principles in the LRRA for the parts of the proposals that consist of general policies, principles or guidance. We consider that they will help firms to understand and meet the regulatory requirements associated with our new capital requirements framework. This will lead to better outcomes for firms and their clients. We also think our proposals are proportionate and take into consideration the variety of firms in scope.

5. We have had regard to the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance. We consider that they do not create an unnecessary burden on firms, or adversely affect competition.

Annex 7
Abbreviations used in this paper

Abbreviation	Description
AIFMD	Alternative Investment Fund Management Directive
ASA	Assets safeguarded and administered
AT1	Additional Tier 1 capital
AUM	Assets under management
BCBS	Basel Committee of Banking Supervisors
BIPRU	Prudential sourcebook for banks, building societies and investment firms
BRRD	Bank Recovery and Resolution Directive
CASS	Client assets sourcebook
CBA	Cost benefit analysis
CCP	Central counterparty
CET1	Common Equity Tier 1 capital
COH	Client orders handled
COREP	Common reporting
CP	Consultation paper
CPMI	Collective Portfolio Management Investment firm
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
EBA	European Banking Authority
ESG	Environmental, Social and Governance
EU	European Union
FCA	Financial Conduct Authority

Abbreviation	Description
FICOD	Financial Conglomerates Directive
FINREP	Financial reporting
FOR	Fixed overheads requirement
FS Bill	Financial Services Bill
FS Register	Financial Services Register
FSB	Financial Stability Board
FSMA	Financial Services and Markets Act
GEN	General Provisions sourcebook
GENPRU	General Prudential sourcebook
ICAAP	Internal capital adequacy assessment process
ICARA	Internal Capital Adequacy and Risk Assessment
IFD	Investment Firm Directive
IFPR	Investment firm prudential regime
IFPRU	Prudential sourcebook for investment firms
IFR	Investment Firm Regulation
IPRU-INV	Interim prudential sourcebook for investment business
K-ASA	K-factor requirement related to the activity of administering and safeguarding assets
K-AUM	K-factor requirement related to the activity of managing assets
K-CON	K-factor requirement based on concentration risk
K-COH	K-factor requirement related to the activity of handling client orders
K-DTF	K-factor requirement related to the daily trading flow
K-NPR	K-factor requirement related to market risk
K-TCD	K-factor requirement related to the risk from the default of a trading counterparty
KFR	K-factor requirement

Abbreviation	Description
MiFID	Markets in Financial Instruments Directive
MIFIDPRU	New Prudential sourcebook for solo regulated MiFID investment firms
MIPRU	Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries
MRT	Material Risk Taker
OFAR	Overall financial adequacy rule
OIREQ	Own initiative requirement
PMR	Permanent minimum requirement
PRA	Prudential Regulation Authority
PS	Policy Statement
QMMF	Qualifying money market fund
RPS	Remuneration Policy Statement
SM&CR	Senior Managers & Certification Regime
SMF	Senior management function
SNI	Small and non-interconnected investment firm
SREP	Supervisory review and evaluation process
SUP	Supervision sourcebook
SYSC	Systems and controls sourcebook
T2	Tier 2 capital
TCD	Trading counterparty default
UCITS	Undertakings for Collective Investment in Transferable Securities Directive
VREQ	Voluntary requirement

Appendix 1
Draft Handbook text

INVESTMENT FIRMS PRUDENTIAL REGIME (CONSEQUENTIAL AMENDMENTS TO OTHER PRUDENTIAL SOURCEBOOKS) INSTRUMENT 2021

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of the following powers and related provisions:

(1) the following sections of the Financial Services and Markets Act 2000 ("the Act"):
(a) section 137A (The FCA's general rules);
(b) section 137T (General supplementary powers);
(c) section 138D (Actions for damages);
(d) section 139A (Power of the FCA to give guidance);
(e) section 247 (Trust scheme rules);
(f) section 261I (Contractual scheme rules); and

(2) regulation 6(1) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).

B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on [*date*].

Revocation of the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)

D. The Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU) is revoked.

Amendments to the Handbook

E. The modules of the FCA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
General Prudential sourcebook (GENPRU)	Annex B
Prudential sourcebook for Investment Firms (IFPRU)	Annex C
Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU)	Annex D
Interim Prudential sourcebook for Investment Businesses (IPRU-INV)	Annex E

F. The FCA confirms and remakes in the Glossary of definitions any defined expressions used in the modules of the FCA's Handbook of rules and guidance referred to in paragraph E where such defined expressions relate to any UK legislation that has been amended since those defined expressions were last made.

Notes

G. In the annexes to this instrument, the "notes" (indicated by "**Note:**" or "*Editor's note*:") are included for the convenience of readers, but do not form part of the legislative text.

Citation

H. This instrument may be cited as the Investment Firms Prudential Regime (Consequential Amendments to Other Prudential Sourcebooks) Instrument 2021.

By order of the Board
[*date*]

Annex A

Amendments to the Glossary of definitions

[*Editor's note*: This Annex makes the changes to Glossary terms that are necessary to explain how the relevant FCA prudential sourcebooks will apply alongside MIFIDPRU. The FCA intends to consult on the remaining consequential changes to the Glossary in a subsequent consultation paper. The text in this Annex takes into account the changes suggested by *CP20/24: A new UK prudential regime for MiFID investment firms* as if they were made.]

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Amend the following definitions as shown.

capital resources	(1)	in relation to a ~~*BIPRU firm*~~ *dormant account fund operator*, the *firm's* capital resources as calculated in accordance with the ~~*capital resources table*~~ relevant regulatory requirements; or
	…	
capital resources requirements	an amount of *capital resources* that:	
	(1)	~~a *BIPRU firm* must hold as set out in the *main BIPRU firm Pillar 1 rules*; or~~ a *dormant account fund operator* must hold in accordance with the relevant regulatory requirements; or
	…	
category B1 firm	a ~~*category B firm*~~ *personal investment firm* whose *permission* includes *dealing in investments as principal*.	
category B2 firm	a ~~*category B firm*~~ *personal investment firm* whose *permission* does not include *dealing* as *principal*; and is not subject to a *requirement* preventing the holding or controlling of *client money* or *custody assets*.	
category B3 firm	a ~~*category B firm*~~ *personal investment firm*:	
	(a)	whose *permission* includes only *insurance distribution activity* in relation to *non-investment insurance contracts*, *home finance mediation activity*, *assisting in the administration and performance of contracts of insurances*, *arranging* transactions in *life policies* and other insurance contracts, a*dvising on investments (except P2P agreements)* and receiving and transmitting, on behalf of investors, orders in relation to *securities* and

		units in *collective investment schemes*, *advising on P2P agreements*; and
	(b)	which is subject to a *requirement* not to hold or control *client money* or *custody assets*.

investment management firm

a *firm* whose *permitted activities* include *designated investment business*, which is not an *authorised professional firm*, *bank*, ~~*IFPRU investment firm*, *BIPRU firm*,~~ *MIFIDPRU investment firm*, *collective portfolio management firm*, *credit union*, *energy market participant*, *friendly society*, *ICVC*, *insurer*, *media firm*, *oil market participant* or *service company*, whose *permission* does not include a *requirement* that it comply with *IPRU-INV* 3 or *IPRU-INV* 13 (Personal investment firms) and which is within (a), (b) or (c):

…

large exposure

(1) ~~(in *BIPRU*) the *exposure* of a *firm* to a *counterparty*, or a *group of connected clients*, whether in the *firm's non-trading book* or *trading book* or both, which in aggregate equals or exceeds 10% of the *firm's capital resources*.~~ [deleted]

(2) ~~(except in (1))~~ has the meaning in article 392 of the *UK CRR* (Definition of a large exposure), as it applied on [*Editor's note*: insert date immediately before the earlier of the date that the MIFIDPRU sourcebook begins to apply or the date that the CRR 2 amendments to the UK CRR take effect].

local firm

has the meaning in article 4(1)(4) of the *UK CRR* as it applied on [*Editor's note*: insert date immediately before the earlier of the date that the MIFIDPRU sourcebook begins to apply or the date that the CRR 2 amendments to the UK CRR take effect].

overall financial adequacy rule

~~(1)~~ ~~(in *GENPRU* and *BIPRU*) *GENPRU* 1.2.26R (Requirement for certain *firms* to have adequate financial resources).~~

~~(2)~~ ~~(in *IFPRU*) *IFPRU* 2.2.1R (Adequacy of financial resources)~~ (for a *dormant account fund operator*) *GENPRU* 1.2.26R as in force at 31 December 2015.

own funds

…

~~(2A)~~ ~~(in *IPRU(INV)* 11) has the meaning in article 4(1)(118) of the *UK CRR*.~~ [deleted]

…

	(4A)	(in *MIFIDPRU*) has the meaning in *MIFIDPRU* 3.2.1R.
	(5)	~~(except in (1) to (4)) has the meaning in *MIFIDPRU* 3.2.1R.~~ (except in (1) to (4A)) has the meaning in article 4(1)(118) of the *UK CRR*, as it applied on [*Editor's note*: insert date immediately before the earlier of the date that the MIFIDPRU sourcebook begins to apply or the date that the CRR 2 amendments to the UK CRR take effect].

personal investment firm	a *firm* whose *permitted activities* include *designated investment business*, which is not an *authorised professional firm*, *bank*, ~~*IFPRU investment firm*, *BIPRU firm*,~~ *MIFIDPRU investment firm*, *building society*, *collective portfolio management firm*, *credit union*, *energy market participant*, *ICVC*, *insurer*, *media firm*, *oil market participant* or *service company*, whose *permission* does not include a *requirement* that it comply with *IPRU(INV)* 3 (Securities and futures firms) or 5 (Investment management firms), and which is within (a), (b) or (c): …
securities and futures firm	a *firm* whose *permitted activities* include *designated investment business*, which is not an *authorised professional firm*, *bank*, ~~*BIPRU firm* (unless it is an *exempt BIPRU commodities firm*), *IFPRU investment firm* (unless it is an *exempt IFPRU investment firm*),~~ *MIFIDPRU investment firm*, *building society*, *collective portfolio management firm*, *credit union*, *friendly society*, *ICVC*, *insurer*, *media firm* or *service company*, whose *permission* does not include a *requirement* that it comply with *IPRU(INV)* 5 (Investment management firms) or 13 (Personal investment firms), and which is within (a), (b), (c), (d), (e) , (f), (g) or (ga): … (g) ~~an *exempt BIPRU commodities firm*~~ [deleted] (ga) ~~an *exempt IFPRU investment firm*~~ [deleted] …

Delete the following definitions. The text is not shown struck through.

category B firm	a *personal investment firm*, other than an *exempt CAD firm*.

Annex B

General Prudential sourcebook (GENPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

1 Application

1.1 Application

1.1.1 G There is no overall application statement for *GENPRU*. Each chapter or section has its own application statement.

1.1.2 G ~~Broadly speaking however, *GENPRU* applies (except as provided in *GENPRU* 1.1.2-AAG) to:~~

…

(4) ~~a *BIPRU firm*; and~~ [deleted]

(5) ~~groups containing such *firms*.~~ [deleted]

1.1.2-AA G [*Editor's note*: Amendments to this provision will be published in a subsequent consultation paper.]

1.1.2-B G ~~*GENPRU* applies to a *collective portfolio management investment firm* that is a *BIPRU firm* in parallel with *IPRU-INV* 11 (see *IPRU-INV* 11.6).~~ [deleted]

1.1.2A G ~~A *firm* should refer to *GEN* 2.2.13AR (cross-references in the Handbook) and *GEN* 2.2.23R to *GEN* 2.2.25G (cutover: application of provisions made by both the *FCA* and the *PRA*) when applying the rules and guidance in *GENPRU*.~~ [deleted]

…

GENPRU 1.2 and 1.3 are deleted in their entirety. The deleted text is not shown but the sections are marked [deleted] as shown below.

1.2 Adequacy of financial resources [deleted]

1.3 Valuation [deleted]

GENPRU 2 is deleted in its entirety. The deleted text is not shown but the chapter is marked [deleted] as shown below.

2 Capital [deleted]

Amend the following as shown.

3 Cross sector groups

[*Editor's note*: Amendments to this section will be published in a subsequent consultation paper.]

GENPRU TP 8, TP8A, TP 8B, Sch 1, Sch 2 and Sch 3 are deleted in their entirety. The deleted text is not shown but the chapters are marked [deleted] as shown below.

TP 8 Miscellaneous capital resources definitions for BIPRU firms [deleted]

TP 8A Further miscellaneous capital resources definitions for BIPRU firms [deleted]

TP 8B Miscellaneous capital resources definitions for BIPRU firms: Core tier one capital [deleted]

Sch 1 Record keeping requirements [deleted]

Sch 2 Notification and reporting requirements [deleted]

Sch 3 Fees and other requirement payments [deleted]

Annex C

Prudential sourcebook for Investment Firms (IFPRU)

IFPRU 1, 2, 3, 4, 5, 6, 7, 8, 9 and 10 are deleted in their entirety. The deleted text is not shown but the chapters are marked [deleted] as shown below.

1 **Application** **[deleted]**

2 **Supervisory processes and governance** **[deleted]**

3 **Own funds** **[deleted]**

4 **Credit risk** **[deleted]**

5 **Operational risk** **[deleted]**

6 **Market risk** **[deleted]**

7 **Liquidity** **[deleted]**

8 **Prudential consolidation and large exposures** **[deleted]**

9 **Public disclosure** **[deleted]**

10 **Capital buffers** **[deleted]**

Amend the following as shown.

11 **Recovery and resolution**

[*Editor's note*: Amendments to this section will be published in a subsequent consultation paper.]

IFPRU TP 1, TP 4, TP 5, TP 8 and TP 9 are deleted in their entirety. The deleted text is not shown but the chapters are marked [deleted] as shown below.

TP 1 **GENPRU and BIPRU waivers: transitional** **[deleted]**

TP 4 **Deductions from own funds** **[deleted]**

TP 5 **Own funds: other transitionals** **[deleted]**

TP 8 **Countercyclical capital buffer: transitional** **[deleted]**

TP 9 **Large exposures limits** **[deleted]**

Annex D

Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

1 Application and general provisions

…

1.3 Remuneration and property valuation requirements for MCD creditors

…

1.3.3 G For the purposes of *MIPRU* 1.3.2R:

(1) reliable standards for the valuation of residential immovable property include internationally recognised valuation standards, in particular those developed by the International Valuation Standards Council (IVSC), the European Group of Valuers' Associations (EGoVA) or the Royal Institution of Chartered Surveyors (RICS), as well as the standards in ~~*BIPRU* 3.4.77R to *BIPRU* 3.4.80R~~ *MIPRU* 1.3.3AG or, where applicable, *MIPRU* 4.2F.27R to *MIPRU* 4.2F.29R.

[**Note:** recital 26 of the *MCD*]

(2) the *MCD creditor* is not limited to on-site inspections where it is possible to demonstrate that any risks posed have been adequately assessed through the overall collateral management process.

1.3.3A G For the purposes of *MIPRU* 1.3.3G(1), reliable standards for the valuation of residential immovable property also include the following standards:

(1) the property must be valued by an independent valuer at or less than the market value. In the *UK* where rigorous criteria for the assessment of the mortgage lending value exist in statutory or regulatory provisions property may instead be valued by an independent valuer at or less than the mortgage lending value;

(2) market value means the estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without

compulsion. The market value must be documented in a transparent and clear manner;

(3) mortgage lending value means the value of the property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property. Speculative elements must not be taken into account in the assessment of the mortgage lending value. The mortgage lending value must be documented in a transparent and clear manner; and

(4) the value of the collateral must be the market value or mortgage lending value reduced as appropriate to reflect the results of any required monitoring and to take account of any prior claims on the property.

…

3 Professional indemnity insurance

3.1 Application and purpose

3.1.1 R …

(5) This chapter does not apply to

…

(c) a *firm* to which *IPRU(INV)* 13.1.5R(1)4 (Financial resource requirements for personal investment firms: requirement to hold professional indemnity insurance) applies.~~; or~~

(d) ~~an *exempt CAD firm* to which *IPRU(INV)* 9.2.5R (Initial capital and professional indemnity insurance requirements - exempt CAD firms that are also IDD insurance intermediaries) applies.~~ [deleted]

…

...

4 Capital resources

4.1 Application and purpose

…

Application: banks, designated investment firms, building societies, insurers and friendly societies

4.1.4 R This chapter does not apply to:

…

(1A) a *designated investment firm*; or

…

…

Application: firms carrying on designated investment business only

…

4.1.7 G A *firm* which carries on *designated investment business*, and no other *regulated activity*, may disregard this chapter. For example, a *firm* with *permission* limited to *dealing in investments as agent* in relation to *securities* is only carrying on *designated investment business* and may be subject to the Prudential sourcebook for MiFID Investment Firms (*MIFIDPRU*) or the Interim Prudential sourcebook for Investment Businesses (*IPRU(INV)*), as appropriate. ~~the Interim Prudential sourcebook for investment businesses or the Prudential sourcebook for Banks, Building Societies and Investment Firms, as appropriate, will apply.~~ However, if its *permission* is varied to enable it to arrange motor insurance as well, this activity is not *designated investment business* so the *firm* will be subject to the higher of the requirements in this chapter and those sourcebooks (see *MIPRU* 4.2.5R).

…

4.2 Capital resources requirements

…

Capital resources requirement: firms carrying on regulated activities including designated investment business

4.2.5 R The capital resources requirement for a *firm* (other than a *credit union*) carrying on *regulated activities*, including *designated investment business* and to which *IPRU(INV)* does not apply, is the higher of:

(1) the requirement which is applied by this chapter according to the activity or activities of the *firm* (treating the relevant *rules* as applying to the *firm* by disregarding its *designated investment business*); and

(2) the financial resources requirement which is applied by the ~~Prudential sourcebook for Investment Firms and the *UK CRR* or the General Prudential sourcebook and the Prudential sourcebook for Banks, Building Societies and Investment~~

~~Firms~~ Prudential sourcebook for MiFID Investment Firms (*MIFIDPRU*).

…

4.4 Calculation of capital resources

The calculation of a firm's capital resources

4.4.1 R (1) …

(2) If the *firm* is subject to ~~the Interim Prudential sourcebook for investment businesses, the Prudential sourcebook for Investment Firms and the *UK CRR*, the General Prudential sourcebook, the Prudential sourcebook for Banks, Building Societies and Investment Firms or the Credit Unions sourcebook,~~ the Prudential sourcebook for MiFID Investment Firms (*MIFIDPRU*) or the Interim Prudential sourcebook for investment businesses (*IPRU(INV)*), the capital resources are the higher of:

(a) the amount calculated under (1); and

(b) the financial resources calculated under those sourcebooks ~~and regulations~~.

…

After TP1 'Transitional Provisions' insert the following new transitional provision. The text is not underlined.

TP 2 Transitional Provisions for former exempt CAD firms

2.1 R

	(1)	**(2) Material to which the transitional provision applies**	**(3)**	**(4) Transitional provision**	**(5) Transitional provision: dates in force**	**(6) Handbook provision: coming into force**
	2.1	*MIPRU* 3.2	R	This *rule* applies to a *MIFIDPRU investment firm* that was classified as an *exempt CAD firm* subject to	Until [*Editor's note*: insert the date three years after the day on	[*Editor's note*: insert the date on which MIFIDPRU

				IPRU-INV 9 on [*Editor's note*: insert the date immediately before the day on which MIFIDPRU begins to apply]. Instead of complying with the requirements relating to professional indemnity insurance in *MIPRU* 3.2, a *firm* may comply with the professional indemnity insurance requirements set out in *IPRU-INV* 9.2.4R(1)(b) (except that the minimum limits of indemnity are at least EUR 1,250,000 for a single claim and EUR 1,850,000 in aggregate), together with *IPRU-INV* 9.2.7R and *IPRU-INV* 9.4.	which MIFIDPRU begins to apply]	begins to apply]
	2.2	*MIPRU* 3.2	R	This *rule* applies to a *MIFIDPRU investment firm* that was classified as an *exempt CAD firm* and was	Until [*Editor's note*: insert the date three years after the day on	[*Editor's note*: insert the date on which MIFIDPRU

				subject to *IPRU-INV* 13 on [*Editor's note*: insert the date immediately before the day on which MIFIDPRU begins to apply]. Instead of complying with the requirements relating to professional indemnity insurance in *MIPRU* 3.2, a *firm* may comply with *IPRU-INV* 13.1.5R; *IPRU-INV* 13.1.7R to 13.1.10R; and *IPRU-INV* 13.1.15R to 13.1.29G.	which MIFIDPRU begins to apply]	begins to apply]
	2.3	*MIPRU* 3.2	R	References in this transitional provision to *IPRU-INV* are to the version of *IPRU-INV* that applied on [*Editor's note*: insert the date immediately before the day on which MIFIDPRU begins to apply].	Until [*Editor's note*: insert the date three years after the day on which MIFIDPRU begins to apply]	[*Editor's note*: insert the date on which MIFIDPRU begins to apply]

				References to an *exempt CAD firm* in *IPRU-INV* are to the *firm* to which this transitional provision applies.		
	2.4	*MIPRU* 3.2	G	*Exempt CAD firms* that carried on activities in scope of *MIPRU* 3.2 were exempt from the requirements in *MIPRU* 3.2, on the basis that they were subject to similar professional indemnity insurance requirements in *IPRU-INV* 9 or 13. The category of *exempt CAD firm* ceases to exist on [*Editor's note*: insert the date on which MIFIDPRU begins to apply]. These *firms* will no longer be subject to *IPRU-INV*, and instead will become subject to prudential requirements in *MIFIDPRU*. *MIFIDPRU* does	Until [*Editor's note*: insert the date three years after the day on which MIFIDPRU begins to apply]	[*Editor's note*: insert the date on which MIFIDPRU begins to apply]

				not require the holding of professional indemnity insurance. Former *exempt CAD firms* that carry on activities in scope of *MIPRU* 3.2 will therefore have to comply with the requirements to hold professional indemnity insurance in *MIPRU* 3.2 for the first time, consistent with other *investment firms* that have always had to comply with *MIPRU* 3.2. The purpose of this transitional provision is to give former *exempt CAD firms* time to comply with any new requirements in *MIPRU* 3.2. In particular, former *exempt CAD firms* should note that the minimum *limit of indemnity* for claims in aggregate can be higher under *MIPRU* 3.2.7R(2)(b) than		

				under the relevant provisions in *IPRU-INV*. *MIPRU* 3.2 also contains material relating to excess levels that differs from the material in *IPRU-INV*. *IPRU-INV* 9.4.4R requires that professional indemnity insurance policies must not be subject to unreasonable limits. *IPRU-INV* 13.1.9R requires that policies must incorporate terms which are appropriate. The *FCA* therefore expects former *exempt CAD firms* to have regard to the requirements in *MIPRU* 3.2 when renewing their professional indemnity insurance whilst this transitional applies.		

Annex E

Interim Prudential sourcebook for Investment Businesses (IPRU-INV)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

1 Application and General Provisions

1.1 Purpose

…

1.1.3A ~~R~~ G ~~This sourcebook does not apply to *BIPRU firms* except:~~

~~(1)~~ ~~it does apply to certain *exempt BIPRU commodities firms*; and~~

~~(2)~~ ~~[deleted]~~ This sourcebook does not apply to a *MIFIDPRU investment firm* (unless it is a *collective portfolio management investment firm*).

1.1.3B R ~~This sourcebook does not apply to *IFPRU investment firms* except it does apply to *exempt IFPRU commodities firms*.~~ [deleted]

…

1.2 Application

…

1.2.2 R (1) *IPRU-INV* applies to:

(a) a *members' adviser*;

(b) an *investment management firm*;

(c) a *personal investment firm*;

(d) an *authorised professional firm*;

(e) a *securities and futures firm*;

(f) a *service company*;

(g) the *Society of Lloyd's* (in relation to *underwriting agents*);

(h) [deleted]

(i) a *credit union* which is a *CTF provider*; ~~and~~

(j) ~~an *exempt CAD firm*; and~~ [deleted]

(k) a *collective portfolio management firm*; and

(l) a *collective portfolio management investment firm*.

(2) *IPRU-INV* does not apply to:

(a) a *lead regulated firm*; or

(b) a *media firm*; or

(c) ~~a *BIPRU firm* (unless it is an *exempt BIPRU commodities firm*); or.~~ a *MIFIDPRU investment firm* (unless it is a *collective portfolio management investment firm*).

(d) ~~an *IFPRU investment firm* (unless it is an *exempt IFPRU commodities firm*).~~ [deleted]

…

…

1.2.5 R Table

This table belongs to *IPRU (INV)* 1.2.4R

Authorised professional firm	Chapters 1 and 2
Securities and futures firm (which is not a *MiFID investment firm*)	Chapters 1 and 3
~~*Securities and futures firm* (which is an *exempt BIPRU commodities firm* or an *exempt IFPRU commodities firm*)~~	~~Chapters 1 and 3~~
The *Society of Lloyd's* (in relation to *underwriting agents*) and *members' advisers*	Chapters 1 and 4
Investment management firm	Chapters 1 and 5
~~An *exempt CAD firm* or a *local firm*~~	~~Chapters 1 and 9~~
Service company	Chapters 1 and 6
Collective portfolio management firm	Chapters 1 and 11

Collective portfolio management investment firm	Chapters 1 and 11
Personal investment firm	Chapters 1 and 13
Credit union which is a *CTF provider*	Chapters 1 and 8

…

2 Authorised professional firms

2.1 Application

…

2.1.2 R (1) An *authorised professional firm* of a kind falling within (2) must comply with such of *IPRU-INV* 3, 5~~, 9~~ or 13 which in accordance with *IPRU-INV* 2.1.4R, most appropriately correlates to the type and scale of the business which it conducts.

(2) The type of *authorised professional firm* to which (1) applies is one:

(a) ~~which is also an *exempt CAD firm*;~~ [deleted]

(b) which acts as a *market maker*;

(c) which acts as a *stabilising manager*;

(da) which acts as a *small authorised UK AIFM* or a *residual CIS operator*;

(db) which acts as a *depositary*;

(e) which acts as a *broker fund adviser* or otherwise participates in a *broker fund* arrangement;

(f) whose main business, having regard to (3), is not the practice of its profession or professions;

(g) whose *permission* includes a requirement that it acts in conformity with the financial resources *rules* applicable to another type of *firm*; or

(h) whose *permission* includes *establishing, operating or winding up a personal pension scheme*.

…

(4) An *authorised professional firm* which, in accordance with (1), is required to comply with *IPRU-INV* 3, 5~~, 9~~ or 13 must immediately give notification of that fact to the *FCA* in accordance with *SUP* 15.7 (Forms and method of notification).

…

2.1.4 R This table belongs to *IPRU-INV* 2.1.1R

TYPE OF BUSINESS ACTIVITY	CHAPTER OF SOURCEBOOK
(i) *managing investments* other than for *retail clients*; or	*Investment management firm - IPRU-INV* 5
(ii) *OPS activity*; or	~~*Investment management firm* (which is an exempt CAD firm) - *IPRU-INV* 5 and 9~~
(iii) [deleted]	
(iv) [deleted]	
(iva) *acting as trustee or depositary of a UK UCITS*; or	
(ivb) *managing an AIF*; or	
(ivc) *acting as trustee or depositary of an AIF*; or	
(v) acting as a *residual CIS operator*; or	
(va) *establishing, operating or winding up a personal pension scheme*; or	
(vi) *safeguarding and administering investments*;	
(i) advising on, or *arranging deals* in, *packaged products*; or	
(ii) *managing investments* for *retail clients*;	*Personal investment firm - IPRU-INV* 13
(i) a *regulated activity* carried on as a member of an exchange; or	~~*Securities and futures firm* (which is an *exempt CAD firm*) - *IPRU-INV* 9~~

(ii) acting as a *market maker* in *securities* or *derivatives*; or	*Securities and futures firm* (which is not a *MiFID investment firm*) - *IPRU-INV* 3
(iii) *corporate finance business*; or	
(iv) *dealing* or *arranging* deals in *securities* or *derivatives*, other than interprofessional investments; or	
(v) the provision of clearing services as a *clearing firm*; or	
(vi) spread betting;	

…

3 Financial resources for Securities and Futures Firms which are not MiFID Investment Firms ~~or which are Exempt BIPRU Commodities Firms or Exempt IFPRU Commodities Firms~~

…

3.-1 R This chapter applies to a *securities and futures firm* which~~:~~

~~(a)~~ is not a *MiFID investment firm*~~;~~

~~(b) is an *exempt CAD firm* that carries on any *regulated activity* other than *MiFID business*; or~~

~~(c) an *exempt BIPRU commodities firm*; or~~

~~(d) is an *exempt IFPRU commodities firm*~~.

3.-1 G ~~An *exempt BIPRU commodities firm* is subject to the non-capital requirements of *GENPRU* and *BIPRU* as indicated in *BIPRU* TP 15. An *exempt IFPRU commodities firm* is subject to the non-capital requirements of *IFPRU* and the *EU CRR*.~~ [deleted]

…

3.-1B R ~~The provisions on concentrated risk in this chapter:~~

~~(a) apply to an *exempt BIPRU commodities firm* if it satisfies the conditions in *BIPRU* TP 16 (Commodities firm transitionals: large exposures) in the version as at 31 December 2013; and~~

(b) ~~do not apply to an *exempt IFPRU commodities firm* which applies the large exposure requirements Part Four (articles 387 to 403) of the *EU CRR*.~~ [deleted]

3.-1B G ~~Part Four (articles 387 to 403) of the *EU CRR* applies to an *exempt IFPRU commodities firm*, unless it qualifies for exemption under article 493(1) of the *EU CRR*.~~ [deleted]

3.-1C G ~~The table in *IPRU(INV)* 3-1DG sets out the parts of the *Handbook* and the *EU CRR* containing provisions on *large exposure* or concentrated risk which apply to a *securities and futures firm*.~~ [deleted]

3.-1D G ~~Table~~

~~Applicability of the provisions to securities and futures firms~~

~~This table belongs to *IPRU(INV)* 3-1CG~~ [deleted]

~~**(1)**~~ [deleted]	~~**(2)**~~	~~**(3)**~~
~~Type of *securities and futures firm*~~	~~Whether conditions in article 493(1) of the *EU CRR* are satisfied~~	~~Part of *Handbook* and *EU CRR* applicable for *large exposure* or concentrated risk requirements~~
~~*Energy market participant* (which is an *exempt IFPRU commodities firm*) with a *waiver* from *IPRU(INV)* 3~~	~~Yes~~	~~Not applicable~~
	~~No~~	~~Part Four (articles 387 to 403) of the *EU CRR* applies~~
~~*Energy market participant* (which is *exempt IFPRU commodities firm*) to which *IPRU(INV)* 3 applies~~	~~Yes~~	~~*IPRU(INV)* 3 applies~~
	~~No~~	~~Part Four (articles 387 to 403) of the *EU CRR* applies~~
~~*Oil market participant* (which is an *exempt IFPRU commodities firm*) if it is a member of a *recognised investment exchange* or a *designated investment exchange* which is, under the rules of that exchange, entitled to trade with other~~	~~Yes~~	~~*IPRU(INV)* 3 applies~~
	~~No~~	~~Part Four (articles 387 to 403) of the *EU CRR* applies~~

~~members to which *IPRU(INV)* 3 applies~~		
~~Other *oil market participant* (which is an *exempt IFPRU commodities* firm) to which *IPRU(INV)* 3 does not apply~~	~~Yes~~	~~Not applicable~~
	~~No~~	~~Part Four (articles 387 to 403) of the *EU CRR* applies~~
~~*Exempt IFPRU commodities firm* which is not an *energy market participant* or *oil market participant*~~	~~Yes~~	~~*IPRU(INV)* 3 applies~~
	~~No~~	~~Part Four (articles 387 to 403) of the *EU CRR* applies~~
~~*Securities and futures firm* (which is not a *MiFID investment firm*)~~	~~Not applicable~~	~~*IPRU(INV)* 3 applies~~

…

~~Exempt CAD firms~~

3.-60(8) R ~~*Rules* 3-61 to 3-182 do not apply to an *exempt CAD firm*, unless it carries on any *regulated activity* other than *MiFID business*.~~ [deleted]

~~Exempt BIPRU commodities firms~~

3.-60(9) G ~~An *exempt BIPRU commodities firm* should determine whether it is a *broad scope firm* or one of the other categories in this *rule*.~~ [deleted]

~~Exempt IFPRU commodities firm~~

3.-60(10) G ~~An *exempt IFPRU commodities firm* should determine whether it is a *broad scope firm* or one of the other categories in this *rule*.~~ [deleted]

…

Obligation to calculate PRR~~*~~

…

3.-80(2) G Notwithstanding the methods available for calculating the *PRR*, a *firm* may, in respect of any individual position, calculate a *PRR* which is more conservative than that calculated under the appropriate *rule*. However, in that case, the *firm* will need to be able to demonstrate that, in all circumstances, the calculation being employed does give rise to a higher *PRR* for the position.

~~* For guidance notes as to which methods to apply, see Appendix 20~~

…

Models approach

3.-169A G A *firm* may seek a modification or *waiver* from the *FCA* to use a *VaR model* as the basis for calculating the *PRR* on its commodity positions.

The *FCA* will grant a modification or *waiver* permitting the use of a *VaR model* only where a number of qualitative and quantitative standards are met. In assessing the *VaR model* the *FCA* will have regard to the matters set out in *BIPRU* 7.10 as it applied on [*Editor's note*: insert date immediately before the date that the MIFIDPRU sourcebook begins to apply].

…

Appendix 1 Glossary of terms for IPRU(INV) 3

…

qualifying debt security means a *debt security* which:

…

(3) (for the purposes of *rule* 3-173B) meets the following conditions:

…

(d) ~~it is a mortgage backed *security* relating to residential real estate of the type referred to in *BIPRU* 3.4.94R(1)(d)(i) which meets the requirements about legal certainty referred to in *BIPRU* 3.4.62R; or~~ [deleted]

…

…

…

IPRU-INV 3 Appendix 20 is deleted in its entirety. The deleted text is not shown but the chapter is marked [deleted] as shown below.

3 Appendix 20 GUIDANCE NOTES ON RECONCILIATION OF FIRM'S BALANCES WITH A COUNTERPARTY WHICH IS A MEMBER OF AN EXCHANGE (RULE 3-11(1)(D)) AND IPRU(INV) 9.6.1R (FOR AN EXEMPT CAD FIRM)) [deleted]

Amend the following as shown.

4 Lloyd's Firms

…

4.2 PURPOSE

…

4.2.4 R A *members' adviser* is not regulated by the *Society* and accordingly this chapter specifies the financial resource and accounting requirements to be met. *Firms* which fall within the scope of this chapter will be *firms* with *permission* only to advise persons on *syndicate* participation at Lloyd's. The nature of that advisory business is akin to corporate finance advice and so the applicable requirements are those in *IPRU-INV* 3 relevant to *firms* giving corporate finance advice. *Firms* with other *permissions* will fall within the scope of other chapters of *IPRU(INV)*, ~~*GENPRU*, *BIPRU*, *IFPRU* (and the *UK CRR*)~~ <u>*MIFIDPRU*</u> or *INSPRU*.

…

5 Financial resources

5.1 Application

5.1.1 R (1) (a) This chapter applies to an *investment management firm*, other than:

(i) [deleted]

(ii) a *MiFID investment firm* ~~(unless it is an *exempt CAD firm* for the purpose of calculating its own funds and if it carries on any *regulated activity* other than *MiFID business*)~~.

(aa) This chapter applies, as set out in *IPRU-INV* 5.1.2R, to:

(i) ~~*exempt CAD firms*;~~ <u>[deleted]</u>

(ii) **OPS firms**;

(iii) non-OPS Life Offices and non-OPS Local Authorities; and

(iv) individuals admitted to membership collectively.

5.1.2 R

	~~**Exempt CAD firms**~~	**OPS firms (see**	**Non-OPS Life Offices and Non-**	**Individuals admitted to membership collectively**

		Note 1 below)	**OPS Local Authorities**	
Financial resources rules				
IPRU-INV 5.2.1R to 5.7.3R	~~No (see Note 3 below)~~	No	No	Yes
	Individuals whose sole **investment business** is giving investment advice to institutional or corporate investors		*Firms* subject to "lead regulator arrangements"	All other *firms*
Financial resources rules				
IPRU-INV 5.2.1R to 5.7.3R	No		No	Yes
			(see Note 2 below)	
Accounting records rules				
IPRU-INV 5.3.1R(1) to 5.3.1R(6)	No		Yes	Yes
Note 1. *Firms* are referred to the specific compliance reports for **OPS firms** required by Chapter 16 of the Supervision ~~Manual~~ manual.				
Note 2. A *firm* subject to "lead regulator arrangements" whereby a body other than the *FCA* is responsible for its financial regulation shall comply with the corresponding **financial resources rules** and **financial returns** rules of that body, and a breach of such rules shall be treated as a breach of the rules of the *FCA*.				
~~Note 3. The financial and non-financial resources rules for an *exempt CAD firm* are set out in *IPRU-INV chapter 9*. However, *IPRU-INV* 5.2.1R~~				

~~to 5.7.3R apply to an *exempt CAD firm* for the purpose of calculating its **own funds** (see *IPRU-INV* 9.2.9R(2)(a)) (although the Category A items of Tier 1 capital as set out in *IPRU-INV* 5.8.1R are replaced by all the items in *IPRU-INV* 9.3.1R) and if it carries on any *regulated activity* other than *MiFID business* (see *IPRU-INV* 9.2.3R).~~

…

5.1.5 R Any reference in *IPRU-INV* 5 to the *UK CRR* is to the *UK CRR* in the form in which it stood at [*Editor's note*: insert date immediately before the earlier of the date that the MIFIDPRU sourcebook begins to apply or the date that the CRR 2 amendments to the UK CRR take effect].

…

5.3 Financial resources

…

5.3.2 R For a *firm* that has a *Part 4A permission* for *acting as trustee or depositary of a UK UCITS*, own funds has the meaning in article 4(1)(118) of the ~~*EU CRR*~~ *UK CRR*.

…

5.4 Financial resources requirement

…

Exceptions from the liquid capital requirement

5.4.2 R The **financial resources requirement** is an **own funds requirement** determined in accordance with *IPRU-INV* 5.4.3R for a *firm* if its **permitted business** does not include *establishing, operating or winding up a personal pension scheme* and ~~which~~ where:

(i) ~~is an *exempt CAD firm* which is also a *residual CIS operator* or a *small authorised UK AIFM* and that scheme or AIF only invests in *venture capital investments* for **non-retail clients**; or~~ [deleted]

(ii) ~~is not an *exempt CAD firm* if:~~

(a) the *firm's* **permitted business** does not include the holding of customers' monies or assets and it neither executes transactions (or otherwise arranges deals) in **investments** nor has such transactions executed for itself or its customers; or

(b) the *firm's* **permitted business** includes the activities as in (a) above, but only in respect of *venture capital investments* for **non-retail clients**; or

(c) the *firm* is a *trustee* of an *authorised unit trust scheme* whose **permitted business** consists only of trustee activities and does not include any other activity constituting **specified trustee business** or the *firm* is a depositary of an *ICVC* or *ACS* or a *depositary* appointed in line with *FUND* 3.11.12R (Eligible depositaries for UK AIFs) or a UK depositary of a *non-UK AIF* whose **permitted business** consists only of depositary activities.

(d) the *firm's* permitted business limits it to acting a residual CIS operator or a small authorised *UK AIFM* where the main purpose of the *collective investment scheme* or *AIF* (as applicable) is to invest in *permitted immovables* whether in the *UK* or abroad.

…

5.4.6 G If a *firm* that is the *depositary* of a *UCITS scheme* is seeking to determine its **own funds requirement** on the basis of the standardised approach in article 317 ~~*EU CRR*~~ *UK CRR*, it should notify the *FCA* in advance.

…

5.4.8 R A *firm* which is the *depositary* of a *UCITS scheme* must comply with the *rules* in *IFPRU* 2 as it applied on [*Editor's note*: insert date immediately before the date that the MIFIDPRU sourcebook begins to apply], as if it were an *IFPRU investment firm* that is not a *significant IFPRU investment firm*.

5.4.9 G ~~A *firm* to which *IPRU-INV* 5.4.8R applies is, in particular, reminded of the *rules* in *IFPRU* 2 that determine whether a *firm* must apply the *ICAAP rules* on an individual basis or comply with them on a *consolidated basis* or *sub-consolidated basis* (see *IFPRU* 2.2.45R to *IFPRU* 2.2.49R).~~ [deleted]

…

5.8 Calculation of own funds and liquid capital

5.8.1 R A *firm* must calculate its **own funds** and **liquid capital** as shown below, subject to the detailed requirements set out in *IPRU-INV* 5.8.2R.

Financial resources			**Category**	**IPRU-INV 5.8.2R paragraph**
Tier 1				
	(1)	Paid-up share capital (excluding preference shares)	A	

	(1A)	Eligible LLP members' capital		
	(2)	Share premium account		
	(3)	Reserves		2A
	(4)	Non-cumulative preference shares		
Less:	(5)	**Investments** in own shares	B	
	(6)	Intangible assets		
	(7)	Material current year losses		4
	(8)	Material holdings in credit and financial institutions ~~and, for *exempt CAD firms* only, material insurance holdings.~~		5 ~~and 5A~~
	(8A)	Excess LLP members' drawings		
Tier 1 capital = (A-B)			C	
Plus: TIER 2				1
	(9)	Revaluation reserves	D	
	(10)	Fixed term cumulative preference share capital		~~1(a)~~
	(11)	Long-term **Qualifying Subordinated Loans**		~~1(a);~~ 6
	(12)	Other cumulative preference share capital and debt capital ~~but, for *exempt CAD firms*, only perpetual cumulative preference share capital and **qualifying capital instruments**~~		~~6A~~
	(13)	Qualifying arrangements		7
"Own Funds" = (C+D)			E	
Plus: TIER 3				
	(14)	Net **trading book** profits	F	~~1(b)(i);~~ 8

	(15)	Short-term **Qualifying Subordinated Loans** and excess Tier 2 capital		1(b)~~(ii);~~ ~~1(c)~~; 9
Less:	(16)	Illiquid assets	G	10
Add:	(17)	**Qualifying Property**		11
"Liquid Capital" = (E+F+G)				

5.8.2 R

1 Deductions and Ratios (Items 10, 11 and 15)	~~(a)~~	~~Notwithstanding *IPRU-INV* 5.8.1R and 5.8.2R for an *exempt CAD firm*, in calculating **own funds**, all of Item 8 must be deducted after the total of Tier 1 and Tier 2 capital and the following restrictions apply:~~ [deleted]	
		~~(i)~~	~~the total of fixed term cumulative preference shares (item 10) and long-term **qualifying subordinated loans** (item 11) that may be included in Tier 2 capital is limited to 50 per cent of Tier 1 capital;~~
		~~(ii)~~	~~Tier 2 capital must not exceed 100 per cent of Tier 1 capital.~~
	(b)	A *firm* ~~which is not an *exempt CAD firm* and~~ which is subject to a **liquid capital requirement** under *IPRU-INV* 5.4.1R may take into account **qualifying subordinated loans** in the calculation of **liquid capital** up to a maximum of 400% of its Tier 1 capital.	
…			
~~5A Material insurance holdings (Item 8)~~	~~(a)~~	~~A material insurance holding means the holdings of an *exempt CAD firm* of items of the type set out in (b) in any:~~	
		~~(i)~~	~~*insurance undertaking*; or~~
		~~(ii)~~	~~*insurance holding company*;~~
		~~that fulfils one of the following conditions:~~	
		~~(iii)~~	~~it is a subsidiary undertaking of that *firm*; or~~
		~~(iv)~~	~~that *firm* holds a participation in it.~~

	~~(b)~~	~~An item falls into this provision for the purpose of (a) if it is:~~	
		~~(i)~~	~~an ownership share; or~~
		~~(ii)~~	~~subordinated debt or another item of capital that forms part of the *tier two capital resources* that falls into *GENPRU* 2 or, as the case may be, *INSPRU* 7, or is an item of "basic own funds" defined in the *PRA Rulebook*: Glossary.~~
…			
~~6A Perpetual cumulative preference share capital~~	~~Perpetual cumulative preference share capital may not be included in the calculation of own funds by an *exempt CAD firm* unless it meets the following requirements:~~		
	~~(a)~~	~~it may not be reimbursed on the holder's initiative or without the prior agreement of the *FCA*;~~	
	~~(b)~~	~~the instrument must provide for the *firm* to have the option of deferring the dividend payment on the share capital;~~	
	~~(c)~~	~~the shareholder's claims on the *firm* must be wholly subordinated to those of all non-subordinated creditors;~~	
	~~(d)~~	~~the terms of the instrument must provide for the loss-absorption capacity of the share capital and unpaid dividends, whilst enabling the *firm* to continue its business; and~~	
	~~(e)~~	~~it must be fully paid-up.~~	
7 Qualifying arrangements (Item 13)	~~(a)~~	~~An *exempt CAD firm* may only include a **qualifying undertaking** or other arrangement in item 13 if it is a **qualifying capital instrument** or a **qualifying capital item**.~~	
	~~(b)~~	A *firm* ~~which is not an *exempt CAD firm*~~ may only include **qualifying undertakings** in its calculation of **liquid capital** if:	
		(i)	it maintains **liquid capital** equivalent to 6/52 of its **annual expenditure** in a form other than **qualifying undertakings**; and

		(ii)	the total amount of all **qualifying undertakings** plus **qualifying subordinated loans** does not exceed the limits set out in paragraph (1)(b) above.
8 Net trading book profits (Item 14)	~~For *firms* which are not *exempt CAD firms* unaudited~~ Unaudited profits can be included at item 14.		
	…		
…			

…

IPRU-INV 9 is deleted in its entirety. The deleted text is not shown but the chapter is marked [deleted] as shown below.

9 Financial resources requirements for an exempt CAD firm [deleted]

Amend the following as shown.

11 Collective Portfolio Management Firms and Collective Portfolio Management Investment Firms

11.1 INTRODUCTION

Application

…

11.1.2 G A *collective portfolio management firm* that manages an *AIF* is an *internally managed AIF* or an *external AIFM*. If the *firm* is a *full-scope UK AIFM* this affects the *firm's base capital resources requirement* (see *IPRU-INV* 11.3.1R). An *internally managed AIF* that is a *full-scope UK AIFM* is not permitted to engage in activities other than the management of that *AIF*, whereas an *external AIFM* that is a *full-scope UK AIFM* may manage *AIFs* and/or *UCITS*, provided it has *permission* to do so. A *full-scope UK AIFM* that is an *external AIFM* and/or a *UCITS management company* may undertake any of the additional investment activities permitted by article 6(4) of *AIFMD* or article 6(3) of the *UCITS Directive* (as applicable), provided it has *permission* to do so, but if so it is classified as a *collective portfolio management investment firm,* as opposed to a *collective portfolio management firm*.

A *collective portfolio management investment firm* is ~~also~~ a *MIFIDPRU investment* firm, and so is subject to the requirements ~~of either (i) *GENPRU* and *BIPRU* or (ii) *IFPRU*~~ of *MIFIDPRU* in addition to the requirements of *IPRU-INV* 11, as explained in ~~*IPRU-INV* 11.6.2G~~ *IPRU-INV* 11.6.3G.

11.1.2A G A *small authorised UK AIFM* that is not also a *UCITS management company* is not a *collective portfolio management firm* or a *collective portfolio management investment firm* and is therefore not subject to *IPRU-INV* 11. This type of *firm* is subject to *IPRU-INV* 5 if it is an *investment management firm*~~, *GENPRU* and *BIPRU* if it is a *BIPRU firm* or *IFPRU* if it is an *IFPRU investment firm*~~ or *MIFIDPRU* if it is a *MIFIDPRU investment firm*.

…

Purpose

11.1.4 G (1) …

(2) ~~This original purpose of this chapter was to implement relevant requirements of *AIFMD* and the *UCITS Directive*, which included imposing capital and professional indemnity insurance requirements on a *full-scope UK AIFM* and a *UCITS management company*. *AIFMD* and the *UCITS Directive* incorporate references to provisions of the *Banking Consolidation Directive* and the *Capital Adequacy Directive* in relation to initial capital, own funds and fixed overheads. However, in line with article 163 of the *CRD*, the *Banking Consolidation Directive* and the *Capital Adequacy Directive* were repealed from 1 January 2014 and references to these directives were replaced with references to the *CRD* and the *UK CRR* in line with the correlation table set out in Annex II to the *CRD* and in Annex IV to the *UK CRR*.~~ [deleted]

11.2 MAIN REQUIREMENTS

Collective portfolio management firm

11.2.1 R A *firm* must:

(1) …

(2) at all times, maintain *own funds* which equal or exceed:

(a) the higher of:

(i) the *funds under management requirement* (in line with *IPRU-INV* 11.3.2R); and

(ii) the amount specified in ~~article 97 of the *UK CRR* (Own funds based on fixed overheads) (as replicated in *IPRU-INV* 11.3.3AUK))~~ IPRU-INV 11.3.3AR; plus

…

(3) at all times, hold liquid assets (in line with *IPRU-INV* 11.3.17R) which equal or exceed:

(a) the higher of:

(i) the *funds under management requirement* (in line with *IPRU-INV* 11.3.2R) less the *base own funds requirement* (in line with *IPRU-INV* 11.3.1R); and

(ii) the amount specified in ~~article 97 of the *UK CRR* (Own funds based on fixed overheads)~~ IPRU-INV 11.3.3AR; plus

…

…

11.3 DETAIL OF MAIN REQUIREMENTS

…

Own Funds based on Fixed Overheads

11.3.3A ~~UK~~ R (1) ~~In accordance with Articles 95 and 96, an investment firm and firms referred to in point (2)(c) of Article 4(1) that provide the investment services and activities listed in points the *UK* legislation that implemented (2) and (4) of Section A of Annex I to Directive 2004/39/EC shall hold eligible capital~~ A *firm* must hold *own funds* of at least one quarter of the fixed overheads of the preceding year.

(2) ~~Where there is a change in the business of an investment firm since the preceding year that the competent authority considers to be material, the competent authority may adjust the requirement laid down in paragraph 1.~~ A *firm* must calculate its fixed overheads using the methodology for calculating *relevant expenditure* in *MIFIDPRU* 4.5 (Fixed overheads requirement).

(3) ~~Where an investment firm has not completed business for one year, starting from the day it starts up, an investment firm shall hold eligible capital of at least one quarter of the fixed overheads projected in its business plan, except where the competent authority requires the business plan to be adjusted.~~ A *firm* that has not been in business for one year may use its projected fixed

overheads in accordance with the approach in *MIFIDPRU* 4.5.11R.

~~[Note: article 97(1) to (3) of the *UK CRR*]~~ ~~*EU CRR*]~~

…

11.6 ADDITIONAL REQUIREMENTS FOR COLLECTIVE PORTFOLIO MANAGEMENT INVESTMENT FIRMS

11.6.1 G A *collective portfolio management investment firm* is required to comply with ~~the applicable requirements of either of the following sourcebooks in addition to complying with *IPRU-INV* 11:~~ *MIFIDPRU* in addition to *IPRU-INV* 11.

~~(1) *GENPRU* and *BIPRU* if it is a *BIPRU firm*; or~~

~~(2) *IFPRU* if it is *IFPRU investment firm*.~~

11.6.2 G (1) A *collective portfolio management investment firm* may undertake the following *MiFID business*: *portfolio management*; investment advice; safekeeping and administration in relation to *shares* or *units* of collective investment undertakings; and (if it is an *AIFM investment firm*) reception and transmission of orders in relation to *financial instruments*.

(2) ~~Subject to the conditions that the *firm* is not authorised to provide safekeeping and administration in relation to *shares* or *units* of collective investment undertakings and is not permitted to hold client money or client assets in relation to its *MiFID business* (and for that reason may not place itself in debt with those clients) competent authorities may allow the *firm* to stay on the capital requirements that would be binding on that *firm* as at 31 December 2013 the *UK* legislation that implemented under the *Banking Consolidation Directive* and the *Capital Adequacy Directive* (in line with article 95(2) of the *UK CRR*). The *FCA* exercised this derogation and, as such, a *firm* meeting those conditions is a *BIPRU firm*. If the above conditions are not met, a *collective portfolio management investment firm* is an *IFPRU investment firm*.~~ [deleted]

11.6.3 G A *collective portfolio management investment firm* is required to comply with the applicable requirements of ~~the sourcebooks set out in *IPRU-INV* 11.6.1G~~ *MIFIDPRU*, in parallel with its requirements under *IPRU-INV* 11. This means that a capital instrument or liquid asset may be used to meet either or both sets of requirements provided it meets the conditions set out in the relevant sourcebook.

11.6.4 G (1) ~~When a *collective portfolio management investment firm* that is a *BIPRU firm* calculates the *credit risk capital requirement* and the *market risk capital requirement* for the purpose of calculating the~~

~~variable capital requirement under *GENPRU* 2.1.40R it must do so only in respect of *designated investment business*. For this purpose, *managing an AIF* or *managing a UK UCITS* is excluded from *designated investment business*.~~ [deleted]

(2) ~~Generally, *BIPRU* only applies to a *collective portfolio management investment firm* that is a *BIPRU firm* in respect of its *designated investment business* (excluding *managing an AIF* and *managing a UK UCITS*). However, *BIPRU* 2.2 (Internal capital adequacy standards), *BIPRU* 2.3 (Interest rate risk in the non-trading book), *BIPRU* 8 (Group risk - consolidation) and *BIPRU* 11 (Disclosure) apply to the whole of its business.~~ [deleted]

11.6.5 G (1) ~~When a *collective portfolio management investment firm* that is an *IFPRU investment firm* calculates the total risk exposure amount in article 92(3) of the *UK CRR*, the *own funds requirements* referred to in article 92(3)(a) (Risk weighted exposure amount for credit risk and dilution risk) and article 92(3)(b) (Risk weighted exposure amount for position risk) should include only those arising from its *designated investment business*. For this purpose, *managing an AIF* or *managing a UK UCITS* is excluded from *designated investment business*.~~ [deleted]

(2) ~~Generally, *IFPRU* only applies to the *designated investment business* (excluding *managing an AIF* and *managing a UK UCITS*) of a *collective portfolio management investment firm* that is an *IFPRU investment firm*. However, *IFPRU* 2.2 (Internal capital adequacy standards) and *IFPRU* 2.3 (Supervisory review and evaluation process: Internal capital adequacy standards) apply to the whole of its business.~~ [deleted]

11.6.6 G A *collective portfolio management investment firm* is not required to include its collective portfolio management activities when calculating its *K-factor metrics* under *MIFIDPRU.*

…

11.7 CAPITAL REPORTING

11.7.1 G The reporting requirements of capital adequacy for a *collective portfolio management firm* and a *collective portfolio management investment firm* are set out in *SUP* 16.12 (Integrated regulatory reporting). In summary, the relevant capital adequacy forms for its business of *managing an AIF* or *managing a UK UCITS* are as follows:

(1) a *collective portfolio management firm* is required to submit FIN066 (and FSA042 if it is a *UCITS firm*); and

(2) a *collective portfolio management investment firm* ~~that is an *IFPRU investment firm*~~ is required to submit FIN067 (and FSA042

if it is a *UCITS investment firm*) and also report ~~using COREP~~ in accordance with *MIFIDPRU* 9. ~~; and~~

(3) ~~a *collective portfolio management investment firm* that is a *BIPRU firm* is required to submit FIN068 (and FSA042 if it is a *UCITS investment firm*) and FSA003.~~ [deleted]

…

13 Financial Resources Requirements for Personal Investment Firms

13.1 APPLICATION, GENERAL REQUIREMENTS AND PROFESSIONAL INDEMNITY INSURANCE REQUIREMENTS

Application

13.1.1 R This chapter applies to a *firm* which is a *personal investment firm* ~~as set out in the table below~~.

~~**Type of personal investment firm**~~	~~**Application of this Chapter**~~
~~A *personal investment firm* which is an *exempt CAD firm*~~	~~13.1, 13.1A, 13.13 and 13.14~~
~~A *personal investment firm* which is a *category B firm*~~	~~13.1 and 13.13 to 13.15~~

…

…

Capital resources: general accounting principles

13.1.4A R (1) …

(2) The accounting principles are referred to in~~:~~

~~(a)~~ the Notes for completion of the Retail Mediation Activities Return (*RMAR*) (under the heading "Accounting Principles") in *SUP* 16 Annex 18BG ~~for a *category B firm*; and~~

~~(b) the Guidance notes for data items in FSA032 (under the heading "Defined terms") in *SUP* 16 Annex 25AG for an *exempt CAD firm*~~.

…

Requirement to hold professional indemnity insurance

…

13.1.6 R ~~An *exempt CAD firm* is not required to effect and maintain professional indemnity insurance unless it chooses this *option* (see 13.1A).~~ [deleted]

…

Limits of indemnity

13.1.10 R If the *firm* is an *IDD insurance intermediary*, ~~whether or not it is also an *exempt CAD firm*,~~ the appropriate minimum *limits of indemnity* per year are no lower than:

(1) EUR 1,250,000 for a single claim against the *firm*; and

(2) EUR 1,850,000 in the aggregate.

[Note: articles 10(4) and 10(5) of the *IDD*]

13.1.11 R ~~If the *firm* is an *exempt CAD firm* that maintains professional indemnity insurance under 13.1A.3(1)(b), the appropriate minimum *limits of indemnity* per year are no lower than:~~

~~(1) EUR 1,000,000 for a single claim against the *firm*; and~~

~~(2) EUR 1,500,000 in the aggregate.~~ [deleted]

~~[Note: article 31(1) of the *CRD* (see also *IPRU-INV* 13.1A.3R)]~~

13.1.12 R ~~If the *firm* is both an *IDD insurance intermediary* and an *exempt CAD firm* that maintains professional indemnity insurance under *IPRU(INV)* 13.1A.4(1)(b), the appropriate additional *limits of indemnity* to *IPRU(INV)* 13.1.10R per year are no lower than:~~

~~(1) EUR 500,000 for a single claim against the *firm*; and~~

~~(2) EUR 750,000 in the aggregate.~~ [deleted]

~~[Note: article 31(2) of the *CRD* (see also *IPRU-INV* 13.1A.4R)]~~

13.1.13 R If the *firm* is not an *IDD insurance intermediary* ~~or an *exempt CAD firm*~~, then the following *limits of indemnity* apply:

(1) if the *firm* has relevant income of up to £3,000,000, no lower than £500,000 for a single *claim* against the *firm* and £500,000 in the aggregate; or

(2) if the *firm* has relevant income of more than £3,000,000, no lower than £650,000 for a single claim against the *firm* and £1,000,000 in the aggregate.

…

Additional capital resources - exclusions

13.1.23 R …

Note 2 - The calculation of a *firm's* capital resources is set out in sections ~~13.1A to 13.15 (see *IPRU-INV* 13.1.1R for application of these sections to an *exempt CAD firm* or a *category B firm*)~~ *IPRU-INV* 13.13 to 13.15.

…

Additional capital resources - excess

13.1.27 R …

Note 2 - The calculation of a *firm's* capital resources is set out in section~~s~~ ~~13.1A to 13.15 (see *IPRU-INV* 13.1.1R for application of these sections to an *exempt CAD firm* or a *category B firm*)~~ *IPRU-INV* 13.13 to 13.15.

…

IPRU-INV 13.1A is deleted in its entirety. The deleted text is not shown but the section is marked [deleted] as shown below.

13.1A Capital resources and professional indemnity insurance requirements for an exempt CAD firm [deleted]

Amend the following as shown.

13.13 CAPITAL RESOURCES REQUIREMENT FOR ~~AN EXEMPT CAD FIRM AND A CATEGORY B FIRM~~ A PERSONAL INVESTMENT FIRM

Application

13.13.1 R This section applies to a *personal investment firm* ~~which is either:~~

~~(1) an *exempt CAD firm*; or~~

~~(2) a *category B firm*.~~

Requirement

13.13.2 R (1) A *firm* to which *MIPRU* does not apply must calculate its capital resources requirement as in (2).

(2) The *firm* must calculate its capital resources requirement as the higher of:

(a) £20,000; and

(b) the amount equivalent to the applicable percentage of its *annual income* specified in table 13.13.2(2)(b), depending on the type of *firm*.

Table 13.13.2(2)(b)

This table forms part of *IPRU-INV* 13.13.2R.

(A)	**(B)** **Type of** *firm*	**(C)** **Applicable percentage of** *annual income*
~~(1)~~	~~*Exempt CAD firm*~~	~~5%~~
…	…	…

…

13.14 CALCULATION OF ANNUAL INCOME FOR ~~AN EXEMPT CAD FIRM AND A CATEGORY B FIRM~~ A PERSONAL INVESTMENT FIRM

Application

13.14.1 R This section applies to a *personal investment firm* ~~which is either:~~

~~(1)~~ ~~an *exempt CAD firm*; or~~

~~(2)~~ ~~a *category B firm*~~.

Annual income

…

13.14.3 R …

(3) The relevant reporting form under *SUP* 16.12 is~~:~~

~~(a)~~ the Retail Mediation Activities Return (*RMAR*) (Section B: Profit and Loss Account) ~~for a *category B firm*; and~~

~~(b)~~ ~~FSA030 (Income Statement) for an *exempt CAD firm*~~.

…

…

13.15 CALCULATION OF OWN FUNDS TO MEET THE CAPITAL RESOURCES REQUIREMENT FOR A ~~CATEGORY B FIRM~~ PERSONAL INVESTMENT FIRM

Application

13.15.1 R This section applies to a *personal investment firm* ~~which is a *category B firm*~~.

13.15.2 G ~~The calculation of *own funds* by an *exempt CAD firm* is in *IPRU-INV* 13.1A.14R.~~ [deleted]

…

~~Subordinated loans – Category B firm~~

13.15.7 R A ~~*category B firm*~~ *firm* may include a short-term subordinated loan as capital resources (see table in *IPRU-INV* 13.15.3R), if all the conditions in *IPRU-INV* 13.15.8R are satisfied.

…

Restrictions

13.15.9 R A ~~*Category B firm*~~ *firm* must calculate:

…

13.15.10 R A ~~*Category B firm*~~ *firm* must treat as a liability in the calculation or its capital resources any amount by which the sum of *IPRU-INV* 13.15.9R(1) exceeds the product of *IPRU-INV* 13.15.9R(2).

14 Consolidated Supervision for Investment Businesses

14.1 APPLICATION

14.1.1 R Subject to rule 14.1.2, *consolidated supervision* and this chapter apply to a *firm* which is a member of a group if:

(1) It is:

(a) a *securities and futures firm*, subject to the financial rules in Chapter 3, which is a *broad scope firm* but not a *venture capital firm*. ~~; and~~

(2) ~~It is neither a *BIPRU firm* nor an *IFPRU investment firm*.~~ [deleted]

…

Cases where consolidated supervision under this chapter will not apply

14.1.2 R A *firm* is not subject to *consolidated supervision* under the rules in this Chapter where any of the following conditions are fulfilled:

(1) the *firm* is included in the supervision on a consolidated basis of the group of which it is a member by a *competent authority* other than the *FCA*; or

(2) the *firm* is a member of a *UK consolidation group* already included in the supervision on a consolidated basis of the group of which it is a member by the *FCA* under ~~*BIPRU* 8~~ *MIFIDPRU* 2.5 (prudential consolidation); or

(3) ~~the *firm* is a member of a group already included in the supervision on a consolidated basis of the group of which it is a member by the appropriate regulator under Part One, Title II, Chapter 2 of the *UK CRR*.~~ the *firm* is subject, along with a *MIFIDPRU investment firm*, to the *group capital test* in *MIFIDPRU* 2.6 (the group capital test).

…

Exemption from consolidated supervision

14.1.4 R A *firm* need not meet the requirements in rules 14.3.1 and 14.3.2 if:

…

(2) no *firm* in the group *deals in investments as principal*, except where it is dealing solely as a result of its activity of operating a *collective investment scheme*~~, or where the *firm's* positions fulfil the *CAD Article 5* exempting criteria;~~

…

…

14.5 GROUP FINANCIAL RESOURCES REQUIREMENT

…

14.5.2 R Financial resources requirements for individual entities in the group are:

…

(2A) for entities that are *recognised third country credit institutions* or *recognised third country investment firms* and which ~~is~~ are subject to the local regulatory capital requirement of that regulator, that local regulatory capital requirement;

(2B) for entities not in (2A) that are regulated by a *third country competent authority* named in the table in *BIPRU* ~~8 Annex 3R~~ 8 Annex 6R as it applied on [*Editor's note*: insert date immediately before the date that the MIFIDPRU sourcebook begins to apply] and which is subject to the local regulatory capital requirement of that regulator, that local regulatory capital requirement; and

…

…

14 App 1 Interpretation

App 1.1 G Glossary of defined terms for Chapter 14

…

~~*CAD Article 5 exempting criteria*~~	~~the following criteria in respect of the *firm's* dealing positions:~~ ~~- such positions arise only as a result of the *firm's* failure to match investors orders precisely;~~ ~~- the total market value of all such positions is subject to a ceiling of 15% of the *firm's* initial capital; and~~ ~~- such positions are incidental and provisional in nature and strictly limited to the time required to carry out the transaction in question.~~

…

Annex A Limited liability partnerships: Eligible members' capital

Annex A 1 Introduction

…

1.5 G The following *rules* allow inclusion of members' capital within a *firm's* capital if it meets the conditions in this annex:

Chapter	**IPRU(INV) rule**	**How eligible LLP members' capital should be treated for the purposes of the IPRU(INV) rule**
3	Table 3-61	*Eligible LLP members' capital* may be counted as Tier 1 capital under item "A" within Table 3-61.
5	Table 5.2.2 (1): Item (1A)	*Eligible LLP members' capital* may be counted

		as Tier 1 capital within Category A of Table 5.2.2(1).
~~9~~	~~9.3.1~~	~~*Eligible LLP members' capital* may be counted as initial capital with *IPRU-INV* 9.3.1~~ <ins>[deleted]</ins>
11	Table 11.4	*Eligible LLP members' capital* may be counted as Item (5) in Table 11.4.
13	Table 13.15.3(1) ~~13.1A.6~~	*Eligible LLP members' capital* may be counted as capital resources relating to companies in *IPRU-INV* 13.15.3(1). ~~*Eligible LLP members' capital* may be counted as initial capital within *IPRU-INV* 13.1A.6.~~

…

Annex D Required Forms

[*Editor's note*: This section will be published in a subsequent consultation paper.]

INVESTMENT FIRMS PRUDENTIAL REGIME (No. 2) INSTRUMENT 2021[1]

Powers exercised

A. The Financial Conduct Authority ("FCA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137A (The FCA's general rules);
(2) section 137T (General supplementary powers);
(3) section 138C (Evidential provisions);
(4) section 138D (Actions for damages);
(5) section 139A (Power of the FCA to give guidance);
(6) section 143D (Duty to make rules applying to parent undertakings);
(7) section 143E (Powers to make rules applying to parent undertakings)[2]; and
(8) paragraph 23 of Schedule 1ZA (Fees).

B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument come into force on [*Editor's note*: insert date one month before the application date specified in paragraph D] solely for the purpose of enabling a person to comply with the rules in Part 2 of Annex A to the Investment Firms Prudential Regime Instrument 2021.

D. This instrument comes into force for all remaining purposes on [*date*].

---

[1] *Editor's note*: In this consultation paper, the additional provisions being added to MIFIDPRU have been published in this separate draft instrument and are shown as amendments to the draft text published in the first consultation paper (CP20/24). The FCA has adopted this approach so that firms can identify the effect of the additional provisions more clearly. However, when the FCA publishes the policy statement for this second consultation paper, we intend to publish a single combined near-final legal instrument that shows the cumulative text from the first and second consultations together. This approach will provide a single, combined near-final MIFIDPRU text to which firms may refer (with the exception of limited parts of MIFIDPRU that will be contained in a third consultation paper). Any further amendments to the MIFIDPRU text in the third consultation paper will be published in a separate, draft legal instrument.

[2] *Editor's note*: The references to sections 143D and 143E of the Financial Services and Markets Act 2000 are to those provisions as they appear in the Financial Services Bill introduced in the House of Commons on 20 October 2020. The reference to the statutory powers and related provisions in this instrument may need to be reviewed and updated if the Bill is amended during the parliamentary process.

Amendments to the FCA Handbook

E. The modules of the FCA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Senior Management Arrangements, Systems and Controls sourcebook (SYSC)	Annex B
Prudential sourcebook for MiFID Investment Firms (MIFIDPRU)	Annex C
Supervision manual (SUP)	Annex D

F. The FCA confirms and remakes in the Glossary of definitions any defined expressions used in the modules of the FCA's Handbook of rules and guidance referred to in paragraph E where such defined expressions relate to any UK legislation that has been amended since those defined expressions were last made.

Notes

G. In the annexes to this instrument, the "notes" (indicated by "**Note:**" or "*Editor's note*:") are included for the convenience of readers, but do not form part of the legislative text.

Citation

H. This instrument may be cited as the Investment Firms Prudential Regime (No. 2) Instrument 2021.

By order of the Board
[*date*]

[*Editor's note*:

The text of the *EU CRR* is amended at the EU level by the EU texts of the Investment Firms Regulation (Regulation (EU) 2019/2033) ("IFR") and Regulation (EU) 2019/876 amending the *EU CRR* ("CRR2"). All references to the *UK CRR* in this instrument are references to the onshored *UK CRR* in the form in which it would appear if it contained equivalent amendments, unless expressly stated otherwise. The FCA expects that such amendments will largely be made to the *UK CRR* by UK primary and secondary legislation. This is consistent with HM Treasury's stated legislative approach in its 'Prudential standards in the Financial Services Bill' policy statement published in June 2020. However, the FCA may replace cross-references to the *UK CRR* in this consultation text with final rules that copy out provisions of the *UK CRR* in full (reflecting the necessary amendments) to the extent that it is necessary or desirable to do so to make the rules easier for firms to use.

Notes marked "**Note:**" in this instrument contain references to provisions of the EU IFR or EU Investment Firms Directive (Directive (EU) 2019/2034) ("IFD"). As the IFR and IFD will not apply in the UK, these references will not appear in the final Handbook text. They are provided in this draft instrument solely to assist firms in identifying EU provisions which have a broadly similar effect to the Handbook provision to which they relate. These references may assist firms and groups that operate on an international basis in understanding how the UK prudential regime for investment firms will achieve similar outcomes to the EU IFR and IFD and therefore may be useful for implementation purposes.

References to the "*Act*" (i.e. the Financial Services and Markets Act 2000) are references to provisions of the *Act* as they are expected to appear following the enactment of the Financial Services Bill 2020-21.]

Annex A

Amendments to the Glossary of definitions

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

ASA	*assets safeguarded and administered*.
assets safeguarded and administered	(in *MIFIDPRU*) the value of assets, as calculated in accordance with the *rules* in *MIFIDPRU* 4.9 (K-ASA requirement), belonging to a *client* that a *firm* holds in the course of *MiFID business*, irrespective of whether those assets appear on the *firm's* own balance sheet or are deposited into accounts opened with third parties.
assets under management	(in *MIFIDPRU*) the value of assets, as calculated in accordance with the *rules* in *MIFIDPRU* 4.7 (K-AUM requirement), that a *firm* manages for its *clients* under the following arrangements, where such arrangements constitute *MiFID business*: (1) discretionary *portfolio management*; and (2) non-discretionary arrangements constituting *investment advice of an ongoing nature*.
AUM	*assets under management*.
average ASA	the rolling average of a *firm's ASA* calculated in accordance with *MIFIDPRU* 4.9.8R.
average AUM	the rolling average of a *firm's AUM* calculated in accordance with *MIFIDPRU* 4.7.5R.
average CMH	the rolling average of a *firm's CMH* calculated in accordance with *MIFIDPRU* 4.8.13R.
average COH	the rolling average of a *firm's COH* calculated in accordance with *MIFIDPRU* 4.10.19R.
average DTF	the rolling average of a *firm's DTF* calculated in accordance with *MIFIDPRU* 4.15.4R.
basic liquid assets requirement	the requirement in *MIFIDPRU* 6.2.1R for a *MIFIDPRU investment firm* to hold a minimum amount of *core liquid assets*.
business unit	(in *SYSC* 19G) means any separate organisational or legal entities, business lines or geographical locations within a *firm*.

client money held	(in *MIFIDPRU*) the amount of *MiFID client money* that a *firm* holds.
client orders handled	(in *MIFIDPRU*) the value of orders, as calculated in accordance with the *rules* in *MIFIDPRU* 4.10 (K-COH requirement), that a *firm* handles for *clients* when providing the following services, where such services constitute *MiFID business*: (1) reception and transmission of *client* orders; and (2) *execution of orders on behalf of clients*.
CMH	*client money held*.
COH	*client orders handled*.
convertible instrument	(in *SYSC* 19G) an instrument the terms of which require the principal amount of that instrument to be converted into instruments that qualify as *common equity tier 1 capital* if a trigger event occurs.
core liquid asset	has the meaning in *MIFIDPRU* 6.3.
early warning indicator	an amount of *own funds* equal to: (1) 110% of a *firm's own funds threshold requirement*; or (2) such other amount as the *FCA* may specify in a *requirement* imposed on a *firm*.
eligible instruments	(in *SYSC* 19G) means instruments falling within *SYSC* 19G.6.18R.
financial entity	(in *MIFIDPRU*) any of the following: (1) a *MIFIDPRU investment firm* (including a *collective portfolio management investment firm*); (2) a *collective portfolio management firm*; or (3) an entity established in a *third country* that is subject to an assets under management-based financial resources requirement that is similar to the *K-AUM requirement*.
group ICARA process	an *ICARA process* operated by an *investment firm group* in accordance with *MIFIDPRU* 7.9.5R.
ICARA document	has the meaning specified in *MIFIDPRU* 7.8.8R(2)(b), which, in summary, is the documentation used to record the *firm's*

	review of the adequacy of its *ICARA process* under *MIFIDPRU* 7.8.2R.
ICARA process	has the meaning specified in *MIFIDPRU* 7.4.9R(4), which, in summary, is the systems, controls and procedures set out in *MIFIDPRU* 7.4.9R(1) to (3) operated by a *MIFIDPRU investment firm* to: (1) identify, monitor and, if proportionate, reduce all material potential harms that may result from the ongoing operation of, or winding down of, the *firm's* business; and (2) assess whether the *firm* should hold additional *own funds* and/or *liquid assets* to address material potential harms.
indirect clearing arrangements	has the meaning in article 1(b) of the *EMIR L2 Regulation*.
indirect clearing firm	a *client* or an *indirect client* of a *clearing member* where that *client* or *indirect client* is providing *indirect clearing arrangements*.
K-ASA requirement	the part of the *K-factor requirement* calculated on the basis of the *ASA* of a *MIFIDPRU investment firm* in accordance with *MIFIDPRU* 4.9 (K-ASA requirement).
K-AUM requirement	the part of the *K-factor requirement* calculated on the basis of the *AUM* of a *MIFIDPRU investment firm* in accordance with *MIFIDPRU* 4.7 (K-AUM requirement).
K-CMH requirement	the part of the *K-factor requirement* calculated on the basis of the *CMH* of a *MIFIDPRU investment firm* in accordance with *MIFIDPRU* 4.8 (K-CMH requirement).
K-COH requirement	the part of the *K-factor requirement* calculated on the basis of the *COH* of a *MIFIDPRU investment firm* in accordance with *MIFIDPRU* 4.10 (K-COH requirement).
K-factor average metric	any of the following: (1) *average ASA*; (2) *average AUM*; (3) *average CMH*; (4) *average COH*; (5) *average DTF*;

	(6)	TM for the purposes of the *K-CMG requirement*, as calculated in accordance with *MIFIDPRU* 4.13.5R.
liquid assets	*core liquid assets* and *non-core liquid assets*.	
liquid assets threshold requirement	the amount of *liquid assets* that a *firm* needs to hold to comply with the *overall financial adequacy rule*.	
liquid assets wind-down trigger	is an amount of *liquid assets* that is equal to:	
	(1)	a *firm's basic liquid assets requirement*; or
	(2)	such other amount as the *FCA* may specify in a *requirement* imposed on a *firm*.
Market Making RTS	Part 1 (FCA) of the *UK* version of Regulation (EU) 2017/578 of 13 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards specifying the requirements on market making agreements and schemes, which is part of *UK* law by virtue of the *EUWA*.	
material risk taker	(in *SYSC* 19G) has the meaning given in *SYSC* 19G.5.1R.	
MiFID client money	(in *MIFIDPRU*) *money* that a *firm* receives from, or holds for or on behalf of, a *client* in the course of, or in connection with, its *MiFID business*. For the purposes of *MIFIDPRU*, this includes:	
	(1)	where such *money* has been deposited into a *client bank account* (including, where applicable, any amounts of the *firm's* own *money* or other *money* received in such an account as a result of applying *prudent segregation*, *alternative approach mandatory prudent segregation* or *clearing arrangement mandatory prudent segregation*);
	(2)	where a *firm* has placed such *money* in a *qualifying money market fund* in accordance with *CASS* 7.13.3R(4);
	(3)	any amount of such *money* which a *firm* has allowed a third party to hold in accordance with *CASS* 7.14.
MIFIDPRU Remuneration Code	as set out in *SYSC* 19G (MIFIDPRU Remuneration Code).	

non-core liquid asset	has the meaning specified in *MIFIDPRU* 7.7.8R, which is any of the following, except to the extent excluded by *MIFIDPRU* 7.7.8R(2): (1) short-term deposits at a *credit institution* that does not have a *Part 4A permission* in the *UK* to *accept deposits*; (2) assets representing claims on, or guaranteed by, multilateral development banks or international organisations; (3) assets representing claims on or guaranteed by any *third country* central bank or government; (4) *financial instruments*; and (5) any other instrument eligible as collateral against the margin requirement of an *authorised central counterparty*.
non-segregated account	(in *MIFIDPRU*) any account which is not a *segregated account*.
own funds threshold requirement	the amount of *own funds* that a *firm* needs to hold to comply with the *overall financial adequacy rule*.
own funds wind-down trigger	is an amount of *own funds* that is equal to: (1) the *firm's fixed overheads requirement*; or (2) such other amount as the *FCA* may specify in a *requirement* applied to the *firm*.
relevant expenditure	(in *MIFIDPRU* 4 and *IPRU(INV)* 11) relevant expenditure as calculated under *MIFIDPRU* 4.5.3R.
segregated account	(in *MIFIDPRU*) an arrangement which satisfies the conditions in *MIFIDPRU* 4.8.8R.
short-term MMF	a *regulated money market fund* that meets the definition of a "short-term MMF" in article 2(14) of the *Money Market Funds Regulation*.
third country MIFIDPRU investment firm	an *overseas firm* that would be a *MIFIDPRU investment firm* if it: (1) were incorporated in, or had its principal place of business in, the *United Kingdom*;

	(2)	carried on all its business in the *United Kingdom*; and
	(3)	had obtained any authorisations necessary under the *Act* to carry on its business.
threshold requirement	either of the following in relation to a *MIFIDPRU investment firm*:	
	(1)	the *liquid assets threshold requirement*; or
	(2)	the *own funds threshold requirement*.
trade receivables	receivables from trade debtors (including fees or commissions).	
UK-authorised credit institution	a *credit institution* with a *Part 4A permission* to *accept deposits*.	
wind-down trigger	either of the following in relation to a *MIFIDPRU investment firm*:	
	(1)	the *liquid assets wind-down trigger*; or
	(2)	the *own funds wind-down trigger*.
write-down instrument	(in *SYSC* 19G) an instrument the terms of which require the principal amount of that instrument to be written down on the occurrence of a trigger event.	

Amend the following definitions as shown.

common platform firm	(a)	a ~~*BIPRU firm*~~ <u>*MIFIDPRU investment firm*</u>; or
	(aa)	a *bank*; or
	(ab)	a *building society*; or
	(ac)	a *designated investment firm*; or
	(ad)	~~an *IFPRU investment firm*; or~~ <u>[deleted]</u>
	(b)	~~an *exempt CAD firm*; or~~ <u>[deleted]</u>
	(c)	~~a *MiFID investment firm* which falls within the definition of ‘local firm’ in article 4(1)(4) of the *UK CRR*; or~~ <u>[deleted]</u>
	(d)	a *dormant account fund operator*.

control functions	(1)	(except in 2) has the meaning in article 3 of the *Material Risk Takers Regulation 2020*.
	(2)	(in *SYSC* 19G) means a function (including, but not limited to, a risk management function, compliance function and internal audit function) that is independent from the *business units* it controls and that is responsible for providing an objective assessment of the *firm's* risks, and for reviewing and reporting on those risks.
discretionary pension benefit	…	
	(2)	(in *IFPRU*, ~~*SYSC* 19A (IFPRU Remuneration Code) and~~ *SYSC* 19D (Dual-regulated firms Remuneration Code) and *SYSC* 19G (MIFIDPRU Remuneration Code)) has the meaning in article 4(1)(73) of the UK CRR.
fixed overheads requirement	(1)	~~(except in *IPRU(INV)* and for the purposes of *GENPRU* (except *GENPRU* 3 and *BIPRU* (except *BIPRU* 12)) the part of the *capital resources requirement* calculated in accordance with *GENPRU* 2.1.53R (Calculation of the fixed overheads requirement).~~ [deleted]
	(2)	(in *IPRU(INV)*) the part of the *own funds* requirement calculated in accordance with *IPRU(INV)* 11.3.3R (Fixed overheads requirement).
	(3)	(in *MIFIDPRU*) the part of the *own funds requirement* calculated in accordance with *MIFIDPRU* 4.5 (Fixed overheads requirement).
managerial responsibility	(1)	(except in *SYSC* 19G) has the meaning in article 2 of the *Material Risk Takers Regulation 2020*.
	(2)	(in *SYSC* 19G) means a situation in which a staff member heads a *business unit* or a *control function* and is directly accountable to the *management body* as a whole, a member of the *management body* or to *senior management*.
overall financial adequacy rule	~~(1)~~	~~(in *GENPRU* and *BIPRU*) *GENPRU* 1.2.26R (Requirement for certain *firms* to have adequate financial resources).~~
	~~(2)~~	~~(in *IFPRU*) *IFPRU* 2.2.1R (Adequacy of financial resources).~~

the requirement in *MIFIDPRU* 7.4.7R(1) (Overall financial adequacy rule), which is the obligation for a *MIFIDPRU investment firm* to hold *own funds* and *liquid assets* which are adequate, both as to their amount and quality, to ensure that:

(1) it is able to remain financially viable throughout the economic cycle, with the ability to address any material potential harm that may result from its ongoing activities; and

(2) its business can be wound down in an orderly manner, minimising harm to *consumers* or to other market participants.

supervisory review and evaluation process	(1)	the *appropriate regulator's* assessment of the adequacy of certain *firms'* capital, as more fully described ~~in *BIPRU* 2.2.9G (*BIPRU firms*) and~~ *INSPRU* 7.1.91G to *INSPRU* 7.1.99G (*insurers*).
	(2)	~~the *FCA's* assessment of the adequacy of an *IFPRU investment firm's* capital, as more fully described in *IFPRU* 2.3 (Supervisory review and evaluation process)~~ (in *MIFIDPRU*) the *FCA's* assessment of the adequacy of a *MIFIDPRU investment firm's own funds* and *liquid assets*, as more fully described in *MIFIDRU* 7.10.
trading book[3]	(1)	[deleted]
	(2)	[deleted]
	(3)	[deleted]
	(4)	[deleted]
	(5)	(in *DTR*) has the meaning in article 4.1(86) of *UK CRR*.
	(6)	(in *MIFIDPRU* and *SYSC* 19G) all positions in *financial instruments* and commodities held by a *MIFIDPRU investment firm* that are: (a) *positions held with trading intent*; or (b) held in order to hedge *positions held with trading intent*.

[3] *Drafting note*: The FCA proposed to amend the existing Glossary definition of "trading book" in CP20/24. The amendments shown in this draft instrument to the definition assume that the proposed amended definition in CP20/24 has been adopted.

Annex B

Amendments to the Senior Management Arrangements, Systems and Controls (SYSC) sourcebook

SYSC 19A (IFPRU Remuneration Code) and SYSC 19C (BIPRU Remuneration Code) are deleted in their entirety. The deleted text is not shown but the chapters are marked [deleted] as shown below.

19A IFPRU Remuneration Code <u>[deleted]</u>

19C BIPRU Remuneration Code <u>[deleted]</u>

Insert the following new chapter after SYSC 19F (Remuneration and performance management). The text is not underlined.

19G MIFIDPRU Remuneration Code

19G.1 General application

Application: non-SNI MIFIDPRU investment firms

19G.1.1 R (1) Subject to (2), the *MIFIDPRU Remuneration Code* applies to a *non-SNI MIFIDPRU investment firm*.

(2) The provisions in (4) do not apply to a *non-SNI MIFIDPRU investment firm*:

(a) where the value of the *firm's* on- and off-balance sheet assets over the preceding 4-year period is a rolling average of £100 million or less; or

(b) where:

(i) the value of the *firm's* on- and off-balance sheet assets over the preceding 4-year period is a rolling average of £300 million or less; and

(ii) the conditions in (3) are satisfied.

(3) The conditions referred to in (2)(b)(ii) are:

(a) that the size of the *firm's* on- and off-balance sheet *trading book* business is equal to or less than £150 million; and

(b) that the size of the *firm's* on- and off-balance sheet derivatives business is equal to or less than £100 million.

(4) The provisions referred to in (2) are:

(a) *SYSC* 19G.6.18R and *SYSC* 19G.6.19G (Shares, instruments and alternative arrangements);

(b) *SYSC* 19G.6.20R and *SYSC* 19G.6.21G (Retention policy);

(c) *SYSC* 19G.6.22R to *SYSC* 19G.6.27R (Deferral); and

(d) *SYSC* 19G.6.33R(2) (Discretionary pension benefits).

(5) For the purposes of paragraph (2), paragraph (6) applies where a *non-SNI MIFIDPRU investment firm* does not have data covering the 4-year period referred to in that paragraph.

(6) Where this *rule* applies, a *non-SNI MIFIDPRU investment firm* must calculate the rolling averages referred to in paragraph (2) over the period that it has data.

19G.1.2 G For the purposes of *SYSC* 19G.1.1R(5), the *FCA* expects a *non-SNI MIFIDPRU investment firm* to have insufficient data for a period only where it did not carry on any *MiFID business* during that period.

19G.1.3 R (1) The amounts referred to in *SYSC* 19G.1.1R must be calculated on an individual basis.

(2) The value of the on- and off-balance sheet assets in *SYSC* 19G.1.1R(2)(a) and (b) must be an arithmetic mean of the assets over the preceding 4 years.

19G.1.4 R (1) When calculating the amounts referred to in *SYSC* 19G.1.1R, *firms* must use their total gross assets, total gross *trading book* assets and the total gross market value of their derivatives business.

(2) Any amounts in foreign currencies must be converted into pound sterling using the relevant conversion rate.

(3) A *firm* must determine the relevant conversion rate referred to in (2) by reference to an appropriate market rate and must record which rate was chosen.

19G.1.5 G The *FCA* considers that an example of an appropriate market rate for the purposes of *SYSC* 19G.1.4R(3) would be the relevant daily spot exchange rate against pound sterling published by the Bank of England.

Application: SNI MIFIDPRU investment firms

19G.1.6 R (1) The provisions in (2) apply to a *SNI MIFIDPRU investment firm*.

(2) The provisions referred to in (1) are:

(a) *SYSC* 19G.2 (Remuneration policies and practices);

(b) *SYSC* 19G.3.1R to *SYSC* 19G.3.3R (Oversight of remuneration policies and practices);

(c) *SYSC* 19G.3.6R to *SYSC* 19G.3.8G (Control functions);

(d) *SYSC* 19G.4.1R to *SYSC* 19G.4.5R and *SYSC* 19G.4.7G(1) and (2) (Fixed and variable components of remuneration);

(e) *SYSC* 19G.6.1R (Remuneration and capital);

(f) *SYSC* 19G.6.2R (Extraordinary public financial support); and

(g) *SYSC* 19G.6.4R to *SYSC* 19G.6.5G (Financial and non-financial criteria in performance assessment).

Application: summary of application to MIFIDPRU investment firms

19G.1.7 G (1) The effect of the application provisions in *SYSC* 19G.1.1R to 19G.1.6R is summarised in the following table.

Type of firm	Applicable sections
Non-SNI MIFIDPRU investment firm not falling within *SYSC* 19G.1.1R(2)	The *MIFIDPRU Remuneration Code*
Non-SNI MIFIDPRU investment firm falling within *SYSC* 19G.1.1R(2)	The *MIFIDPRU Remuneration Code* except for: *SYSC* 19G.6.18R and *SYSC* 19G.6.19G (Shares, instruments and alternative arrangements); *SYSC* 19G.6.20R and *SYSC* 19G.6.21G (Retention policy); *SYSC* 19G.6.22R to *SYSC* 19G.6.27R (Deferral); and *SYSC* 19G.6.33R(2) (Discretionary pension benefits)
SNI MIFIDPRU investment firm	*SYSC* 19G.2 (Remuneration policies and practices); *SYSC* 19G.3.1R to *SYSC* 19G.3.3R (Oversight of remuneration policies and practices); *SYSC* 19G.3.6R to *SYSC* 19G.3.8G (Control functions);

	SYSC 19G.4.1R to *SYSC* 19G.4.5R and *SYSC* 19G.4.7G(1) and (2) (Fixed and variable components of remuneration); *SYSC* 19G.6.1R (Remuneration and capital); *SYSC* 19G.6.2R (Extraordinary public financial support); and *SYSC* 19G.6.4R to *SYSC* 19G.6.5G (Financial and non-financial criteria in performance assessment)

(2) *Firms* are reminded that *MIFIDPRU* 1.2 contains provisions regarding the classification of a *firm* as a *SNI MIFIDPRU investment firm* and *non-SNI MIFIDPRU investment firm*.

Application: where the application of SYSC 19G.1.1R changes in relation to a firm

19G.1.8 R (1) This *rule* applies to a *non-SNI MIFIDPRU investment firm* that does not fall within either *SYSC* 19G.1.1R(2)(a) or (b) but subsequently satisfies the conditions to do so.

(2) The provisions referred to in *SYSC* 19G.1.1R(2) cease to apply to the *firm* in (1) if:

(a) the *firm* has met the necessary conditions to fall within either *SYSC* 19G.1.1R(2)(a) or (b) for a continuous period of at least 6 *months* (or such longer period as may have elapsed before the *firm* submits the notification in (b)); and

(b) it has notified the *FCA* that it has met the conditions in (a).

(3) The notification in (2)(b) must be submitted via the *online notification and application system* using the form in *MIFIDPRU* Annex 3R.

19G.1.9 G The effect of *SYSC* 19G.1.8R(2)(a) is that *firms* may move between meeting the conditions in *SYSC* 19G.1.1R(2)(a) and (b) during the 6-*month* period.

19G.1.10 R Where a *non-SNI MIFIDPRU investment firm* previously met the conditions necessary for it to fall within *SYSC* 19G.1.1R(2)(a) or (b) but no longer does so, it must comply with the provisions referred to in *SYSC* 19G.1.1R(2) within 12 *months* from the date on which the *firm* ceased to meet the conditions.

19G.1.11 R (1) Where a *non-SNI MIFIDPRU investment firm* ceases to meet the conditions necessary for it to fall within *SYSC* 19G.1.1R(2)(a) or (b), it must promptly notify the *FCA*.

(2) The notification in (1) must be submitted via the *online notification and application system* using the form in *MIFIDPRU* Annex 3R.

19G.1.12 G Where a *firm* ceases to meet the conditions necessary for it to fall under *SYSC* 19G.1.1R(2)(a) or (b), but subsequently meets the conditions again within a period of 6 *months*, the *firm* will still be subject to the provisions referred to in *SYSC* 19G.1.1R(2) 12 *months* after the date on which it first ceased to meet the conditions. The *firm* will only cease to be subject to the provisions referred to in *SYSC* 19G.1.1R(2) where it meets the conditions in *SYSC* 19G.1.8R(2).

19G.1.13 R The requirements in *SYSC* 19G.1.8R(2)(b) and *SYSC* 19G.1.11R(1) do not apply where a *non-SNI MIFIDPRU investment firm* has notified the *FCA* in accordance with the requirements of *MIFIDPRU* 7.1.9R(2)(b) or *MIFIDPRU* 7.1.12R(1) for the same event.

Application: collective portfolio management investment firms

19G.1.14 R (1) The *MIFIDPRU Remuneration Code* applies to the *MiFID business* of a *collective portfolio management investment firm*.

(2) Paragraph (3) applies where a staff member at a *collective portfolio management investment firm* is a *material risk taker* and also either *AIFM Remuneration Code Staff* or *UCITS Remuneration Code Staff*.

(3) Where this paragraph applies, a *collective portfolio management investment firm* must apply to the relevant *material risk taker* the most stringent of the applicable *remuneration* requirements in:

(a) the *MIFIDPRU Remuneration Code*;

(b) the *AIFM Remuneration Code*; and

(c) the *UCITS Remuneration Code*.

Application: levels of application

19G.1.15 G *SYSC* 19G.1.1R to *SYSC* 19G.1.14R and *SYSC* 19G.1.16R explain when the *MIFIDPRU Remuneration Code* applies to a *firm* on an individual basis. *SYSC* 19G.1.17R to 19G.1.20R explain when the *MIFIDPRU Remuneration Code* applies on a consolidated basis, and what that means.

19G.1.16 R The *MIFIDPRU Remuneration Code* applies to a *firm* on an individual basis where the *FCA* has granted a *firm* permission under *MIFIDPRU* 2.4.17R and *MIFIDPRU* 2.4.18R to apply the *group capital test*.

19G.1.17 R (1) Where *MIFIDPRU* 2.5 applies to a *UK parent undertaking*, the *MIFIDPRU Remuneration Code* applies to that *UK parent undertaking* on a consolidated basis.

(2) For the purposes of *SYSC* 19G, application on a consolidated basis means on the basis of the situation that results from applying the requirements in the *MIFIDPRU Remuneration Code* to a *UK parent undertaking* as if that *undertaking* formed, together with all the *investment firms, financial institutions, ancillary services undertakings* and *tied agents* in the *investment firm group,* a single *MIFIDPRU investment firm*.

(3) For the purposes of (2), the terms *investment firm*, *financial institution*, *ancillary services undertaking* and *tied agent* shall apply to *undertakings* established in *third countries*, which, were they established in the *UK*, would fulfil the definitions of those terms.

(4) Where an *undertaking* in a *third country* is included in the consolidated situation of a *UK parent undertaking* as a result of (3), the *MIFIDPRU Remuneration Code* only applies in relation to *material risk takers* at that *undertaking* who oversee or are responsible for business activities that take place in the *UK*.

19G.1.18 G Where the *MIFIDPRU Remuneration Code* applies on a consolidated basis, the effect of *SYSC* 19G.1.17(2) is that the *UK parent undertaking* and all the *investment firms*, *financial institutions*, *ancillary services undertakings* and *tied agents* in the *investment firm group* are treated for these purposes as a single *MIFIDPRU investment firm*. This means, for example, treating a staff member of an *undertaking* within the *investment firm group* as if they were a staff member of the *UK parent undertaking*.

19G.1.19 R (1) Paragraph (2) applies where the *MIFIDPRU Remuneration Code* applies on a consolidated basis and where:

(a) the professional activities of a *material risk taker* in one *undertaking* in the *investment firm group* (‘*undertaking* A’) have a material impact on the risk profile of:

(i) another *undertaking* in the same *investment firm group* (‘*undertaking* B’), or on the assets it manages; or

(ii) the whole *investment firm group* (‘group C’), or on the assets it manages; and

(b) on an individual basis, *undertaking* B or any *undertaking* in group C is subject to *remuneration* requirements that differ from those that apply to *undertaking* A, as a result of the application of:

(i) different provisions within the *MIFIDPRU Remuneration Code*;

(ii) the *AIFM Remuneration Code*;

(iii) the *Dual-regulated firms Remuneration Code*; or

(iv) the *UCITS Remuneration Code*.

(2) Where this paragraph applies, the *UK parent undertaking* must apply to the relevant *material risk taker*:

(a) where the professional activities of the *material risk taker* have a material impact on the risk profile of the whole of group C, or on the assets it manages, the most stringent of the *remuneration* requirements that, in accordance with (1)(b), apply to *undertaking* A, *undertaking* B or any other *undertaking* in group C; or

(b) where the professional activities of the *material risk taker* have a material impact on the risk profile of any other *undertaking* in group C, or on the assets it manages, the most stringent of the *remuneration* requirements that, in accordance with (1)(b), apply to *undertaking* A or that other *undertaking*.

19G.1.20 G (1) The effect of *SYSC* 19G.1.19R is that where an *investment firm group* contains both a *PRA-designated investment firm* and an *FCA investment firm* (but not a *credit institution*), the *UK parent undertaking* must ensure the consolidated requirements of both the *dual-regulated firms Remuneration Code* and the *MIFIDPRU Remuneration Code* are applied.

(2) *Firms* in a *group* that contains a *credit institution* should refer to the *dual-regulated firms Remuneration Code*.

Application: staff

19G.1.21 G The term ‘staff’ should be interpreted broadly in the *MIFIDPRU Remuneration Code* so as to include employees of the *firm* itself, *partners* or members (in the case of partnership structures), *employees* of other entities in the *group*, *employees* of joint service companies, and secondees.

Application: proportionality

19G.1.22 R A *firm* must comply with the *MIFIDPRU Remuneration Code* in a manner that is appropriate to its size and internal organisation and to the nature, scope and complexity of its activities.

When?

19G.1.23 R A *firm* must apply the *MIFIDPRU Remuneration Code* from the start of its first performance year that begins on or after 1 January 2022.

19G.2 Remuneration policies and practices

General requirements

19G.2.1 R A *MIFIDPRU investment firm* must establish, implement and maintain *remuneration* policies and practices.

19G.2.2 G The *FCA* expects that the *remuneration* policies and practices referred to in *SYSC* 19G.2.1R cover all aspects of *remuneration* within the scope of the *MIFIDPRU Remuneration Code*, and all staff.

Proportionality

19G.2.3 R A *firm's remuneration* policies and practices must be appropriate and proportionate to the nature, scale and complexity of the risks inherent in the business model and the activities of the *firm*.

19G.2.4 G The proportionality principle in *SYSC* 19G.2.3R means that the content and level of detail of a *firm's remuneration* policy may depend on a number of factors. These may include the number of staff it employs, the different types of roles, the activities it carries out, and whether the *firm* is part of a *group* with a *group*-wide *remuneration* policy.

Gender neutral remuneration policies and practices

19G.2.5 R A *firm* must ensure that its *remuneration* policy is a *gender neutral remuneration policy* and the practices referred to in *SYSC* 19G.2.1R are gender neutral.

19G.2.6 G *Firms* are reminded that the Equality Act 2010 prohibits discrimination on the basis of an individual's protected characteristics both before and after employment is offered. The Act applies to pay and all other contractual terms, including variable *remuneration*. A *firm* is reminded of the need to ensure that its *remuneration* policy complies with the Equality Act 2010.

Risk management, business strategy and avoiding conflicts of interest

19G.2.7 R A *firm* must ensure that its *remuneration* policies and practices are consistent with, and promote sound and effective, risk management.

19G.2.8 R A *firm* must ensure that its *remuneration* policies and practices are in line with the business strategy, objectives and long-term interests of the *firm*.

19G.2.9 G For the purposes of *SYSC* 19G.2.8R, the business strategy, objectives and long-term interests of the *firm* should include consideration of:

(1) the *firm's* risk appetite and strategy, including environmental, social and governance risk factors;

(2) the *firm's* culture and values; and

(3) the long-term effects of the investment decisions taken.

19G.2.10 R A *firm* must ensure that its *remuneration* policy:

(1) contains measures to avoid conflicts of interest;

(2) encourages responsible business conduct; and

(3) promotes risk awareness and prudent risk taking.

19G.2.11 R A *MIFIDPRU investment firm* must not pay variable *remuneration* to members of the *management body* who do not perform any executive function in the *firm*.

19G.3 Governance and oversight

Oversight of remuneration policies and practices

19G.3.1 R A *MIFIDPRU investment firm* must ensure that its *management body in its supervisory function* adopts and periodically reviews the *remuneration* policy and has the overall responsibility for overseeing its implementation.

19G.3.2 G (1) It is for each *firm* to assess the most appropriate frequency for the periodic reviews referred to in *SYSC* 19G.3.1R, taking into account all relevant factors.

(2) The development and review of the *remuneration* policy should be supported by the *control functions*, including (where they exist) risk management, compliance, internal audit and human resources, and by *business units*.

(3) The processes and decision-making around the development, review and amendment of *remuneration* policies and practices are subject to the general record-keeping requirements set out in *SYSC* 9.

19G.3.3 R A *firm's remuneration* committee, where it has one, must oversee the implementation of the *firm's remuneration* policies and practices established under *SYSC* 19G.2.1R.

Control functions

19G.3.4 R A *non-SNI MIFIDPRU investment firm* must ensure that the implementation of its *remuneration* policy is, at least annually, subject to central and independent internal review by staff engaged in *control functions*.

19G.3.5 G (1) The review referred to in *SYSC* 19G.3.4R should be conducted by the internal audit function, where one exists.

(2) The *FCA* expects a *non-SNI MIFIDPRU investment firm* to document appropriately the results of the review and the actions taken to remedy any findings.

19G.3.6 R A *MIFIDPRU investment firm* must ensure that staff engaged in *control functions*:

(1) are independent from the *business units* they oversee;

(2) have appropriate authority; and

(3) are remunerated in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control.

19G.3.7 R A *MIFIDPRU investment firm* must ensure that the *remuneration* of the senior officers in risk management and compliance functions is directly overseen by the *remuneration* committee, or, if such a committee has not been established, by the *management body in its supervisory function*.

19G.3.8 G *SYSC* 19G.3.6R and *SYSC* 19G.3.7R are designed to manage the conflicts of interest which might arise if other business areas had undue influence over the *remuneration* of staff in *control functions*. Conflicts of interest can easily arise when staff members are involved in the determination of *remuneration* for their own business area. Where these could arise, they need to be managed by having in place independent *control functions* (in particular risk management and compliance) and human resources.

19G.4 Fixed and variable components of remuneration

Categorising fixed and variable remuneration

19G.4.1 R A *MIFIDPRU investment firm* must ensure that the *remuneration* policy makes a clear distinction between criteria for setting fixed and variable *remuneration*.

19G.4.2 G (1) The effect of *SYSC* 19G.4.1R is that all *remuneration* paid to a staff member must be clearly categorised as either fixed or variable *remuneration*.

(2) In allocating individual *remuneration* components to fixed or variable *remuneration*, it is the quality and purpose of the component that is decisive, not the label applied to it.

(3) The *FCA* considers that:

(a) fixed *remuneration*:

(i) should primarily reflect a staff member’s professional experience and organisational responsibility as set out in the staff member’s job description and terms of employment; and

(ii) should be permanent, pre-determined, non-discretionary, non-revocable and not dependent on performance; and

(b) variable *remuneration*:

(i) should be based on performance or, in exceptional cases, other conditions;

(ii) where based on performance, should reflect the long-term performance of the staff member as well as performance in excess of the staff member's job description and terms of employment; and

(iii) includes *discretionary pension benefits*.

19G.4.3 G (1) Returns made by staff on co-investment arrangements are shares in the profits as a pro rata return on an investment. The *FCA* does not usually consider such returns to be *remuneration* for the purposes of the *MIFIDPRU Remuneration Code*. However, the investment made by the individual should be with their own funds and not in the form of a loan from the *firm*. Where this is not the case, the *FCA* would expect the returns to be categorised as *remuneration*.

(2) Payments made under carried interest arrangements represent a share in the profits of a *fund* managed by the *firm's* staff. They are received by the *firm* for the benefit of the relevant staff as compensation for the management of the *fund*. In the *FCA's* view, these payments should be considered as *remuneration* for the purposes of the *MIFIDPRU Remuneration Code*.

19G.4.4 G (1) In relation to *remuneration* received by a *partner* or a member in a *limited liability partnership*, the *FCA's* view on how to categorise certain payments received by those individuals is as follows:

(a) at the end of each year, the residual profits of a *partnership* or *limited liability partnership* are distributed among the *partners* or members. The level of ownership of each *partner* or member is reflected in the number of ownership shares they have. Residual profits are distributed according to the ownership shares, so are not linked to work or performance. In the *FCA's* view, payments on this basis are not *remuneration*;

(b) a *partner* or member may receive an amount fixed at the beginning of the year and subject only to the *firm* making a profit. These are often called fixed profit shares. A *partner* or member usually takes drawings on it throughout the year, often monthly. If profits at year-end are insufficient, drawings may have to be paid back. The *FCA* considers that drawings on fixed profit shares are usually fixed *remuneration*;

(c) a *partner* or member may receive a discretionary share of the profit at the end of the year. These may be distributed to all *partners* or members but are usually dependent on the performance of the individual or their *business unit*. Awards may be at the discretion of the *remuneration* committee. The

FCA considers that payments made on this basis are usually variable *remuneration*.

(2) A *firm* that is a *partnership* or *limited liability partnership* may use a benchmarking approach instead of, or in addition to, the approach in (1) to categorise payments made to *partners* or members of *limited liability partnerships*, for example by taking into account:

(a) the *remuneration* structures of other individuals performing similar tasks or working in similar businesses as the *partner* or member in question; or

(b) where the *partner* or member has invested in a *fund* or *firm*, the return expected in a similar investment context.

(3) The *FCA* expects a material portion of the profit share of a *partner* or member of a *limited liability partnership* to be categorised as *remuneration*. What constitutes a material portion may depend on whether the *partner* or member works full-time or part-time. For example, if a *partner* or member works part-time and receives less *remuneration* than a *partner* or member who works full-time, the *FCA* would expect a smaller proportion of the part-time *partner* or member's profit share to be classed as *remuneration*.

Balance of fixed and variable components of total remuneration

19G.4.5 R A *MIFIDPRU investment firm* must ensure that:

(1) the fixed and variable components of the total *remuneration* are appropriately balanced; and

(2) the fixed component represents a sufficiently high proportion of the total *remuneration* so as to enable the operation of a fully flexible policy on variable *remuneration*, including the possibility of paying no variable *remuneration* component.

19G.4.6 R For the purposes of *SYSC* 19G.4.5R, *non-SNI MIFIDPRU investment firms* must set an appropriate ratio between the variable and the fixed component of the total *remuneration* in their *remuneration* policies.

19G.4.7 G (1) When determining what constitutes an appropriate balance and an appropriate ratio for the purposes of *SYSC* 19G.4.5R and *SYSC* 19G.4.6R respectively, *firms* should consider all relevant factors, including:

(a) the *firm's* business activities and associated prudential and conduct risks; and

(b) the role of the individual in the *firm* and, in the case of *material risk takers*, the impact that different categories of staff have on the risk profile of the *non-SNI MIFIDPRU investment firm* or of the assets it manages.

(2) It may be appropriate for some staff to receive only fixed *remuneration*. The *FCA* does not consider it would be an appropriate balance for any individual to receive only variable *remuneration*.

(3) A *non-SNI MIFIDPRU investment firm* may wish to set different ratios for different categories of staff. For example, the *FCA* considers that it will usually be appropriate to set a lower ratio for *control functions* than for the *business units* they control.

(4) Ratios may differ from one performance year to the next.

19G.5 Application of remuneration requirements to material risk takers

Identifying material risk takers

19G.5.1 R A *material risk taker* is a staff member at a *non-SNI MIFIDPRU investment firm* whose professional activities have a material impact on the risk profile of the *firm* or of the assets that the *firm* manages.

19G.5.2 R A *firm* falling under *SYSC* 19G.5.1R must assess at least once a year which of its staff members are *material risk takers*.

19G.5.3 R For the purposes of *SYSC* 19G.5.1R, a staff member is be deemed to have a material impact on a *firm's* risk profile or the assets the *firm* manages if one or more of the following criteria are met:

(1) the staff member is a *member of the management body* in its management function;

(2) the staff member is a *member of the management body* in respect of the *management body in its supervisory function*;

(3) the staff member is a member of the *senior management*;

(4) the staff member has *managerial responsibility* for *business units* that are carrying on at least one of the following *regulated activities*:

(a) *arranging (bringing about) deals in investments*;

(b) *dealing in investments as agent*;

(c) *dealing in investments as principal*;

(d) *managing investments*;

(e) *making investments with a view to transactions in investments*;

(f) *advising on investments (except P2P agreements)*; and/or

(g) *operating an organised trading facility*;

(5) the staff member has *managerial responsibilities* for the activities of a *control function*;

(6) the staff member has *managerial responsibilities* for the prevention of money laundering and terrorist financing;

(7) the staff member is responsible for managing a material risk within the *firm*;

(8) in a *firm* that has permission for carrying on at least one of the *regulated activities* in (4)(a) to (g), the staff member is responsible for managing one of the following activities:

(a) information technology;

(b) information security; and/or

(c) outsourcing arrangements of critical or important functions as referred to in article 30(1) of the *MiFID Org Regulation*; and

(9) the staff member has authority to take decisions approving or vetoing the introduction of new products.

19G.5.4 G The *FCA* considers the following are key indicators of an individual (X) being a staff member whose professional activities have a material impact on the risk profile of the *firm* or of the assets that the *firm* manages, for the purposes of *SYSC* 19G.5.1R:

(1) there is no sufficiently senior and experienced *material risk taker* who supervises X on a day-to-day basis or to whom X reports;

(2) X is responsible for key strategic decisions; and

(3) X is responsible for significant revenue, material assets under management or for approving transactions.

19G.5.5 G The *FCA* expects individuals in the following roles would usually be categorised as *material risk takers*:

(1) in relation to portfolio management business, heads of key areas including equities, fixed income, alternatives, private equity;

(2) heads of investment research;

(3) individuals responsible for a high proportion of revenue;

(4) senior advisors where they can exert key strategic influence;

(5) chief market strategists, where media profile is linked to reputational risk and risk to market integrity;

(6) heads of a trading or broking desk; and

(7) all individuals with responsibility for information technology, information security and outsourcing where there is not a single person with responsibility for all three areas. For example, if there is a chief operating officer and a chief information technology officer who are both equally senior and have shared responsibility for these areas, then both should be identified as *material risk takers*.

19G.5.6 G (1) The *FCA* expects a *firm* to update its assessment under *SYSC* 19G.5.2R as necessary throughout the year.

(2) The *FCA* considers that it is important that *firms* consider all types of roles that may have a material impact on the *firm's* risk profile or on the assets it manages. The categories of staff referred to in *SYSC* 19G.5.3G are intended to be a starting point only. The *FCA* expects *firms* to develop their own additional criteria to identify further individuals based on the specific types of activities and risks relevant to the *firm*.

(3) In identifying its *material risk takers*, a *firm* should consider all types of risks involved in its professional activities. These may include prudential, operational, market, conduct and reputational risks.

(4) The decisive factor when identifying *material risk takers* is not the name of the function or role, but the authority and responsibility held by the individual.

19G.5.7 R (1) If a *non-SNI MIFIDPRU investment firm* is part of an *FCA investment firm group* to which prudential consolidation applies, its *material risk takers* must be identified at both solo and consolidated level.

(2) The *UK parent undertaking* of a *firm* is responsible for the *material risk taker* identification process at a consolidated level and must assess which individuals have a material impact on the risk profile of the *investment firm group*.

19G.5.8 G The *FCA* considers it may be helpful for the *UK parent undertaking* to play a role in coordinating the process for identifying *material risk takers* across the *group* entities.

Exemption for individuals

19G.5.9 R (1) The provisions in (2) do not apply in relation to a *material risk taker* (X), where X's annual variable *remuneration*:

(a) does not exceed £167,000; and

(b) does not represent more than one-third of X's total annual *remuneration*.

(2) The provisions referred to in (1) are:

(a) *SYSC* 19G.6.18R and *SYSC* 19G.6.19G (Shares, instruments and alternative arrangements);

(b) *SYSC* 19G.6.20R and *SYSC* 19G.6.21G (Retention policy);

(c) *SYSC* 19G.6.22R to *SYSC* 19G.6.27R (Deferral); and

(d) *SYSC* 19G.6.33R(2) (Discretionary pension benefits).

19G.5.10 G (1) *SYSC* 19G.5.9R is relevant only to *material risk takers* of *non-SNI MIFIDPRU investment firms* not falling within *SYSC* 19G.1.1R(2).

(2) *Non-SNI MIFIDPRU investment firms* not falling within *SYSC* 19G.1.1R(2) should therefore assess whether staff members are *material risk takers* before applying the thresholds in *SYSC* 19G.5.9R.

19G.5.11 R When considering whether an individual that becomes a *material risk taker* at a point during the *firm's* performance year falls within *SYSC* 19G.5.9R, *firms* must:

(1) apply the full £167,000 variable *remuneration* threshold;

(2) apply the requirement that the variable *remuneration* must not be more than one-third of the individual's total *remuneration* to the relevant portion of the total *remuneration* paid for the part of the performance year that the individual is a *material risk taker* at that *firm*; and

(3) include any guaranteed variable *remuneration*, for example a 'sign-on bonus', in the individual's variable *remuneration* for the part of the performance year that the individual is a *material risk taker* at that *firm*.

19G.5.12 G (1) An individual may become a *material risk taker* at any point during the *firm's* performance year, either by changing role within the *firm* or by joining the *firm*.

(2) As an example of the effect of *SYSC* 19G.5.11R, an individual ('X'), becomes a *material risk taker* 6 *months* into the *firm's* performance year. X receives annual fixed *remuneration* of £900,000. This means X will receive £450,000 for the 6 *months* of the performance year for which X is a *material risk taker*. X receives variable *remuneration* of £100,000 in respect of the first 6 *months*. X falls below the thresholds in *SYSC* 19G.5.9R because X's variable *remuneration* of £100,000 is:

(a) less than the £167,000 threshold in *SYSC* 19G.5.9R(1), and

(b) less than one-third of the £450,000 fixed *remuneration* received (which would be £150,000) for the purposes of *SYSC* 19G.5.9R(2).

19G.6 Variable remuneration

Remuneration and capital

19G.6.1 R A *MIFIDPRU investment firm* must ensure that variable *remuneration* does not affect the *firm's* ability to ensure a sound capital base.

Extraordinary public financial support

19G.6.2 R A *MIFIDPRU investment firm* that benefits from *extraordinary public financial support* must ensure that:

(1) no variable *remuneration* is paid to members of its *management body*; and

(2) variable *remuneration* is limited to a portion of net revenue when its payment to staff that are not members of its *management body* would be inconsistent with:

(a) the maintenance of the *firm's* sound capital base; and

(b) its timely exit from *extraordinary public financial support*.

Assessment of performance

19G.6.3 R A *non-SNI MIFIDPRU investment firm* must ensure that where variable *remuneration* is performance-related:

(1) the total amount of the variable *remuneration* is based on a combination of the assessment of the performance of:

(a) the individual;

(b) the *business unit* concerned; and

(c) the overall results of the *firm*;

(2) it bases the assessment in (1) on a multi-year period, taking into account the business cycle of the *firm* and its business risks.

19G.6.4 R When assessing individual performance for the purpose of determining the amount of variable *remuneration* to be paid to an individual, a *MIFIDPRU investment firm* must take into account financial as well as non-financial criteria.

19G.6.5 G (1) For some *firms* it will be appropriate to give equal weight to financial and non-financial criteria for the purposes of *SYSC* 19G.6.4R. For other *firms* a slightly different split may be appropriate.

(2) In the *FCA's* view, non-financial criteria under *SYSC* 19G.6.4R should:

(a) form a significant part of the performance assessment process;

(b) override financial criteria, where appropriate;

(c) include metrics on conduct, which should make up a substantial portion of the non-financial criteria; and

(d) include how far the individual adheres to effective risk management and complies with relevant regulatory requirements.

(3) Examples of non-financial criteria under *SYSC* 19G.6.4R include:

(a) measures relating to building and maintaining positive customer relationships and outcomes, such as positive customer feedback;

(b) performance in line with firm strategy or values, for example by displaying leadership, teamwork or creativity;

(c) adherence to the *firm's* risk management and compliance policies;

(d) achieving targets relating to:

(i) environmental, social and governance factors; and

(ii) diversity and inclusion.

(4) *Firms* are reminded that they should ensure that when they assess individual performance, the assessment process and any variable *remuneration* awarded in accordance with *SYSC* 19G.6.3R does not discriminate on the basis of the protected characteristics of an individual in accordance with the Equality Act 2010.

General requirements for awards of non-performance related variable remuneration

19G.6.6 R (1) A *non-SNI MIFIDPRU investment firm* must ensure that all guaranteed variable *remuneration*, retention awards, severance pay and buy-out awards falling under *SYSC* 19G.6.7R to *SYSC* 19G.6.13G are:

(a) subject to malus and clawback;

(b) in the case of *non-SNI MIFIDPRU investment firms* to which those *rules* apply:

(i) subject to the requirements in *SYSC* 19G.6.18R and *SYSC* 19G.6.19G (Shares, instruments and alternative arrangements), *SYSC* 19G.6.20R and *SYSC* 19G.6.21G (Retention policy), and *SYSC* 19G.6.22R to *SYSC* 19G.6.27R (Deferral); and

(ii) included in the variable component of the fixed to variable ratio for the performance period in which the award is made.

(2) A *non-SNI MIFIDPRU investment firm* must ensure that each decision it makes to award variable *remuneration* falling within the scope of (1) is appropriate, taking all relevant circumstances into account.

Guaranteed variable remuneration

19G.6.7 R A *non-SNI MIFIDPRU investment firm* must not award, pay or provide guaranteed variable *remuneration* to a *material risk taker* unless:

(1) it occurs in the context of hiring a new *material risk taker*;

(2) it is limited to the first year of service; and

(3) the *firm* has a strong capital base.

19G.6.8 G (1) Guaranteed variable *remuneration* is sometimes referred to as a 'sign-on bonus' or 'golden handshake'.

(2) Guaranteed variable *remuneration* can be used as a way of compensating new staff members where they have lost the opportunity to receive variable *remuneration* by leaving their previous employment during the performance year. Such awards may be called 'lost opportunity bonuses'.

(3) The *FCA* expects *non-SNI MIFIDPRU investment firms* to award guaranteed *remuneration* only rarely and not as common practice.

Retention awards

19G.6.9 R Retention awards must only be paid to *material risk takers*:

(1) after a defined event; or

(2) at a specified point in time.

19G.6.10 G (1) Retention awards are bonuses which are dependent on an individual remaining in role until a defined event or for a set period of time. For example, retention bonuses can be used under restructurings, in wind-down or in the context of specific projects within a *firm*.

(2) The *FCA* expects *non-SNI MIFIDPRU investment firms* to make retention awards to *material risk takers* only rarely and not as common practice.

Severance pay

19G.6.11 R (1) A *non-SNI MIFIDPRU investment firm* must ensure that payments to *material risk takers* relating to the early termination of an employment contract reflect the individual's performance over time and do not reward failure or misconduct.

(2) A *non-SNI MIFIDPRU investment firm* must set out in its *remuneration* policy whether severance payments may be paid, and any maximum amount or criteria for determining the amount.

Buy-out awards

19G.6.12 R A *non-SNI MIFIDPRU investment firm* must ensure that *remuneration* packages for *material risk takers* relating to compensation for, or buy out from, a staff member's contracts in previous employment:

(1) align with the long term interests of the *firm*; and

(2) remain subject to the same pay-out terms required by the previous employer, for example by following the same deferral and vesting schedule, and being subject to the same ex post risk adjustment arrangements, where relevant.

19G.6.13 G Buy-out awards involve a *firm* compensating a new staff member, or 'buying out' their previous contract with another employer, where the deferred variable *remuneration* of the staff member was reduced, revoked or cancelled by the previous employer. This could be because they terminated their contract or because the individual has to pay back some money, for example where the employer has paid for a training course or qualification for the individual that was attached to a retention clause.

Risk adjustment

19G.6.14 R A *non-SNI MIFIDPRU investment firm* must ensure that any measurement of performance used as a basis to calculate pools of variable *remuneration* takes into account all types of current and future risks and the cost of the capital and liquidity required in accordance with *MIFIDPRU*.

19G.6.15 R A *non-SNI MIFIDPRU investment firm* must ensure that the allocation of variable *remuneration* components within the *firm* takes into account all types of current and future risks.

19G.6.16 R For the purposes of *SYSC* 19G.6.14R and *SYSC* 19G.6.15R, a *non-SNI MIFIDPRU investment firm* must:

(1) determine at what level the adjustments should be applied (for example at *business unit*, trading desk or individual level), which risks are relevant, and which risk adjustment techniques and measures are most appropriate; and

(2) in considering all types of current and future risks, include both financial risks (for example economic profit or economic capital) and non-financial risks (for example reputation, conduct and customer outcomes, values and strategy).

19G.6.17 R A *non-SNI MIFIDPRU investment firm* must ensure that its total variable *remuneration* is generally considerably contracted, including through malus or clawback arrangements, where the financial performance of the *firm* is subdued or negative.

Shares, instruments and alternative arrangements

19G.6.18 R A *non-SNI MIFIDPRU investment firm* to which this *rule* applies must ensure that at least 50% of the variable *remuneration* paid to a *material risk taker* in relation to a performance year consists of any of the following *eligible instruments*:

(1) *shares*, or subject to the *firm's* legal structure, equivalent ownership interests;

(2) *share*-linked instruments, or subject to the *firm's* legal structure, equivalent non-cash instruments;

(3) instruments that comply with the requirements in *SYSC* 19G Annex 1R; or

(4) non-cash instruments which reflect the instruments of the portfolios managed.

19G.6.19 G (1) Where a *MIFIDPRU investment firm* is unable to issue *eligible instruments*, the *firm* may apply to the *FCA* for a modification under section 138A of the *Act* to permit the *firm* to use alternative arrangements. The *firm* will need to provide a detailed explanation in its application of the alternative arrangements it is proposing to operate.

(2) The *FCA* may grant a modification under section 138A of the *Act* for these purposes only where it is satisfied that:

(a) compliance by the *firm* with the requirement to issue variable *remuneration* in *eligible instruments* would be unduly burdensome or would not achieve the purpose for which the *rules* were made; and

(b) granting the modification would not adversely affect the advancement of any of the *FCA's* objectives.

(3) As part of its assessment of whether the modification would adversely affect the advancement of its objectives, the *FCA* will consider whether the proposed alternative arrangements for variable *remuneration* achieve similar outcomes to the standard requirements applicable to *eligible instruments*. In particular, the *FCA* will normally consider the following non-exhaustive factors:

(a) whether the proposed alternative arrangement ensures suitable alignment between the interests of the staff member and the long-term interests of the *firm*, its *clients* and creditors;

(b) whether the proposed alternative arrangement is subject to a retention policy that is of sufficient length to align the incentives of the staff member with the long-term interests of the *firm*, its *clients* and creditors;

(c) whether the proposed alternative arrangement is clear and transparent to the staff member and contains sufficient detail on the applicable conditions;

(d) whether the *firm* will ensure that any amounts that are subject to deferral and retention arrangements cannot be accessed, transferred or redeemed by the staff member during the deferral and retention periods;

(e) whether the proposed alternative arrangement would facilitate the appropriate application of malus and clawback requirements;

(f) whether the proposed alternative arrangements adequately ensure that the value of the variable *remuneration* received does not increase during the deferral period through distributions or other payments on the instrument; and

(g) where the proposed alternative arrangements allow for predetermined changes of the value received as variable *remuneration* during deferral and retention periods, based on the performance of the *firm* or the managed assets, whether the following conditions would be met:

(i) the change of the value is based on predefined performance indicators that are based on the credit quality of the *firm* or the performance of the managed assets;

(ii) where deferral and retention must be applied, value changes are calculated at least annually and at the end of the retention period;

(iii) the rate of possible positive and negative value changes is equally based on the level of positive or negative credit quality changes or performance measured;

(iv) where the value change under (i) is based on the performance of assets managed, the percentage of value change should be limited to the percentage of value change of the managed assets;

(v) where the value change under (i) is based on the credit quality of the *firm*, the percentage of value change should be limited to the percentage of the annual total gross revenue in relation to the *firm's* total *own funds*.

(4) The fact that a *firm* cannot issue *eligible instruments* because of its legal structure is likely to be a reason for the *FCA* to conclude that requiring the *firm* to comply with *SYSC* 19G.6.18R would not achieve the purpose for which that *rule* was made.

Retention policy

19G.6.20 R A *non-SNI MIFIDPRU investment firm* to which this *rule* applies must establish an appropriate retention policy for *eligible instruments* that is designed to align the interests of the staff member with the longer-term interests of the *firm*, its creditors and clients.

19G.6.21 G (1) In considering what is an appropriate retention policy for the purposes of *SYSC* 19G.6.20R, *firms* should consider at least the following:

(a) the length of the deferral period referred to in *SYSC* 19G.6.22R(1);

(b) the length of the *firm's* business cycle;

(c) the types of risks relevant to the role of the staff member; and

(d) how long it could take for the risks underlying the staff member's performance to crystallise.

(2) In the *FCA's* view, the greater the impact of the *material risk taker* on the risk profile of the *firm* and of the assets managed, the longer the retention period should be. Different retention periods for different *material risk takers* may be appropriate, particularly where the applicable deferral periods differ.

Deferral

19G.6.22 R (1) A *non-SNI MIFIDPRU investment firm* to which this *rule* applies must not award, pay or provide a variable *remuneration* component unless at least 40% is deferred over a period which is at least 3 years.

(2) Where the variable *remuneration* is a particularly high amount, and in all cases where the variable *remuneration* is £500,000 or more, at least 60% of the amount must be deferred.

(3) Deferred variable *remuneration* must vest no faster than on a pro-rata basis.

(4) The first deferred portion of the variable *remuneration* must not vest sooner than a year after the start of the deferral period.

19G.6.23 R (1) A *non-SNI MIFIDPRU investment firm* must take into account the factors in (2) when determining:

(a) the amount of variable *remuneration* to be deferred under *SYSC* 19G.6.22R(1) and (2);

(b) the length of the deferral period under *SYSC* 19G.6.22R(1); and

(c) the speed of vesting of the variable *remuneration* for the purposes of *SYSC* 19G.6.22R(3).

(2) The factors referred to in (1) are:

(a) the *firm's* business cycle, the nature of its business and its risk profile;

(b) the activities and responsibilities of the staff member in question and how these may impact the risk profile of the *firm* or the assets the *firm* manages;

(c) whether the deferred variable *remuneration* is paid out in instruments or cash;

(d) the amount of the variable *remuneration*; and

(e) the ratio of variable to fixed *remuneration*.

19G.6.24 G (1) Where appropriate, *firms* should tailor the proportion of deferred variable *remuneration*, the deferral period and the speed of vesting in different ways for different categories of *material risk taker*.

(2) The *FCA* expects the variable *remuneration* of *material risk takers* whose roles and responsibilities mean they have a considerable impact on the risk profile of the *firm* or of the assets the *firm* manages (for example members of the *management body* or *senior management*), to be subject to a deferral period longer than the 3-year minimum.

(3) It may be appropriate for *firms* to apply different proportions of deferred variable *remuneration*, deferral periods or vesting

arrangements to the portion of variable *remuneration* paid out in cash and the portion paid out in instruments.

(4) In the *FCA's* view, the higher the amount of the variable *remuneration*, and the higher the ratio of variable to fixed *remuneration*, the more appropriate it is likely to be to defer a greater proportion of the variable *remuneration*.

(5) In certain circumstances variable *remuneration* below £500,000 may still be considered 'particularly high' and so subject to 60% deferral. We would expect a *firm* to take into account the average *remuneration* at the *firm*, the ratio of the variable to fixed *remuneration* of the *material risk taker*, and the amount of variable *remuneration* compared to that of other staff at the *firm*.

(6) After the first deferred portion of the variable *remuneration* vests in accordance with *SYSC* 19G.6.22R(4), the *FCA* does not expect vesting to take place more often than once a year.

19G.6.25 R A *non-SNI MIFIDPRU investment firm* must pay out at least 50% of the variable *remuneration* deferred under *SYSC* 19G.6.22R in instruments falling within *SYSC* 19G.6.18R.

19G.6.26 G The *FCA* considers it good practice for the deferred portion to contain a higher proportion of instruments than the non-deferred portion.

19G.6.27 R A *non-SNI MIFIDPRU investment firm* must not pay to a *material risk taker* interest or dividends on variable *remuneration* in respect of the period it is deferred under *SYSC* 19G.6.22R.

Performance adjustment

19G.6.28 R A *non-SNI MIFIDPRU investment firm* must ensure that any variable *remuneration*, including a deferred portion, is paid or vests only if it is sustainable according to the financial situation of the *firm* as a whole, and justified on the basis of the performance of the *firm*, the *business unit* and the individual concerned.

19G.6.29 R A *non-SNI MIFIDPRU investment firm* must:

(1) ensure that all of the total variable *remuneration* is subject to in-year adjustments, malus or clawback arrangements;

(2) set specific criteria for the application of malus and clawback; and

(3) ensure that the criteria for the application of malus and clawback in particular cover situations where the *material risk taker*:

(a) participated in or was responsible for conduct which resulted in significant losses to the *firm*; and/or

(b) failed to meet appropriate standards of fitness and propriety.

19G.6.30 R A *non-SNI MIFIDPRU investment firm* must:

(1) set minimum malus and clawback periods as part of its *remuneration* policies;

(2) ensure that malus can be applied until the award has vested in its entirety; and

(3) ensure that the clawback period spans at least the combined length of the deferral and retention periods, where they exist.

19G.6.31 G (1) A *non-SNI MIFIDPRU investment firm* that is not required by *SYSC* 19G.6.22R to apply deferral will not be able to apply malus, so should foresee the use of in-year adjustments and clawback arrangements only. Alternatively, such a *firm* may choose to use deferral which would enable the use of malus arrangements.

(2) A *non-SNI MIFIDPRU investment firm* should ensure that the malus and clawback periods it sets and applies allow sufficient time for any potential risks to crystallise. This may mean that different periods are set for different categories of *material risk takers*.

(3) In setting appropriate malus and clawback periods, a *non-SNI MIFIDPRU investment firm* should take into account all relevant factors, including:

(a) the nature of the *material risk taker's* activities;

(b) the *material risk taker's* impact on the risk profile of the *firm* or of the assets it manages; and

(c) the length of the business cycle that is relevant for the *material risk taker's* role.

(4) *Firms* are reminded that the *FCA's* 'General guidance on the application of ex-post risk adjustment to variable remuneration' provides further detail of the *FCA's* expectations on *firms'* use of malus and clawback arrangements.

19G.6.32 G (1) In the *FCA's* view, malus should be applied when, as a minimum:

(a) there is reasonable evidence of staff member misbehaviour or material error;

(b) the *firm* or the relevant *business unit* suffers a material downturn in its financial performance; or

(c) the *firm* or the relevant *business unit* suffers a material failure of risk management.

(2) In the *FCA's* view, clawback should, in particular, be applied in cases of fraud or other conduct with intent or severe negligence which led to significant losses.

Discretionary pension benefits

19G.6.33 R (1) A *non-SNI MIFIDPRU investment firm* must ensure that:

(a) any *discretionary pension benefits* it awards or pays to *material risk takers* are:

(i) in line with its business strategy, objectives, values and long-term interests; and

(ii) paid only in *eligible instruments*;

(b) it applies malus and clawback arrangements to *discretionary pension benefits* in the same way as to other elements of variable *remuneration*.

(2) A *non-SNI MIFIDPRU investment firm* to which this paragraph applies must ensure that:

(a) where a *material risk taker* leaves the *firm* before retirement age, any *discretionary pension benefits* are held by the *firm* for a period of 5 years; and

(b) where a *material risk taker* reaches retirement age, any *discretionary pension benefits* are subject to a 5-year retention period by that individual.

Personal investment strategies

19G.6.34 R A *non-SNI MIFIDPRU investment firm* must take all reasonable steps to ensure that *material risk takers* do not use personal hedging strategies or *remuneration*- and liability-related *contracts of insurance* to undermine the *remuneration rules* in the *MIFIDPRU Remuneration Code*.

19G.6.35 G Actions a *firm* might take under *SYSC* 19G.6.34R include requesting an undertaking or declaration from its *material risk takers* and implementing policies regarding dealing in *financial instruments*.

Avoidance of the MIFIDPRU Remuneration Code

19G.6.36 R A *non-SNI MIFIDPRU investment firm* must not pay variable *remuneration* through financial vehicles or methods that facilitate non-compliance with the *MIFIDPRU Remuneration Code* or *MIFIDPRU*.

19G.7 Remuneration committee

19G.7.1 G (1) *Non-SNI MIFIDPRU investment firms* are reminded of the requirement, where it applies to the *firm*, to establish a *remuneration* committee under *MIFIDPRU* 7.3.3R(1).

(2) The *FCA* encourages *non-SNI MIFIDPRU investment firms* that are not required to establish a *remuneration* committee under *MIFIDPRU* 7.3.3R(1) to consider whether establishing and maintaining a *remuneration* committee would contribute to the better alignment of risk and individual reward across the *firm*.

19G Annex 1 Other instruments for use in variable remuneration

Purpose

1.1 G *SYSC* 19G.6.18R requires that at least 50% of variable *remuneration* must be paid in *eligible instruments*. Under *SYSC* 19G.6.18R(3), *eligible instruments* include instruments that meet the requirements set out in this Annex. The instruments within the scope of this Annex include *additional tier 1 instruments*, *tier 2 instruments* and other instruments which can be fully converted to *common equity tier 1 instruments*, or written down, and that adequately reflect the *firm's* credit quality.

Requirements for instruments

1.2 R An instrument under *SYSC* 19G.6.18R(3) must satisfy the following requirements:

(1) the instrument must be issued by the *firm*;

(2) the instrument must not be secured or subject to a guarantee or any other arrangement that enhances the seniority of the claims of its holder in insolvency;

(3) the terms of the instrument must provide that any distributions on the instrument will be paid on at least an annual basis and will be paid to the holder;

(4) the instrument must be priced at its value at the time of issuance under the accounting framework applicable to the *firm*;

(5) the valuation of the instrument in (4) must be subject to independent review;

(6) if the instrument is part of an issuance which has the sole purpose of being used for variable *remuneration*, the price at which the instrument is redeemed, called, repurchased or converted must be subject to an independent valuation in accordance with the accounting framework applicable to the *firm*;

(7) if the instrument is not perpetual, at the time at which the instrument is awarded as variable *remuneration*, the remaining period before the maturity of the instrument must be at least equal to the sum of any deferral and retention periods that would apply to the staff member to whom the instrument is awarded;

(8) the instrument must not be subject to redemption, call or repurchase during any deferral and retention periods that would apply to the *material risk taker* to whom the instrument is awarded;

(9) any right to redeem, call or repurchase the instrument must be exercisable only at the sole discretion of the *firm*;

(10) the holder of the instrument must have no rights to accelerate the future scheduled payment of interest or principal, except in the insolvency or liquidation of the *firm*;

(11) the terms of the instrument must provide that the claim on the principal amount of the instrument is wholly subordinated to the claim of all non-subordinated creditors;

(12) one of the requirements in *SYSC* 19G Annex 1.3R must be satisfied; and

(13) the instrument must be either:

(a) a *convertible instrument*, in which case the requirements in *SYSC* 19 Annex 1.4R and *SYSC* 19 Annex 1.5R must be satisfied; or

(b) a *write-down instrument*, in which case the requirements in *SYSC* 19 Annex 1.6R must be satisfied.

1.3 R (1) An instrument under *SYSC* 19G.6.18R(3) must meet either the conditions in (2) or the conditions in (4).

(2) The first set of conditions is as follows:

(a) the instrument must be part of an issuance which has the sole purpose of being used as variable *remuneration*; and

(b) the terms of the instrument must ensure that any distributions payable on the instrument are paid at a rate which is:

(i) consistent with market rates for similar issuances issued by other *firms* with comparable credit quality; and

(ii) subject to (3), no higher than 8% above the Consumer Price Index 12-month rate as published by the UK Office of National Statistics from time to time.

(3) If the instrument has been awarded to a member of staff whose professional duties are predominantly performed outside the *UK* and the instruments are denominated in a currency other than pound sterling, a *firm* may substitute another similar independently-calculated consumer price index for a relevant *third country* in place of the rate specified in (2)(b)(ii).

(4) The second set of conditions is that, at the time at which the instrument was awarded as variable *remuneration*, at least 60% of that class of instrument in issuance was:

(1) issued other than for use as variable *remuneration*; and

(2) not held by any person who has close links to:

(i) the *firm*;

(ii) the *firm's group*; or

(iii) a *connected undertaking* included within the *firm's investment firm group*.

Additional requirements for convertible instruments

1.4 R A *firm* must satisfy the following requirements in relation to an instrument under *SYSC* 19G.6.18R(3) that is a *convertible instrument*:

(1) the instrument must contain a trigger event which, if it occurs, results in the full principal amount of the instrument being converted into *common equity tier 1 capital* of the *firm*;

(2) the trigger event in (1) must occur where the *common equity tier 1 capital* of the *firm* falls below a specified level that is no lower than 64% of the *firm's own funds requirement*;

(3) to the extent necessary to give full effect to the required conversion following the trigger event in (1), the issuing *firm* must ensure the following at all times:

(a) where applicable, the *firm* has sufficient authorised share capital;

(b) the *firm* has all necessary permissions, authorisations and corporate authorities; and

(c) there are no other restrictions in the *firm's* constitutional documents, contractual arrangements or applicable national law that would prevent the *firm* from issuing the required *common equity tier 1 capital* instruments.

1.5 R The rate of conversion of the principal amount into *common equity tier capital* of the *firm* specified in the terms governing an instrument under *SYSC* 19G.6.18R(3) that is a *convertible instrument* must be set a level that ensures that the value of the *common equity tier 1 capital* received by the holder upon conversion:

(1) would not be higher than the value of the instrument at the time that it was originally awarded as variable *remuneration*; and

(2) if the *convertible instrument* is part of an issuance which has the sole purpose of being used as variable *remuneration*, would not be higher than the value of the instrument at the time of conversion.

Additional requirements for write-down instruments

1.6 R A *firm* must satisfy the following requirements in relation to an instrument under *SYSC* 19G.6.18R(3) that is a *write-down instrument*:

(1) the instrument must contain a trigger event which, if it occurs, results in the principal amount of the instrument being written down;

(2) the trigger event in (1) must occur where the *common equity tier 1 capital* of the *firm* falls below a specified level that is no lower than 64% of the *firm's own funds requirement*;

(3) the aggregate principal amount of *write-down instruments* that must be written down following the trigger event in (1) must be at least equal to the lower of the following:

(a) the amount required to ensure that the *common equity tier 1 capital* of the *firm* referenced in the trigger event is restored to a level that is higher than the specified trigger; or

(b) the full principal amount of the instrument;

(4) any write-down in the principal amount of the instrument following the trigger event in (1) must:

(a) apply on a pro rata basis across all *write-down instruments* that contain the same trigger event;

(b) generate items that, under the accounting framework applicable to the *firm*, qualify as *common equity tier 1 capital*;

(c) result in a proportional reduction in the holder's entitlement to receive:

(i) distributions paid in connection with the instrument;

(ii) payment if the instrument is called or redeemed; and

(iii) repayment in the insolvency or liquidation of the *firm*;

(5) any write-down in the principal amount of the instrument following the trigger event in (1) may be permanent or temporary, but if it is temporary, any subsequent write-up must comply with the following requirements:

(a) it cannot increase the principal amount of the instrument beyond its level before the write-down occurred;

(b) it must be at the absolute discretion of the *firm*;

(c) the *firm* must have a reasonable basis to conclude that the write-up is appropriate, having regard to the following factors, among others:

(i) the importance of effectively aligning the interests of the recipient with the longer-term interests of the *firm*, its clients and its creditors;

(ii) the financial position of the *firm* and the effect of the write-up on the *firm's own funds*; and

(iii) if the *firm* or any member of its *group* has been subject to extraordinary public financial support, whether the write-up is consistent with the objective of ensuring the timely exit from such support;

(d) it must be applied on a pro rata basis between all recipients of instruments falling under *SYSC* 19G.6.18R(3) that are *write-down instruments* where such instruments have previously been subject to a write-down.

…

SYSC TP 10 **MIFIDPRU Remuneration Code transitional provision**

Application

10.1 R *SYSC* TP 10 applies to an *undertaking* to whom *SYSC* 19G (MIFIDPRU Remuneration Code) will apply for the first time in the performance year beginning on or after [*Editor's note*: insert date that *SYSC* 19G comes into force].

Duration of transitional

10.2 R *SYSC* TP 10 applies to *remuneration* awarded for performance or services provided in the performance year before the performance year to which *SYSC* 19G first applies.

10.3 G While *SYSC* 19G comes into force on [*Editor's note*: insert date that *SYSC* 19G comes into force], it only applies to performance years that begin on or after that date (see *SYSC* 19G.1.23R). This transitional provision therefore addresses the position for remuneration for performance or services provided between the date on which *SYSC* 19G comes into force and the date on which it first applies to a firm.

Transitional

10.4 R (1) Where an *undertaking* was subject to any of the remuneration codes listed in (2) immediately before *SYSC* 19G came into force, that remuneration code (and any related reporting requirements) will continue to apply.

(2) The remuneration codes referred to in (1) are:

(a) *SYSC* 19A (IFPRU Remuneration Code); and

(b) *SYSC* 19C (BIPRU Remuneration Code).

10.5 R The reference in *SYSC* TP 10.4R(1) to an *undertaking* being subject to a remuneration code includes the situation in which those *rules* include an obligation for a *firm* to ensure a *parent undertaking* complies with certain requirements.

10.6	G	Under previous remuneration codes, certain obligations were not applied directly to unregulated *parent undertakings* but were applied indirectly through the imposition of an obligation on a *firm* within the *group* to ensure compliance by the *parent undertaking*. *SYSC* TP 10.5R makes clear that the transitional provision in *SYSC* TP 10.4R also applies to those indirect obligations on the *parent undertaking*. This means that where provisions in *SYSC* 19A or *SYSC* 19C applied on an indirect basis to a *parent undertaking* prior to the coming into force of *SYSC* 19G, those remain the relevant obligations for performance or services provided during the performance year in which *SYSC* 19G comes into force.

Annex C

Amendments to the Prudential sourcebook for MiFID Investment Firms (MIFIDPRU)

The text in this Annex takes into account the rules and guidance in MIFIDPRU proposed in *CP20/24: A new UK prudential regime for MiFID investment firms* as if such rules and guidance had been made.

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

1 Application

1.1 Application and purpose

Application

1.1.1 G There is no overall application provision for *MIFIDPRU*. Each chapter or section has its own application statement. However, *MIFIDPRU* broadly applies to the following:

(1) *MIFIDPRU investment firms*;

(2) *UK parent entities*; and

(3) *parent undertakings* in an *investment firm group* that are incorporated in, or have their principal place of business in, the *United Kingdom*.

1.1.2 G (1) The definition of a *MIFIDPRU investment firm* includes a *collective portfolio management investment firm*. This means that a *collective portfolio management investment firm* must comply with the *rules* in *MIFIDPRU*, except to the extent that any provision of *MIFIDPRU* otherwise provides.

(2) *Collective portfolio management investment firms* are also subject to the prudential requirements in *IPRU-INV* 11 (Collective Portfolio Management Firms and Collective Portfolio Management Investment Firms). Such *firms* should refer to *IPRU-INV* 11.6 for further *guidance* on how the requirements in *MIFIDPRU* interact with the requirements in *IPRU-INV* 11.

(3) *Collective portfolio management investment firms* are reminded that, as explained in *MIFIDPRU* 1.1.5G, many requirements in *MIFIDPRU* apply only in relation to the *MiFID business* of a *firm* (and therefore will not apply to the collective portfolio management activities carried on by a *collective portfolio management investment firm*), but certain requirements apply to the *firm* as a whole.

Application to overseas firms

1.1.3 G *MIFIDPRU* does not directly apply to an *undertaking* which is not incorporated in, and does not have its principal place of business in, the *United Kingdom*. However, *MIFIDPRU* imposes certain obligations on *UK parent entities* and *responsible UK parents* relating to *undertakings* established in a *third country* that form part of the same *investment firm group*. *MIFIDPRU* 2 (Levels of application) contains additional *guidance* on the application of *MIFIDPRU* to *investment firm groups*.

1.1.4 G (1) This *guidance* provision applies to a *third country MIFIDPRU investment firm*. It is without prejudice to the *FCA's* general approach to authorising *overseas firms*.

(2) The *FCA* will not generally give a *Part 4A permission* to a *third country MIFIDPRU investment firm* unless the *FCA* is satisfied that the applicant will be subject to prudential regulation by a *regulatory body* in its home jurisdiction, the requirements of which are broadly equivalent to the requirements that would apply under *MIFIDPRU.*

(3) When conducting the assessment described in (2), the *FCA* will take into account the following non-exhaustive factors:

(a) whether the requirements of the relevant jurisdiction are likely to achieve similar prudential outcomes to *MIFIDPRU*;

(b) how the relevant overseas *regulatory body* supervises and enforces those requirements in practice;

(c) the broader legal framework applicable to the applicant in the relevant jurisdiction; and

(d) whether there are adequate arrangements in place between the *FCA* and the overseas *regulatory body* to facilitate any necessary supervisory cooperation.

(4) The *FCA* considers that the approach described in (2) and (3) is consistent with:

(a) the requirements in the *threshold conditions* (and in particular, the effective supervision *threshold condition* described in *COND* 2.3, the appropriate resources *threshold condition* described in *COND* 2.4 and the suitability *threshold condition* described in *COND* 2.5);

(b) the fact that appropriate protection for *consumers* or potential *consumers* requires the *FCA* to be able to apply effective supervision to a *third country MIFIDPRU investment firm*. In turn, this relies on cooperation between the *FCA* and the overseas *regulatory body* that supervises that *third country MIFIDPRU investment firm* and on the *FCA* being able to place appropriate reliance on the supervision applied by that overseas *regulatory body*.

(5) If a *third country MIFIDPRU investment firm* is not subject to prudential regulation by a *regulatory body* in its home jurisdiction which is broadly equivalent to the requirements that would apply under *MIFIDPRU*, the *FCA* will normally expect it to establish a *subsidiary* in the *United Kingdom*. That *subsidiary* would need to be authorised as a *MIFIDPRU investment firm* and would then be directly subject to the requirements in *MIFIDPRU*. The *subsidiary* would need to demonstrate that it meets the *threshold conditions* to obtain *authorisation*.

(6) *Third country MIFIDPRU investment firms* that are granted a *Part 4A permission* are reminded that although they are not subject to *MIFIDPRU*, they must still comply with the requirements in the *threshold conditions* and *Principles* on an ongoing basis. This includes the obligation under *Principle* 11 (Relations with regulators) to inform the *FCA* of anything of which the *FCA* would reasonably expect notice, which may include interactions between the *firm* and its overseas *regulatory body*.

Purpose

1.1.5 G The purpose of *MIFIDPRU* is to set out the detailed prudential requirements that apply to *MIFIDPRU investment firms*. *MIFIDPRU* does not apply to *designated investment firms*, which are subject to prudential regulation by the *PRA*. Generally, the *rules* in *MIFIDPRU* are intended to cover the *MiFID business* undertaken by a *firm*, but certain requirements apply to a *firm* in its entirety.

1.1.6 G The requirements in *MIFIDPRU* expand upon the basic requirements under the *threshold condition* referred to in *COND* 2.4 (Appropriate resources) and the requirement in *Principle* 4 for a *firm* to maintain adequate financial resources.

Tied agents

1.1.7 G (1) Certain provisions of *MIFIDPRU* refer to, or apply in relation to, *tied agents*. The definition of a *tied agent* refers to a *person* who, on behalf of an *investment firm* (including a *third country investment firm*):

(a) promotes *investment services* and/or *ancillary services* to *clients* or prospective *clients*;

(b) receives and transmits instructions or orders from the *client* in respect of *investment services* or *financial instruments*;

(c) places *financial instruments*;

(d) and/or provides advice to *clients* or prospective *clients* in respect of *investment services* or *financial instruments*.

(2) The references in *MIFIDPRU* to *tied agents* do not include *appointed representatives* that do not meet the definition of a *tied agent* (for example, because the relevant *appointed representative* does not carry on its activities in relation to the *MiFID business* of its principal firm). However, a *firm's* potential responsibility for *appointed representatives* (whether or not they are also *tied agents*) will be a relevant factor for a *firm's ICARA process* under *MIFIDPRU* 7 (Governance and risk management).

Voluntary application of stricter requirements

1.1.8 R No provision in *MIFIDPRU* prevents a *firm* from:

(1) holding *own funds* (or components of *own funds*) or *liquid assets* that exceed those required by *MIFIDPRU*; or

(2) applying other measures that are stricter than those required by *MIFIDPRU*.

[**Note:** article 3 of the *IFR*.]

1.1.9 G (1) If a *firm* chooses to apply stricter measures than those required under *MIFIDPRU* in accordance with *MIFIDPRU* 1.1.8R, the *firm* must still ensure that it is meeting the basic requirements of *MIFIDPRU*. This is illustrated by the following two examples:

(a) Example 1: A *firm* chooses to hold *own funds* which exceed those required under *MIFIDPRU* by deciding to hold 0.03% of its *average AUM*, rather than 0.02% as required under *MIFIDPRU* 4.7.5R. This would be a stricter measure that still meets the basic requirements of *MIFIDPRU* and therefore would be permitted under *MIFIDPRU* 1.1.8R.

(b) Example 2: A *firm* decides to hold a significant amount of additional *own funds* instead of applying the deductions from its *common equity tier 1 capital* required under *MIFIDPRU* 3.3.6R. This is on the basis that the additional *own funds* far exceed the estimated value of the required deductions and the *firm* considers that the deduction calculations are too onerous. While the *firm* may consider that holding these additional *own funds* is a stricter measure, this approach would not meet the basic requirements of *MIFIDPRU* (which, at a minimum, require the *firm* to calculate and apply such deductions). In addition, the failure to apply the correct deductions to *common equity tier 1 capital* may result in the *firm* incorrectly applying the concentration risk requirements and limits in *MIFIDPRU* 5. This approach would therefore not be permitted under *MIFIDPRU* 1.1.8R because it does not meet the basic requirements of *MIFIDPRU*.

(2) If a *firm* wishes to apply a stricter measure but is unsure of whether that measure would also meet the basic requirements of *MIFIDPRU*, it should discuss the proposal with the *FCA* before applying that measure.

1.2 SNI MIFIDPRU investment firms

Basic conditions to be classified as an SNI MIFIDPRU investment firm

1.2.1 R A *MIFIDPRU investment firm* is an *SNI MIFIDPRU investment firm* if it satisfies the following conditions:

(1) its ~~*AUM*~~ *average AUM*, as calculated in accordance with *MIFIDPRU* 4.7.5R is less than £1.2 billion;

(2) its ~~*COH*~~ *average COH*, as calculated in accordance with *MIFIDPRU* 4.10.19R is less than:

(a) £100 million per *day* for *cash trades*; and

(b) £1 billion per *day* for *derivatives trades*;

(3) its ~~*ASA*~~ *average ASA*, as calculated in accordance with *MIFIDPRU* 4.9.8R is zero;

(4) its ~~*CMH*~~ *average CMH*, as calculated in accordance with *MIFIDPRU* 4.8.13R is zero;

…

(6) the on- and off-balance sheet total of the *firm* is less than £100 million; ~~and~~

(7) the total annual gross revenue from *investment services and/or activities* of the *firm* is less than £30 million, calculated as an average on the basis of the annual figures from the two-year period immediately preceding the given financial year~~.~~ ; and

(8) the *firm* has not been classified as a *non-SNI MIFIDPRU investment firm* due to the effect of *MIFIDPRU* 10.2 (Categorisation of clearing firms as non-SNI MIFIDPRU investment firms).

1.2.2 G The definitions of *ASA* and *CMH* relate to *client* assets and *client money* that are held in the course of *MiFID business*. As a result, a *firm* may hold *client* assets or *client money* in the course of business other than *MiFID* *business* (provided that it has the necessary *permissions* to do so) and still meet the conditions to be classified as an *SNI MIFIDPRU investment firm*. When determining whether *client* assets or *client money* are to be treated as held in the course of *MiFID business* for these purposes, *MIFIDPRU investment firms* should refer to the *rules* and *guidance* in *MIFIDPRU* 4.8 (K-CMH requirement) and 4.9 (K-ASA requirement).

Additional provisions relating to the calculation of conditions to be classified as an SNI MIFIDPRU investment firm

1.2.3 R Notwithstanding the calculation methodologies in *MIFIDPRU* 4, the *firm* shall use the following for the purposes of the criteria in *MIFIDPRU* 1.2.1R:

(1) end-of-day values to assess each of the following conditions:

(a) its ~~*AUM*~~ *average AUM* under *MIFIDPRU* 1.2.1R(1);

(b) its ~~*COH*~~ *average COH* under *MIFIDPRU* 1.2.1R(2);

(c) its ~~*ASA*~~ *average ASA* under *MIFIDPRU* 1.2.1R(3);

(2) intra-day values to assess its ~~*CMH*~~ *average CMH* under *MIFIDPRU* 1.2.1R(4).

[**Note:** article 12(1), second to fourth subparagraphs of the *IFR*.]

1.2.4 R (1) By way of derogation from *MIFIDPRU* 1.2.1R, a *firm* may use the alternative approach in (2) to measure:

(a) its ~~*AUM*~~ *average AUM* for the purposes of *MIFIDPRU* 1.2.1R(1); and/or

(b) its ~~*COH*~~ *average COH* for the purposes of *MIFIDPRU* 1.2.1R(2).

(2) The alternative approach is to apply the methodologies in *MIFIDPRU* 4 for measuring ~~*AUM*~~ *average AUM* and ~~*COH*~~ *average COH*, but with the following modifications:

(a) the measurement must be performed over the immediately preceding 12 *months*; and

(b) the exclusion of the ~~three~~ 3 most recently monthly values does not apply.

…

…

1.2.7 R (1) A *firm* may use the end-of-day value for ~~*CMH*~~ *average CMH* instead of the intra-day value under *MIFIDPRU* 1.2.3R(2) if:

…

…

…

1.2.9 R A *MIFIDPRU investment firm* must assess the following conditions on the basis of the *firm's* individual situation:

(1) ~~*ASA*~~ *average ASA* under *MIFIDPRU* 1.2.1R(3);

(2) ~~*CMH*~~ *average CMH* under *MIFIDPRU* 1.2.1R(4); and

(3) whether the *firm* has *permission* to *deal on own account*.

[**Note:** article 12(2), second subparagraph of the *IFR*.]

1.2.10 R (1) A *MIFIDPRU investment firm* must assess the conditions in (2) on the basis of the combined position of each of the following entities that form part of the same *group* as that *MIFIDPRU investment firm*:

(a) *MIFIDPRU investment firms*;

(b) *designated investment firms*;

(c) *collective portfolio management investment firms*; and

(d) *third country investment firms* that carry on *investment services and/or activities* in the *UK*.

(2) The relevant conditions are:

(a) ~~*AUM*~~ *average AUM* under *MIFIDPRU* 1.2.1R(1);

(b) ~~*COH*~~ *average COH* under *MIFIDPRU* 1.2.1R(2);

(c) the on- and off-balance sheet total under *MIFIDPRU* 1.2.1R(6); and

(d) total annual gross revenue under *MIFIDPRU* 1.2.1R(7).

…

…

1.2.12 G The following table summarises the effect of *MIFIDPRU* 1.2.1R to 1.2.10R.

Measure	Measurement of relevant values	Threshold to be classified as an SNI	Application of threshold on an individual	

		MIFIDPRU investment firm	**basis or combined basis of investment firms within a group (see MIFIDPRU ~~1.2.8R~~ 1.2.9R and 1.2.10R)**	
~~*AUM*~~ *Average AUM*	End-of-day	Less than £1.2 billion	Combined	See Note 1
~~*COH*~~ *Average COH* (cash trades)	End-of-day	Less than £100 million per day	Combined	See Note 1
~~*COH*~~ *Average COH* (derivatives)	End-of-day	Less than £1 billion per day	Combined	See Note 1
~~*ASA*~~ *Average ASA*	End-of-day	Zero	Individual	
~~*CMH*~~ *Average CMH*	Intra-day	Zero	Individual	See Note 2
~~*DTF*~~ *Average DTF*	*Firm* must not have *permission* to *deal on own account*, so these measures must always be zero		Individual	
NPR			Individual	
CMG			Individual	
TCD			Individual	
On- and off-balance sheet total	End of last financial year for which accounts finalised by *management body*	Less than £100 million	Combined	See Note 3
Total annual gross revenue from *investment*	End of last financial year for which accounts finalised by	Less than £30 million, based on an average of annual figures for	Combined	See Notes 3 and 4

services and/or activities	*management body*	the two-year period immediately preceding the current financial year		
Whether *firm* is a *clearing member* or *indirect clearing firm* under *MIFIDPRU* 10.2	*Firm* must not be a *clearing member* or *indirect clearing firm*		Individual	
Notes				
Note 1:	The *firm* may calculate the relevant values for these measures by applying the applicable methodologies in *MIFIDPRU* 4, but over a period of the most recent 12 *months* and without excluding the three most recent monthly values, in accordance with *MIFIDPRU* 1.2.4R.			
Note 2:	If there has been an error in record keeping or in reconciliation of accounts that incorrectly indicated the *firm* has breached the zero threshold for ~~*CMH*~~ *average CMH* and the error is corrected before the end of the *business day* to which it relates, the *firm* may use the end-of-day value in accordance with *MIFIDPRU* 1.2.7R.			
Note 3:	Where the relevant accounts have not been finalised and approved after six *months* from the end of the last financial year, the *firm* must use provisional accounts for these purposes, in accordance with *MIFIDPRU* 1.2.6R.			
Note 4:	The *firm* may exclude any double counting that may arise in respect of gross revenues generated within the *group*, in accordance with *MIFIDPRU* 1.2.10R.			

…

1.2.15 R (1) Where a *MIFIDPRU investment firm* no longer meets one or more of the thresholds in (2), but continues to meet all other conditions in *MIFIDPRU* 1.2.1R, it shall cease to be an *SNI MIFIDPRU investment firm* ~~three~~ 3 *months* after the date on which the relevant threshold was first exceeded.

(2) The relevant conditions are:

(a) the ~~*AUM*~~ *average AUM* threshold in *MIFIDPRU* 1.2.1R(1);

(b) either or both of the ~~*COH*~~ *average COH* thresholds in *MIFIDPRU* 1.2.1R(2);

(c) the on- and off-balance sheet total threshold in *MIFIDPRU* 1.2.1R(6); and

(d) the total annual gross revenue threshold in *MIFIDPRU* 1.2.1R(7).

[**Note:** article 12(3), second subparagraph of the *IFR*.]

…

Application of senior management, remuneration and systems and controls requirements to SNI MIFIDPRU investment firms

1.2.18 R (1) Subject to (2) and (3), the following provisions do not apply to an *SNI MIFIDPRU investment firm*:

(a) *MIFIDPRU* 7.3 (Risk, remuneration and nomination committees);

(b) the provisions in *SYSC* 19G (MIFIDPRU Remuneration Code) which are not listed in *SYSC* 19G.1.6R(2).

(2) ~~If~~ Subject to (4) and (5), if a *non-SNI MIFIDPRU investment firm* meets the conditions to be classified as an *SNI MIFIDPRU investment firm*, the provisions in (1) will cease to apply only:

(a) six *months* after the date on which the *firm* first met the conditions to be reclassified as an *SNI MIFIDPRU investment firm*; and

(b) provided that the *firm*:

(i) continued to meet the conditions to be classified as an *SNI MIFIDPRU investment firm* without interruption throughout that six-*month* period; and

(ii) has given the notification in *MIFIDPRU* 1.2.13R(3)(b) to the *FCA* promptly following the expiry of the relevant period.

(3) ~~If~~ Subject to (4) and (5), if an *SNI MIFIDPRU investment firm* no longer meets the conditions to be classified as such, it must:

(a) notify the *FCA* immediately of the date on which it ceased to be eligible to be classified as an *SNI MIFIDPRU investment firm*; and

(b) comply with the provisions in (1) within 12 *months* from the date on which the *firm* ceased to be eligible to be an *SNI MIFIDPRU investment firm*.

(4) *MIFIDPRU* 7.3 (Risk, remuneration and nomination committees) does not apply to a *non-SNI MIFIDPRU investment firm* if the *firm* meets the conditions in *MIFIDPRU* 7.1.4R.

(5) The provisions listed in *SYSC* 19G.1.1R(4) do not apply to a *non-SNI MIFIDPRU investment firm* if the *firm* meets the conditions in that *rule*.

…

2 Level of application of requirements

…

2.3 Exemptions

…

2.3.2 R A *MIFIDPRU investment firm* will be exempt from *MIFIDPRU* 6 (Liquidity), as applied by *MIFIDPRU* 2.2.1R, where:

…

2.5 Prudential consolidation

…

2.5.3 G The table below is a guide to the content of this section.

Provisions of *MIFIDPRU* 2.5	**Summary of content**
…	…
MIFIDPRU 2.5.51G	Consolidated governance and remuneration requirements
MIFIDPRU 2.5.52G	Application of the *ICARA process* on a ~~*consolidated basis*~~ group basis

…

Tied agents included in the consolidated situation

2.5.6 G (1) …

(2) The *guidance* in (1) relates to a *tied agent* that is included within the *consolidated situation*. There are separate requirements in:

(a) *MIFIDPRU* 4.5.6R, which applies in relation to the individual *fixed overheads requirement* of a *MIFIDPRU investment firm* where a *tied agent* incurs expenses on behalf of that *firm*; and

(b) *MIFIDPRU* 4.7.2R, *MIFIDPRU* 4.8.3R, *MIFIDPRU* 4.9.2R or *MIFIDPRU* 4.10.2R, which apply in relation to the individual *K-factor requirement* of a *MIFIDPRU investment firm* where a *tied agent* carries on certain *investment services and/or activities* on behalf of that *firm*.

…

2.5.11 R A *UK parent entity* must comply with *MIFIDPRU* 6 (Liquidity) on the basis of its *consolidated situation*.

…

…

Consolidated K-CMH and K-ASA requirements

2.5.30 R The consolidated *K-CMH requirement* and consolidated *K-ASA requirement* for an *investment firm group* must be calculated in accordance with the following:

(1) the contribution of any individual *MIFIDPRU investment firm* to the *consolidated situation* must be determined by applying the relevant *rules* for calculating *CMH* and *ASA* in *MIFIDPRU* 4.8 and 4.9 to that individual *firm*; and

(2) the contribution of any other entity ("X") in the *investment firm group* to the *consolidated situation* must be determined by:

…

(b) subject to (3), treating:

(i) the amounts identified in (a)(i) as *CMH*;

(ii) the amounts identified in (a)(ii) as *ASA*;

and applying the calculation *rules* in *MIFIDPRU* 4.8 or 4.9 to those amounts; and

…

(3) when applying the calculation *rules* in *MIFIDPRU* 4.8, an arrangement operated by X in relation to client money may be classified as a *segregated account* only if (ignoring *MIFIDPRU* 4.8.9E, which does not apply for these purposes) it meets the conditions in *MIFIDPRU* 4.8.8R.

…

2.5.41 R (1) This *rule* applies where a *third country* entity ("B") is included within the *consolidated situation* of a *UK parent entity*.

…

(3) For the purposes of (2), the following modifications shall apply to the *rules* relating to the calculation of the *K-CMG requirement* in *MIFIDPRU* 4.13:

…

(e) the obligation in *MIFIDPRU* 4.13.13R(1)(b) ~~to integrate understanding of the margin model into the *ICARA process* applies in relation to the *UK parent entity*, but only if the *FCA* has directed under *MIFIDPRU* [7] that the relevant *investment firm group* must operate the *ICARA process* on a *consolidated basis*.~~ does not apply, but B must ensure that its ongoing processes and systems for assessing the nature and level of risks to which it is, or might be, exposed incorporate the understanding of relevant individuals within B of the margin model for the purposes of considering whether:

(i) the resulting consolidated *K-CMG requirement* for the *portfolio(s)* is sufficient to cover the relevant risks to which B is exposed; and

(ii) the *K-CMG permission* remains appropriate in relation to the *portfolio(s)* in respect of which it was granted.

…

Prudential consolidation in practice: reporting by investment firms

2.5.50 G Under *MIFIDPRU* 2.5.7R, a *UK parent entity* is required to comply with the reporting obligations in *MIFIDPRU* 9 on a *consolidated basis*. In practice, this involves reporting the same categories of information that would be reported by a *MIFIDPRU investment firm* to the *FCA* on an individual basis, but using the figures that result from applying the relevant requirements on a *consolidated basis* in accordance with this section. This does not apply to *data item* MIF007 (ICARA assessment questionnaire), which does not need to be submitted on a *consolidated basis*.

Prudential consolidation in practice: governance requirements

2.5.51 G (1) Under *MIFIDPRU* 7.1.3R, a *UK parent entity* to which *MIFIDPRU* 2.5.7R applies must comply with the general governance requirements in *MIFIDPRU* 7.2 (Senior management and systems and controls) on a *consolidated basis*. In practice, this means that the *UK parent entity* must ensure that it has a proper organisational structure, effective processes and adequate internal controls covering the business of the *investment firm group*.

(2) The requirements in *MIFIDPRU* 7.3 (Risk, remuneration and nomination committees) do not apply on a *consolidated basis*.

Prudential consolidation in practice: ICARA requirements

2.5.52 G As explained in *MIFIDPRU* 7.9.4G, an *investment firm group* is not required to operate an *ICARA process* on a *consolidated basis*. However, *MIFIDPRU* 7.9.5R permits an *investment firm group* to operate a single *group ICARA process* covering the business carried on by that *investment firm group*, provided that certain requirements are met.

…

3 Own funds

… …

3.6 General requirements for own funds

…

Notification of issuance of additional tier 1 and tier 2 instruments

3.6.5 R (1) A *firm* must notify the *FCA* at least 20 *business days* before the intended issuance date of the *firm's* intention to issue:

(a) *additional tier 1 instruments*; or

(b) *tier 2 instruments*.

(2) The notification requirement in (1) does not apply if:

(a) the *firm* has previously notified the *FCA* of an issuance of the same class of *additional tier 1 instruments* or *tier 2 instruments*; and

(b) the terms of the new instruments being issued are identical in all material respects to the terms of the instruments comprising the issuance previously notified to the *FCA*.

(3) The notification under (1) must:

(a) be submitted to the *FCA* via the *online notification and application system* using the form in *MIFIDPRU* 3 Annex 6R; and

(b) include the following:

(i) confirmation of whether the instruments being issued are intended to be classified as *additional tier 1 instruments* or *tier 2 instruments*;

(ii) confirmation of whether the instruments are intended to be issued to external investors or only to other members of the *firm's group* or connected parties;

(iii) a copy of the term sheet and details of any features of the capital instrument which are novel, unusual or different from a capital instrument of a similar nature previously issued by the *firm* or widely available in the market;

(iv) confirmation from a member of the *firm's senior management* or *governing body* who has oversight of the intended issuance that the instrument meets the conditions in *MIFIDPRU* 3.4 or *MIFIDPRU* 3.5 (as applicable, and including any conditions in the *UK CRR* applied by those sections) to be classified as *additional tier 1 instruments* or *tier 2 instruments*; and

(v) a properly reasoned legal opinion from an appropriately qualified individual, confirming that the capital instruments meet the conditions in (iv).

3.6.6 G (1) *MIFIDPRU investment firms* that were classified as *CRR firms* immediately before [*Editor's note*: insert date that *MIFIDPRU* begins to apply] should refer to *MIFIDPRU* TP 1 for transitional provisions relating to *own funds* permissions that were issued, and notifications that were made, before that date.

(2) *MIFIDPRU investment firms* that were in existence immediately before [*Editor's note*: insert date that *MIFIDPRU* begins to apply], but were not classified as *CRR firms*, should refer to *MIFIDPRU* TP 7 for transitional provisions relating to *own funds* instruments issued before that date.

3.6.7 G *Firms* that are proposing to classify an issuance of capital instruments as *common equity tier 1 capital* should refer to the obligations and guidance in *MIFIDPRU* 3.3.3R and *MIFIDPRU* 3.3.4G. In particular, *firms* are reminded that they must obtain the *FCA's* prior permission for the first issuance of a class of instruments that is intended to comprise *common equity tier 1 capital*.

3.6.8 R (1) A *UK parent entity* must apply the modifications in (2) when any of the following apply on a *consolidated basis* in accordance with *MIFIDPRU* 2.5.7R:

(a) *MIFIDPRU* 3.3.2R to *MIFIDPRU* 3.3.4G; and

(b) *MIFIDPRU* 3.6.5R.

(2) The *Handbook* provisions in (1)(a) and (b) apply as if references to:

(a) a "*firm*" were references to the *UK parent entity*;

(b) "capital instruments" were to capital instruments issued by the *UK parent entity*;

(c) "*additional tier 1 instruments*" and "*tier 2 instruments*" were to such instruments issued by the *UK parent entity*; and

(d) "*common equity tier 1 capital*" were to such capital as calculated on a *consolidated basis*.

3.6.9 G *Firms* and *parent undertakings* are reminded that submitting a notification in accordance with *MIFIDPRU* 3.6.5R to 3.6.8R does not guarantee that the relevant instruments meet the required conditions in *MIFIDPRU* 3.4 or *MIFIDPRU* 3.5 to qualify as *own funds*. It is the ongoing responsibility of the *firm* or *parent undertaking* to ensure that any instruments being counted as *own funds* meet the necessary conditions on an ongoing basis (including, where applicable, if there is any subsequent variation in their terms).

3.7 Composition of capital for parent undertakings subject to the group capital test

… …

3.7.4 R (1) Subject to (2), a *parent undertaking* must:

(a) when issuing *own funds instruments* which are intended to qualify as *common equity tier 1 capital*, comply with *MIFIDPRU* 3.3.2R to *MIFIDPRU* 3.3.4G;

(b) when issuing *own funds instruments* which are intended to qualify as *additional tier 1 instruments* or *tier 2 instruments*, comply with *MIFIDPRU* 3.6.5R.

(2) When the *Handbook* provisions in (1)(a) and (b) apply, those provisions apply as if references to:

(a) a "*firm*" were references to the *parent undertaking*;

(b) "capital instruments" were to capital instruments issued by the *parent undertaking*;

(c) "*additional tier 1 instruments*" and "*tier 2 instruments*" were to such instruments issued by the *parent undertaking*; and

(d) "*common equity tier 1 capital*" were to such capital as held by the *parent undertaking*.

3.7.5 R (1) This *rule* applies where a *responsible UK parent* has chosen to apply the approach in *MIFIDPRU* 2.6.7R(2)(a) in relation to an *undertaking* established in a *third country*.

(2) Where this *rule* applies, a *responsible UK parent* must comply with *MIFIDPRU* 3.7.4R in relation to any issuance of own funds instruments by the *undertaking* established in a *third country*.

…

3 Annex 6 **Notification under MIFIDPRU 3.6.5R of issuance of additional tier 1 or tier 2 instruments**

R [*Editor's note*: The form can be found at this address: https://www.fca.org.uk/publication/forms/[xxx]]

4 Own funds requirements

… …

4.4 Permanent minimum capital requirement

… …

4.4.5 G The relevant *permanent minimum capital requirement* under this section applies to a *collective portfolio management investment firm* in parallel with its *base own funds requirement* under *IPRU-INV* 11. This means that a *collective portfolio management investment firm* must comply with both requirements, but they are not cumulative.

4.5 Fixed overheads requirement

4.5.1 R (1) The *fixed overheads requirement* of a *MIFIDPRU investment firm* is an amount equal to one quarter of the *firm's relevant expenditure* during the preceding year.

(2) When calculating its *fixed overheads requirement* in (1), a *firm* must use the figures resulting from the accounting framework applied by the *firm* in accordance with *MIFIDPRU* 4.5.2R.

(3) This *rule* is subject to *MIFIDPRU* 4.5.7R and *MIFIDPRU* 4.5.9R.

[**Note:** article 13(1) of the *IFR*.]

4.5.2 R (1) For the purposes of the calculation in *MIFIDPRU* 4.5.1R, a *firm* must use the figures in its most recent:

(a) audited *annual financial statements*; or

(b) unaudited *annual financial statements*, where audited financial statements are not available.

(2) If a *firm* has used unaudited *annual financial statements* in accordance with (1)(b) and audited *annual financial statements* subsequently become available, the *firm* must update the calculation in *MIFIDPRU* 4.5.1R to reflect the audited figures.

(3) Where the financial statements in (1) do not reflect a 12-*month* period, the *firm* must:

(a) divide the amounts included in those statements by the number of *months* that are reflected in those financial statements; and

(b) multiply the result of the calculation in (a) by 12, so as to produce an equivalent annual amount.

[**Note:** article 1(1) and 1(2) of the EBA RTS on fixed overheads.]

4.5.3 R (1) For the purpose of *MIFIDPRU* 4.5.1R(1), a *firm* must calculate its *relevant expenditure* by:

(a) calculating the *firm's* total expenditure after distribution of profits; and

(b) deducting any of the items in (2) from the total expenditure in (1)(a) to the extent that those items have been included in that expenditure.

(2) The items that a *firm* may deduct from its total expenditure are:

(a) any of the following, if they are fully discretionary and have not been treated as a distribution of profits under (1)(a):

(i) staff bonuses and other variable *remuneration*;

(ii) *employees*', *directors*' and *partners*' shares in profits; and

(iii) other appropriations of profits;

(b) shared commission and fees payable that meet all of the following conditions:

(i) they are directly related to commission and fees receivable;

(ii) the commission and fees receivable are included within total revenue; and

(iii) the payment of the commission and fees payable is contingent on the actual receipt of the commission and fees receivable;

(c) fees paid to *tied agents*;

(d) non-recurring expenses from non-ordinary activities;

(e) subject to *MIFIDPRU* 4.5.4R, fees, brokerage and other charges paid to *central counterparties*, exchanges and other *trading venues* and intermediate brokers for the purposes of executing, registering and clearing transactions, if they are directly passed on and charged to customers;

(f) interest paid to customers on *client money*, where there is no obligation of any kind to pay such interest;

(g) taxes where they fall due in relation to the annual profits of the *firm*;

(h) losses from trading on own account in *financial instruments*;

(i) payments related to contract-based profit and loss transfer agreements according to which the *firm* is obliged to transfer its annual profit to the *parent undertaking* following the preparation of the *firm's annual financial statements*;

(j) payments into a fund for general banking risk in accordance with article 26(1)(f) of the *UK CRR*, as applied by *MIFIDPRU* 3.3.1R; and

(k) expenses reflecting the amortisation of software assets where those software assets:

(i) have been prudently valued; and

(ii) have already been deducted from *own funds* as intangible assets under *MIFIDPRU* 3.3.6R(2).

[**Note:** article 13(4) of the *IFR* and article 1 of the EBA RTS on fixed overheads.]

4.5.4 R The deducted amounts in *MIFIDPRU* 4.5.3R(2)(e) must not include fees and other charges necessary to maintain membership of, or otherwise meet loss-sharing financial obligations to, central counterparties, exchanges and other trading venues.

Additional deduction for commodity and emission allowance dealers

4.5.5 R In addition to the deductions in *MIFIDPRU* 4.5.3R(2), a *commodity and emission allowance dealer* may deduct expenditure on raw materials in connection with the underlying commodity of the commodity derivatives the *firm* trades.

[**Note:** article 2 of the EBA RTS on fixed overheads.]

Expenses incurred on behalf of the firm by third parties

4.5.6 R (1) A *firm* must add any fixed expenses that have been incurred on its behalf by third parties, including *tied agents*, to the *firm's* total expenditure for the purposes of *MIFIDPRU* 4.5.3R in accordance with the remainder of this *rule*.

(2) A *firm* is not required to add fixed expenses incurred on its behalf by a third party to the *firm's* expenditure if those expenses are already included in the figures resulting from *MIFIDPRU* 4.5.2R.

(3) Where a break-down of the third party's expenses is available, the *firm* must add to the *firm's* total expenditure the share of the third party's expenses incurred on behalf of the *firm*.

(4) Where a break-down of the third party's expenses is not available, the *firm* must:

(a) add to the *firm's* total expenditure the share of the third party's expenses incurred on behalf of the *firm* as projected in the *firm's* business plan; or

(b) if the *firm* does not have a business plan that addresses the expenses incurred by the third party, reasonably estimate the share of those expenses that are attributable to the *firm's* business and add that estimated share of expenses to the *firm's* total expenditure.

[**Note:** article 1(5) of the EBA RTS on fixed overheads.]

Material change to projected relevant expenditure during the year

4.5.7 R (1) This *rule* applies where there:

(a) is an increase of 30% or more in the *firm's* projected *relevant expenditure* for the current year; or

(b) would be an increase of £2 million or more in the *firm's* *fixed overheads requirement* based on projected *relevant expenditure* for the current year.

(2) Where this *rule* applies, a *firm* must:

(a) immediately recalculate its *fixed overheads requirement* by applying the methodology in *MIFIDPRU* 4.5.3R to the projected *relevant expenditure*, taking into account the increase in (1);

(b) substitute the revised *fixed overheads requirement* that results from the calculation in (a) for the *firm's* original *fixed overheads requirement* under *MIFIDPRU* 4.5.1R(1); and

(c) immediately recalculate its *basic liquid assets requirement* using the revised *fixed overheads requirement* in (b).

[**Note:** article 13(2) of the *IFR* and article 3 of the EBA RTS on fixed overheads.]

4.5.8 G (1) Where there is a material increase in the *firm's* projected *relevant expenditure* that triggers the obligation in *MIFIDPRU* 4.5.7R, the *FCA* expects that a *firm* will also consider the potential impact on its *ICARA process* and the conclusions documented in its last *ICARA document*. In particular, the *firm* should consider any potential impact on:

(a) the *liquid assets* that the *firm* needs to hold to comply with *MIFIDPRU* 6, as the requirements in that chapter are calibrated by reference to the *fixed overheads requirement*;

(b) the level of *own funds* and *liquid assets* that the *firm* holds to comply with its obligations under *MIFIDPRU* 7; and

(c) the calibration of the *firm's wind-down triggers*.

(2) The *FCA* considers that the review in (1) is particularly important if, immediately before the change occurred, the *firm's own funds requirement* was determined by the *fixed overheads requirement*.

4.5.9 R (1) This *rule* applies where there:

(a) is a decrease of 30% or more in the *firm's* projected *relevant expenditure* for the current year; or

(b) would be a decrease of £2 million or more in the *firm's fixed overheads requirement* based on projected *relevant expenditure* for the current year.

(2) Where this *rule* applies, a *firm* may:

(a) recalculate its *fixed overheads requirement* by applying the methodology in *MIFIDPRU* 4.5.3R to the projected *relevant expenditure*, taking into account the decrease in (1); and

(b) if it has obtained prior permission from the *FCA* in accordance with (3), substitute the revised *fixed overheads requirement* that results from the calculation in (a) for the *firm's* original *fixed overheads requirement* under *MIFIDPRU* 4.5.1R.

(3) To obtain the permission in (2), a *firm* must:

(a) complete the application form in *MIFIDPRU* 4 Annex 10 and submit it to the *FCA* in accordance with the instructions on that form;

(b) demonstrate all of the following to the satisfaction of the *FCA*:

(i) that one of the conditions in (1)(a) or (b) is met and the projected reduction in the *firm's relevant expenditure* is a reasonable projection;

(ii) that the *firm* has adequately considered the impact of the reduction on the *firm's ICARA* *process* and the conclusions documented in the *firm's* last *ICARA document*; and

(iii) that there is a reasonable basis to conclude that, following the reduction in the *firm's fixed overheads requirement*, the *firm* will continue to hold sufficient *own funds* and *liquid assets* to comply with its obligations under *MIFIDPRU* 7.

4.5.10 G (1) Under *MIFIDPRU* 4.5.1R, a *MIFIDPRU investment firm* is required to calculate its *fixed overheads requirement* based on its *relevant expenditure* as reflected in its *annual financial statements* for the previous year.

(2) Under *MIFIDPRU* 4.5.7R, if there is a material increase in the *firm's* projected *relevant expenditure* for the current year, the *firm* must recalculate its *fixed overheads requirement* on the basis of that projected increased *relevant expenditure*, taking into account the impact of that change.

(3) However, under *MIFIDPRU* 4.5.9R, if there is a material change that results in a decrease in the *firm's* projected *relevant expenditure* for the current year, the *firm* must obtain the prior permission of the *FCA* before substituting a reduced *fixed overheads requirement* calculated on the basis of the projected decrease.

(4) In many cases, a material change of the type specified in *MIFIDPRU* 4.5.7R(1) or *MIFIDPRU* 4.5.9R(1) is likely to result from planned changes to the *firm's* business. Non-exhaustive examples of such changes may include:

(a) starting or ceasing a major business line;

(b) acquiring or disposing of a major business; or

(c) undertaking a significant investment, upgrade or restructuring programme.

The *FCA* expects that a *firm* that is planning to implement a material change to its business will calculate the anticipated impact of that change on its *fixed overheads requirement* (and its broader *own funds requirement*) before executing the relevant change. This should include considering the potential impact on its *ICARA process* and its obligations under *MIFIDPRU* 7.

Firms that have been providing investment services and/or activities for less than a year

4.5.11 R (1) This *rule* applies where a *firm* has been in business for less than one year.

(2) For the purposes of the calculation in *MIFIDPRU* 4.5.1R, a *firm* must use the *relevant expenditure* included in its projections for the first 12 *months*' trading, as submitted in its application for *authorisation*.

[**Note:** article 13(3) of the *IFR*.]

4.6 Overall K-factor requirement

4.6.1 R The *K-factor requirement* of a *MIFIDPRU investment firm* is the sum of each of the following that apply to the *firm*:

(1) *K-AUM requirement*;

(2) *K-CMH requirement*;

(3) *K-ASA requirement*;

(4) *K-COH requirement*;

(5) *K-NPR requirement*;

(6) *K-CMG requirement*;

(7) *K-TCD requirement*;

(8) *K-DTF requirement*; and

(9) *K-CON requirement*.

4.6.2 G (1) The *rules* and *guidance* in *MIFIDPRU* 4.7 to 4.16 explain how a *MIFIDPRU investment firm* should calculate each component of its overall *K-factor requirement*.

(2) The manner in which *firms* carry on activities that are potentially relevant to one or more *K-factor metrics* may vary considerably. It is not practical for the *FCA* to give an exhaustive set of *rules* and *guidance* covering every conceivable business arrangement that *firms* may operate when carrying on such activities.

(3) If a *firm* is unsure whether a particular arrangement is within scope of one or more components of the *K-factor requirement*, the *FCA* expects the *firm* to apply a purposive approach to the interpretation of the requirement, as required by *GEN* 2.2.1R. Among other factors, the *FCA* would therefore expect the *firm* to consider:

(a) whether the arrangement is sufficiently analogous to another arrangement that is clearly covered by any *rules* or associated *guidance*;

(b) the risks that the relevant component of the *K-factor requirement* is designed to address and whether the same or similar risks arise in relation to the arrangement in question; and

(c) where the component of the *K-factor requirement* is calculated by reference to a specific *investment service and/or activity*, the approach that the *firm* has adopted to applying other *rules* or *guidance* elsewhere in the *Handbook* to the arrangement, where those *rules* or *guidance* refer to the same *investment service and/or activity*.

(4) The *FCA* expects that if asked, a *firm* will be able to justify the approach that the *firm* has taken to applying the *K-factor requirement* to a particular activity.

(5) *MIFIDPRU investment firms* are reminded that even if an activity does not contribute towards the *K-factor requirement*, they should still consider, in accordance with the requirements in *MIFIDPRU* 7, whether that activity may give rise to potential material risks of harm or may be relevant to the *firm's* wind-down analysis.

… …

4.7 K-AUM requirement

4.7.1 R The *K-AUM requirement* of a *MIFIDPRU investment firm* is equal to 0.02% of the *firm's average AUM*.

[**Note:** article 15(2) and 16 of the *IFR*.]

4.7.2 R When measuring its *AUM*, a *MIFIDPRU investment firm* must include any amounts that relate to the *MiFID business* of the *firm* that is carried on by any *tied agents* acting on its behalf.

4.7.3 G For the avoidance of doubt, the definition of *AUM* does not include any amounts arising from the *firm's* provision of the *ancillary service* in paragraph 3 of Part 3A of Schedule 2 the *Regulated Activities Order* (i.e. providing advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to mergers and the purchase of undertakings).

4.7.4 R A *firm* must calculate its *K-AUM requirement* on the first *business day* of each *month*.

[**Note:** article 17(1) of the *IFR*.]

4.7.5 R (1) A *firm* must calculate the amount of its *average AUM* by:

(a) taking the total *AUM* as measured on the last *business day* of each of the previous 15 *months*;

(b) excluding the 3 most recent monthly values; and

(c) calculating the arithmetic mean of the remaining 12 monthly values.

(2) When measuring the value of its *AUM* on the last *business day* of each *month*, a *firm* must convert any amounts in foreign currencies on that date into the *firm's* functional currency.

(3) For the purposes of the currency conversion in (2), a *firm* must:

(a) determine the conversion rate by reference to an appropriate market rate; and

(b) record the rate that was chosen.

[**Note:** article 17(1) of the *IFR*.]

4.7.6 G (1) The effect of *MIFIDPRU* 4.7.5R(2) is that when measuring the value of *AUM* at the end of each *month*, a *firm* must apply the relevant conversion rate on that date to the *AUM* attributable to that *month*. The *AUM* for each relevant preceding *month* should continue to be measured by reference to the conversion rate that was applicable at the end of that particular preceding *month*.

(2) For purposes of *MIFIDPRU* 4.7.5R(3), where a *firm* is carrying out a conversion that involves sterling, the *FCA* considers that an example of an appropriate market rate would be the relevant daily spot exchange rate against sterling published by the Bank of England.

4.7.7 R (1) When measuring the amount of its *AUM*, a *firm* must:

(a) where available, use the market value of the relevant assets;

(b) where a market value is not available for an asset, use an alternative measure of fair value, which may include an estimated value calculated on a best efforts basis;

(c) exclude any amounts that are included in the *firm's* calculation of its *CMH*.

(2) When measuring the amount of its *AUM*, a *firm* may offset any negative values or liabilities attributable to positions within the

relevant portfolios, so that *AUM* is equal to the net total value of the relevant assets.

4.7.8 R Where the *firm* has delegated the management of assets to another entity, the *firm* must include the value of those assets in its measurement of *AUM*.

[**Note:** article 17(2), first paragraph of the *IFR*.]

4.7.9 R (1) Subject to (2), where a *financial entity* has formally delegated the management of assets to the *firm*, the *firm* may exclude the value of those assets from its measurement of *AUM*.

(2) The exclusion in (1) does not apply if the *financial entity* that is formally delegating to the *firm* has itself excluded the relevant assets from the *financial entity's* calculation of its own capital requirements due to the *financial entity* also acting as a delegated manager.

(3) For the purposes of (1), formal delegation occurs where there is a legally binding agreement in place between the *financial entity* and the *firm* that sets out the rights and obligations of each party in relation to the delegation of the relevant *portfolio management* activities.

[**Note:** article 17(2), second paragraph of the *IFR*.]

4.7.10 G (1) *MIFIDPRU* 4.7.8R and 4.7.9R address the position where one entity delegates management of assets to another entity. For these purposes, delegation involves a delegating entity ("A") assuming a duty to the relevant *client* to manage the assets, and A then delegating the performance of that duty (in whole or in part) to another entity ("B").

(2) The following do not constitute delegation for the purposes of *MIFIDPRU* 4.7.8R or 4.7.9R:

(a) where A is only arranging for B to provide a service directly to the relevant *client*, so that B owes a duty directly to the *client* to manage the assets and A does not; or

(b) where A advises a *client* to use B's management services in relation to certain assets, but A does not itself assume any responsibility to the *client* for managing those assets.

(3) *MIFIDPRU* 4.7.8R explains that a *MIFIDPRU investment firm* cannot reduce its *AUM* by delegating management of assets to another entity. This is because the *firm* will normally continue to

owe a duty directly to the *client*, even if performance of that duty has been delegated (wholly or partly) to another entity.

(4) *MIFIDPRU* 4.7.9R permits a *firm* to whom the management of assets has been formally delegated to exclude the value of those assets when measuring its *AUM* if the delegating entity is a *financial entity*. However, if the delegation does not meet the requirements to be a formal delegation, the *firm* may not exclude the relevant assets from its measurement of *AUM*. The definition of a *financial entity* covers entities that are subject to an AUM-based capital requirement that is similar to the *K-AUM requirement*.

(5) The *rule* in *MIFIDPRU* 4.7.9R is designed to ensure that assets under management are not "double-counted" for the purposes of applying regulatory capital requirements. The *FCA* considers that double-counting is unlikely to occur in relation to delegating entities which are not *financial entities*, as those delegating entities will not have capital requirements based specifically upon their level of assets under management. Therefore, where an entity that is not a *financial entity* has delegated the management of assets to the *firm*, the *firm* must include the value of those assets in its measurement of *AUM*.

(6) *MIFIDPRU* 4.7.9R(2) will be relevant if a *firm* is managing a portfolio under sub-delegation arrangements. The effect can be illustrated through the following example. Firm A (a *third country* entity that is a *financial entity*) formally delegates the management of a portfolio of assets to Firm B (a *MIFIDPRU investment firm*). Firm B formally sub-delegates the management of part of the portfolio to Firm C (another *MIFIDPRU investment firm*). Firm B may choose to apply the exclusion in *MIFIDPRU* 4.7.9R(1), on the basis that Firm A is a *financial entity*. However, if Firm B claims the exclusion in *MIFIDPRU* 4.7.9R(1), Firm C cannot also exclude the value of the sub-delegated assets from Firm C's measurement of *AUM*. This is because *MIFIDPRU* 4.7.9R(2) disapplies the exclusion if the delegating entity has already applied a similar exclusion in relation to the same portfolio.

(7) *MIFIDPRU* 4.7.9R(2) also applies if the delegating entity is a *financial entity* in a *third country* and is applying an equivalent exclusion. For example, Firm D (an entity in a *third country*) delegates the management of a portfolio to Firm E (a *financial entity* in a *third country*). Firm E sub-delegates the management of part of that portfolio to Firm F (a *MIFIDPRU investment firm*). The *third country* rules to which Firm E is subject permit Firm E to exclude the value of the assets delegated by Firm D from Firm E's AUM-based capital requirement. If Firm E is

relying on that exclusion, Firm F cannot rely on the exclusion in *MIFIDPRU* 4.7.9R(1).

4.7.11 G Where a *financial entity* ("A") is providing *investment advice of an ongoing nature* to a *MIFIDPRU investment firm* ("B") and B undertakes discretionary *portfolio management*, such an arrangement does not fall within *MIFIDPRU* 4.7.9R. This is because the arrangement is not a formal delegation of the management of assets by A to B, but involves two distinct activities: ongoing *investment advice* provided by A and discretionary *portfolio management* undertaken by B. In this situation, if A is a *MIFIDPRU investment firm*, it must include any assets in relation to which it is providing such advice in its measurement of *AUM*. Where B is undertaking discretionary *portfolio management* in relation to the same assets, B must also include those assets in its own measurement of *AUM*.

4.7.12 R (1) This *rule* applies where a *firm* has been managing assets for its *clients* under discretionary *portfolio management* or non-discretionary arrangements constituting *investment advice of an ongoing nature*:

(a) for less than 15 *months*; or

(b) for 15 *months* or longer, but has been classified as a *non-SNI MIFIDPRU investment firm* for less than 15 *months*.

(2) For the purposes of its calculation of *average AUM* under *MIFIDPRU* 4.7.5R, a *firm* must use:

(a) historical data for the periods specified in (1) as soon as such data becomes available; or

(b) such other amounts as the *FCA* may specify to replace any missing data points, based on the business projections that the *firm* submitted to the *FCA* when obtaining *permission* to perform the relevant activities.

[**Note:** article 17(2), third paragraph of the *IFR*.]

4.7.13 G *MIFIDPRU* 4.10.26G to *MIFIDPRU* 4.10.32G contain additional *guidance* on the interaction between the measurement of a *firm's AUM* and the measurement of a *firm's COH*.

4.8 K-CMH requirement

4.8.1 R The *K-CMH requirement* of a *MIFIDPRU investment firm* is equal to the sum of:

(1) 0.4% of *average CMH* held by the *firm* in *segregated accounts*; and

(2) 0.5% of *average CMH* held by the *firm* in *non-segregated accounts*.

[**Note:** article 15(2) of the *IFR*.]

4.8.2 G (1) Generally, the *FCA* would expect that a *MIFIDPRU investment firm* would be holding *client money* in one or more *segregated accounts*. *MIFIDPRU* 4.8.9E explains that where a *firm* is complying with the applicable requirements of *CASS* 7 in relation to an amount of *client money*, there is a presumption that such an amount is being held in a *segregated account*.

(2) As a result, the *FCA* considers that the *K-CMH requirement* for *non-segregated accounts* is most likely to be relevant where:

(a) the *K-CMH requirement* applies on a *consolidated basis* and:

(i) the *consolidated situation* includes one or more entities to which *CASS* does not apply, such as *third country* entities, that receive *money* from customers; and

(ii) the arrangements under which the entity in (i) holds *money* received from customers do not satisfy the conditions in *MIFIDPRU* 4.8.8R (as they apply on a *consolidated basis* under *MIFIDPRU* 2.5.30R); or

(b) a *MIFIDPRU investment firm* has been failing to comply with the applicable requirements of *CASS* 7 during a certain period, in which case the *firm* should treat any non-compliant arrangements as *non-segregated accounts* for the purposes of calculating any *K-CMH requirement* that includes that period of non-compliance.

(3) For the avoidance of doubt, the scenario in (2)(b) does not affect any obligations that the *firm* has under *CASS*, or under any other *rule*, to take specified action or to notify the *FCA* where the *firm* has identified that it has breached the requirements of *CASS*.

4.8.3 R When calculating its *CMH* in accordance with this section, a *MIFIDPRU investment firm* must include any amounts that relate to *MiFID business* of the *firm* that is carried on by any *tied agents* acting on its behalf.

4.8.4 G Due to the restrictions in *SUP* 12.6.5R and *SUP* 12.6.15R, the *FCA* generally expects that *MIFIDPRU* 4.8.3R would not be directly relevant to *MIFIDPRU investment firms* on an individual basis. However, where this section applies on a *consolidated basis* in accordance with

MIFIDPRU 2.5 (Prudential consolidation), the *UK parent entity* will need to include any *CMH* attributable to *tied agents* of a *third country investment firm* included within the *consolidated situation*.

4.8.5 G (1) The definition of *CMH* includes only *client money* which is *MiFID client money*. Therefore, *client money* which is received in connection with business other than *MiFID business* does not need to be included within a *MIFIDPRU investment firm's* calculation of *CMH*, except to the extent that *MIFIDPRU* 4.8.6R applies.

(2) The definition of *MiFID client money* includes:

(a) *money* deposited into a *client bank account* in accordance with *CASS* 7.13.3.R;

(b) *money* originally received in connection with *MiFID business* which a *firm* has placed in a *qualifying money market fund* in accordance with *CASS* 7.13.3R(4). This means that while the *units* or *shares* in the relevant *qualifying money market fund* must still be treated by the *firm* as *client* assets for the purposes of *CASS* and must be dealt with in accordance with *CASS* 7.13.26G, the value of those *units* or *shares* must be included in *CMH* for the purposes of *MIFIDPRU*;

(c) an amount of the *firm's* own *money* that the *firm* has paid into its *client bank account* for the purposes of *CASS* 7.13.65R where the *firm* is applying *alternative approach mandatory prudent segregation*; and

(d) *money* received from a *client* in connection with *MiFID business* which a *firm* has allowed a third party (such as an exchange, a *clearing house* or an *intermediate broker*) to hold in accordance with *CASS* 7.14 (Client money held by a third party).

(3) Where a *firm* controls *money* by virtue of a *mandate* in accordance with *CASS* 8, such *money* is not *MiFID client money* where it is not *client money* received or held by the *firm*. A *firm* is not required to include any such sums it controls but does not hold within its calculation of *CMH*.

(4) *MIFIDPRU investment firms* are reminded that while *money* that is not *MiFID client money* does not contribute to the *K-CMH requirement*, they should still consider any potential material harms that may arise in connection with receiving *money* from *clients* as part of their *ICARA process* under *MIFIDPRU* 7. This includes any material harms that may arise in relation to amounts received that are not treated as *client money*, such as under a *title transfer collateral arrangement*.

4.8.6 R If a *MIFIDPRU investment firm* is unsure whether a particular amount of *client money* should be classified as *MiFID client money*, it must treat the relevant amount as *MiFID client money* for the purposes of this section until the *firm* is satisfied that the amount is not *MiFID client money*.

4.8.7 G For the avoidance of doubt, *MIFIDPRU* 4.8.6R applies only for the purposes of determining how the *client money* concerned should be treated for the purposes of *MIFIDPRU*. It does not affect how such *client money* should be treated for the purposes of other provisions in the *Handbook* (such as *CASS* or *COBS*) or under any other applicable legislation.

4.8.8 R An arrangement will constitute a *segregated account* if it is an arrangement in respect of which a *firm* ("A") ensures that all of the following conditions are satisfied:

(1) A keeps records and accounts enabling A, at any time and without delay, to distinguish assets held for one *client* from assets held for any other *client* and from A's own assets;

(2) A maintains its records and accounts in a way that ensures their accuracy, and in particular that they correspond to the assets held for *clients* and may be used as an audit trail;

(3) A conducts, on a regular basis, reconciliations between A's internal accounts and records and those of any third parties by whom those assets are held;

(4) A takes the necessary steps to ensure that deposited *client* funds are held in an account or accounts identified separately from any accounts used to hold funds belonging to A;

(5) A operates adequate organisational arrangements to minimise the risk of the loss or diminution of *client* assets or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence; and

(6) the applicable national law provides that, in the event of A's insolvency or entry into resolution or administration, assuming that A has complied with (1) to (5), *client* funds cannot be used to satisfy claims against A, other than claims by the relevant *clients*.

4.8.9 E (1) This *rule* applies for the purposes of *MIFIDPRU* 4.8.8R.

(2) A *MIFIDPRU investment firm* which holds *client money* must comply with, among other requirements, the applicable requirements on:

(a) organisational requirements in relation to *client money* in *CASS* 7.12;

(b) segregation of *client money* in *CASS* 7.13 or *client money* held by a third party in *CASS* 7.14;

(c) records, accounts and reconciliations in *CASS* 7.15; and

(d) acknowledgement letters in *CASS* 7.18.

(3) Compliance with (2) in relation to an arrangement may be relied on as tending to establish compliance with the conditions for that arrangement to be classified as a *segregated account* in *MIFIDPRU* 4.8.8R.

(4) Contravention of (2) in relation to an arrangement may be relied on as tending to establish contravention of the conditions for that arrangement to be classified as a *segregated account* in *MIFIDPRU* 4.8.8R.

4.8.10 G The effect of *MIFIDPRU* 4.8.9E is that if a *MIFIDPRU investment firm* complies with the requirements in the provisions of *CASS* specified in *MIFIDPRU* 4.8.9E(2) in relation to a particular arrangement for *client money*, it can proceed on the basis that such *client money* is being held in a *segregated account* for the purposes of the *K-CMH requirement*. Conversely, if the *firm* does not comply with the relevant *CASS* provisions in relation to a *client money* arrangement, this will generally be evidence that the relevant *client money* should be treated as being held in a *non-segregated account* for the purposes of calculating the *K-CMH requirement*.

4.8.11 G Where consolidation under *MIFIDPRU* 2.5 (Prudential consolidation) applies to an *investment firm group*, *MIFIDPRU* 2.5.30R and *MIFIDPRU* 2.5.31R explain how to calculate the consolidated *K-CMH requirement*.

4.8.12 R A *firm* must calculate its *K-CMH requirement* on the first *business day* of each *month*.

[**Note:** article 18(1), third paragraph of the *IFR*.]

4.8.13 R A *firm* must calculate the amount of its *average CMH* by:

(1) taking the total *CMH* as measured at the end of each *business day* during the previous 9 *months*;

(2) excluding the daily values for the most recent 3 *months*; and

(3) calculating the arithmetic mean of the daily values for the remaining 6 *months*.

[**Note:** article 18(1), first and second paragraphs of the *IFR*.]

4.8.14 R For the purpose of the calculation in *MIFIDPRU* 4.8.13R, a *firm* must measure *CMH* in accordance with, to the extent applicable:

(1) any records, accounts and reconciliations that the *firm* maintains to comply with the requirements of *CASS* 7.15 (Records, accounts and reconciliations); and

(2) any values contained in accounting records.

4.8.15 R Where a *firm* has been holding *CMH* for less than 9 *months*, for the purpose of the calculating its *average CMH*, it must use:

(1) historical data for the period in *MIFIDPRU* 4.8.13R to calculate *average CMH* as soon as it becomes available; or

(2) such other amounts as the *FCA* may specify to replace any missing data points, based on the business projections that the *firm* submitted to the *FCA* when obtaining *permission* to perform the relevant activities to which the *client money* relates.

[**Note:** article 18(2) of the *IFR*.]

4.9 K-ASA requirement

4.9.1 R The *K-ASA requirement* of a *MIFIDPRU investment firm* is equal to 0.04% of the *firm's average ASA*.

[**Note:** article 15(2) of the *IFR*.]

4.9.2 R When calculating its *K-ASA requirement* in accordance with this section, a *MIFIDPRU investment firm* must include within its *ASA* any amounts that relate to *MiFID business* of the *firm* that is carried on by any *tied agents* acting on its behalf.

4.9.3 G Due to the limited types of activities in respect of which a *tied agent* may be exempt from the requirement for *authorisation* in the *UK* (as explained in *SUP* 12.2.7G), the *FCA* generally expects that *MIFIDPRU* 4.9.2R would not be directly relevant to *MIFIDPRU investment firms* on an individual basis. However, where *MIFIDPRU* 4.9 applies on a *consolidated basis* in accordance with *MIFIDPRU* 2.5 (Prudential consolidation), the *UK parent entity* will need to include any *ASA* attributable to *tied agents* of a *third country investment firm* included within the *consolidated situation*.

4.9.4 R A *firm* must exclude from its measurement of *ASA* any units or shares in a *qualifying money market fund* that are treated as *MiFID client money*.

4.9.5 G (1) The definition of *ASA* includes only *client* assets held by a *MIFIDPRU investment firm* in the course of *MiFID business*.

Therefore, *client* assets which are held in connection with business other than *MiFID business* do not need to be included within a *MIFIDPRU investment firm's* calculation of *ASA*, except to the extent that *MIFIDPRU* 4.9.6R applies.

(2) *MIFIDPRU investment firms* should note that, as explained in *MIFIDPRU* 4.8.5G, the definitions of *MiFID client money* and *CMH* include amounts that a *MIFIDPRU investment firm* has placed with *qualifying money market funds* in accordance with *CASS* 7.13.3R(4). Due to *MIFIDPRU* 4.9.4R and the definition of *MiFID client money*, although the resulting units or shares in a *qualifying money market fund* may be treated as *client* assets for the purposes of the *custody rules*, for the purposes of *MIFIDPRU*, their value should be included in *CMH* and not in *ASA*.

(3) *MIFIDPRU investment firms* are reminded that while *client* assets that a *firm* holds otherwise than in the course of *MiFID business* do not contribute to the *K-ASA requirement*, they should still consider any potential material harms that may arise in connection with receiving assets from *clients* as part of their *ICARA process* under *MIFIDPRU* 7.

(4) As part of their *ICARA processes*, *firms* should also consider material harms that may arise in relation to amounts received that are not treated as *client* assets for the purposes of the *custody rules* but in relation to which the *firm* may have future obligations to a *client*, such as under a *title transfer collateral arrangement*.

4.9.6 R If a *MIFIDPRU investment firm* is unsure whether particular *client* assets are held in the course of *MiFID business*, it must treat those assets as held in the course of *MiFID business* for the purposes of this section until it is satisfied that the assets are not held in the course of such business.

4.9.7 R A *firm* must calculate its *K-ASA requirement* on the first *business day* of each *month*.

[**Note:** article 19(1), third paragraph of the *IFR*.]

4.9.8 R A *firm* must calculate the amount of its *average ASA* by:

(1) taking the total *ASA* as measured at the end of each *business day* for the previous 9 *months*;

(2) excluding the values for the most recent 3 *months*; and

(3) calculating the arithmetic mean of the daily values for the remaining 6 *months*.

[**Note:** article 19(1), first and second paragraphs of the *IFR*.]

4.9.9 R When measuring *ASA*, a *firm* must:

(1) where available, use the market value of the relevant assets; and

(2) where a market value is not available for an asset, use an alternative measure of fair value, which may include an estimated value calculated on a best efforts basis.

4.9.10 G The values used by a *firm* under *MIFIDPRU* 4.9.8R should be consistent with the information on *client assets* contained in any relevant regulatory data reported by the *firm* to the *FCA*, and in any internal or external reconciliations and records maintained in accordance with *CASS* 6.6 (Records, accounts and reconciliations), except where a *rule* or relevant *guidance* expressly requires the *firm* to take a different approach.

4.9.11 R Where either of the following applies, a *firm* must include the value of the relevant assets in its measurement of *ASA*:

(1) the *firm* has delegated the safeguarding and administration of assets to another entity; or

(2) another entity has delegated the safeguarding and administration of assets to the *firm*.

[**Note:** article 19(2) of the *IFR*.]

4.9.12 G The effect of *MIFIDPRU* 4.9.11R is that a *firm* will not reduce its level of *ASA* by delegating the safeguarding of assets to a third party. However, a *firm* will increase the level of its *ASA* by accepting the delegation of safeguarding and administration of assets to the *firm* by a third party. This reflects the risk of harm that may result from the *firm's* direct safeguarding responsibilities and the *firm's* responsibilities in relation to the selection, appointment and periodic review of any third party to which the *firm* has delegated safeguarding.

4.9.13 R Where a *firm* has been safeguarding assets for less than 9 *months*, for the purposes of calculating its *average ASA*, it must use:

(1) historical data for the period in *MIFIDPRU* 4.9.8R to calculate *average ASA* as soon as it becomes available; or

(2) such other amounts as the *FCA* may specify to replace any missing data points, based on the business projections that the *firm* submitted to the *FCA* when obtaining *permission* to perform the relevant safeguarding activities.

[**Note:** article 19(3) of the *IFR*.]

4.10 K-COH requirement

4.10.1 R The *K-COH requirement* of a *MIFIDPRU investment firm* is equal to the sum of:

(1) 0.1% of *average COH* attributable to *cash trades*; and

(2) 0.01% of *average COH* attributable to *derivatives trades*.

[**Note:** article 15(2) of the *IFR*.]

4.10.2 R When calculating its *K-COH requirement* in accordance with this section, a *MIFIDPRU investment firm* must include within its *COH* any amounts that relate to *MiFID business* of the *firm* that is carried on by any *tied agents* acting on its behalf.

4.10.3 G The definition of *COH* includes orders that a *firm* handles when carrying on either of the following types of *MiFID business*:

(1) reception and transmission of client orders; and

(2) *execution of orders on behalf of a client*.

4.10.4 R A *firm* is not required to include the following in its measurement of *COH*:

(1) orders executed by a *firm* in its own name (including where the *firm* executes an order in its own name on behalf of a *client*);

(2) orders that a *firm* handles when acting in the capacity as the operator of a *multilateral trading facility* or *organised trading facility*;

(3) transactions that are caught within the definition of reception and transmission of *client* orders only as a result of the situation described in recital 44 of *MiFID*; or

(4) orders that are not ultimately executed.

[**Note:** article 20(2), fifth to seventh subparagraphs of the *IFR*.]

4.10.5 G *MIFIDPRU* 4.10.6G to *MIFIDPRU* 4.10.17G contain further *guidance* on whether particular arrangements are included within the measurement of *COH*.

Execution of orders in the firm's own name

4.10.6 G Where a *firm* executes orders in its own name (irrespective of whether those orders are ultimately for the benefit of a *client*), those orders are included within the *firm's* measurement of its *DTF* under *MIFIDPRU*

4.15 (K-DTF requirement) and not within its measurement of *COH* under this section.

The extended ("bringing together") definition of reception and transmission

4.10.7 G Transactions that are described in recital 44 of *MiFID* are, in summary, transactions that result from a *firm* bringing together two or more investors (such as introducing an issuer to a potential source of funding), where the *firm* does not otherwise interpose itself within the chain of execution of any resulting order. In practice, this is most likely to be relevant in the context of *corporate finance business* or private equity business. A *firm* may exclude such transactions from its measurement of *COH* provided that its role does not go beyond this "extended" definition of reception and transmission (which is further described in in the *guidance* in *PERG* 13.3 (Investment Services and Activities)).

Matched principal trading

4.10.8 G A *firm* that trades in a matched principal capacity will be placing orders in its own name. Such orders must therefore be included in the measurement of the *firm's DTF* and are not included in the calculation of *COH*.

Name give-up activities

4.10.9 G (1) The *FCA* understands that activities that are described as involving "name give-up" may take different forms.

(2) In certain cases, a *firm* may be distributing indications of interest that indicate a willingness to enter into a transaction, but do not have fixed terms. The *firm* may then pass the names of the counterparties to each other following a match in order to allow them to facilitate the trade. In the *FCA's* view, the indications of interest and name-passing that occur as part of this activity are not included within the measurement of *COH*. However, this does not mean that every transaction which begins with an indication of interest is always outside the scope of *COH*. Where a *firm* is subsequently instructed to transmit an order on firm terms, or to execute an order, that transaction will be within scope of *COH*, even if the order results from a process that began with an initial indication of interest.

(3) In some circumstances, a *firm* may be disseminating orders on firm terms that result in a transaction as soon as they are confirmed by the recipient, following which the *firm* will disclose the name of the relevant counterparty. In the *FCA's* view, this activity is included within the measurement of *COH* because it involves reception and transmission of an order on firm terms.

Exchange give-up activities

4.10.10 G (1) In some circumstances, *firms* may facilitate trading by their *clients* on exchanges. Once a transaction has been executed, the relevant trade is then given up to the *client's* clearing firm.

(2) In the *FCA's* view, a *firm* should consider the exact capacity in which it is acting, and whether it incurs any liability as principal, when determining if orders resulting from exchange give-up activities are included within the measurement of *COH*.

(3) If the *firm* enters into the transaction in its own name and therefore incurs principal liability, even for a short period, in relation to the trade before it is given up, the *FCA* considers that the order should be included within the *firm's* measurement of *DTF* and not within its measurement of *COH*.

(4) If the *firm* does not incur liability as principal and merely acts as agent in the name of a third party in relation to the trade, the *FCA* considers that the order should be included within the *firm's* measurement of *COH*.

Exchange block trades

4.10.11 G (1) A *firm* may be involved in negotiating a bilateral trade in relation to an exchange-traded instrument between counterparties that takes place off-exchange because the size of the trade exceeds certain specified levels. In some cases, the exchange may provide communications functionality to facilitate such block trades, but the trades are not executed on the exchange's public market.

(2) In the *FCA's* view, a *firm* will need to determine the capacity in which the *firm* is acting in relation to the block trade to determine if the value of the trade should be included in the *firm's* measurement of *COH*.

(3) If the *firm* enters into the block trade in its own name and the trade is then given up to a *client*, the *firm* should include the value of that trade in its measurement of *DTF*.

(4) If the *firm* executes the block trade as agent by committing the *client* to the terms of the trade, the *firm* should include the value of that trade in its measurement of *COH*.

(5) If the *firm* receives firm terms of the block trade from the *client* and transmits such terms to the counterparty in order for the counterparty to confirm those terms to create a binding transaction, the *firm* should include the value of that trade in its measurement of *COH*.

Broker functionality

4.10.12 G In some circumstances, a *firm* may be a member of an exchange and may provide functionality whereby trades can be executed and booked directly into the account of the relevant *client*. In such a case, the *FCA* considers that such trades should be included in the *firm's* measurement of *COH*, as the *firm* is still being used to execute the relevant trade.

Orders connected with the operation of trading venues

4.10.13 G (1) A *firm* which is *operating a multilateral trading facility* or *operating an organised trading facility* does not need to include any orders it handles solely in that capacity in its measurement of *COH*. Nonetheless, it should consider as part of its *ICARA process* whether that activity gives rise to the risk of material potential harm which might require it to hold additional *own funds* or *liquid assets* under *MIFIDPRU* 7.

(2) However, if the operator of an *organised trading facility* is engaging in *matched principal trading*, as permitted by *MAR* 5A.3.5R, any matched principal trades are included in its measurement of *DTF* under *MIFIDPRU* 4.15 (K-DTF requirement).

4.10.14 G For the avoidance of doubt, a *firm* that executes *client* orders on a *multilateral trading facility* or an *organised trading facility* when the *firm* is not acting in the capacity of the trading venue operator must include such orders in its measurement of *COH* (unless the *firm* executes such orders in its own name, in which case they must be included in its measurement of *DTF*).

4.10.15 G In certain circumstances, the same *firm* may both act as the operator of a *multilateral trading facility* or an *organised trading facility* and also be submitting an order on that *trading venue* on behalf of a *client*. In such a case, although the *firm* is not required to measure *COH* in relation to its role as the operator of the *trading venue*, it must still measure *COH* (or *DTF* if it is possible to enter into transactions in its own name on the *trading venue*) in relation to the order that it is executing for the *client*.

Orders that are never executed

4.10.16 G (1) The effect of *MIFIDPRU* 4.10.4R(4) is that where a *firm* receives a *client* order but that order is not ultimately executed, it does not have to include the value of that order in its measurement of *COH*. However, as part of its *ICARA process*, a *firm* should consider whether the fact that an order has not been executed gives rise to any material risks to the *firm* or to its *clients*. This may depend upon the reasons why *client* orders have not been executed.

(2) If, for example, the order was not executed because market conditions did not allow the *firm* (or another entity to whom the order was ultimately transmitted) to achieve an appropriate outcome for the *client*, this may be consistent with the *firm's* contractual and regulatory duties. In that case, this may not give rise to any additional material risks.

(3) However, if, for example, the *firm* failed to transmit or execute orders because of an oversight or an internal systems failure, this may indicate that the *firm* has been failing in its duties to its *client* or in its regulatory obligations. Alternatively, the *firm* may have successfully transmitted an order, but failed to select an appropriate entity to receive and execute that order, and therefore may have failed to comply with its obligations to act in the best interests of the *client* when transmitting the order. In these types of cases, the *firm* should consider as part of its *ICARA process* whether such failures may give rise to material risks and how such risks should be addressed.

4.10.17 G (1) *Firms* are reminded that while failure to achieve the execution of an individual order may not necessarily be indicative of potential material harms, a series or pattern of failures may be evidence of such harms.

(2) *Firms* are also reminded that the analysis under their *ICARA process* is separate from the application of any individual regulatory or other legal duties owed to an individual *client*. Therefore, while a *firm* may conclude that an isolated oversight in relation to a *client* order does not give rise to the risk of material harm in the context of the *ICARA process*, this does not affect any conduct obligations owed by the *firm* to that particular *client*.

Calculating COH

4.10.18 R A *firm* must calculate its *K-COH requirement* on the first *business day* of each *month*.

[**Note:** article 20(1), third paragraph of the *IFR*.]

4.10.19 R A *firm* must calculate the amount of its *average COH* by:

(1) taking the total *COH* measured throughout each *business day* over the previous 6 *months*;

(2) excluding the daily values for the most recent 3 *months*; and

(3) calculating the arithmetic mean of the daily values of the remaining 3 *months*.

[**Note:** article 20(1) of the *IFR*.]

Measuring the value of orders for COH

4.10.20 R (1) When measuring its *COH*, a *firm* must use the sum of the absolute value of each buy order and sell order, as determined in accordance with the remainder of this *rule*.

(2) For *cash trades* relating to *financial instruments* the value of the order is the amount paid or received on the trade at the time at which it is executed, unless the *firm* has chosen to apply the approach in *MIFIDPRU* 4.10.23R.

(3) For *derivatives trades* other than orders relating to interest rate derivatives, the value of the order is the notional amount of the contract, determined in accordance with *MIFIDPRU* 4.14.20R(2).

(4) For orders relating to interest rate derivatives, the value of the order is the notional amount of the contract determined in accordance with *MIFIDPRU* 4.14.20R(2), adjusted in accordance with *MIFIDPRU* 4.10.25R.

(5) A *firm* may calculate the value of an order by deducting any transaction costs so as to reflect the consideration received or paid by the *client* for the relevant instruments, provided that such transaction costs are not paid separately to the *firm* by the *client*.

4.10.21 G (1) Under the general approach in *MIFIDPRU* 4.10.20R(2), a *firm* would ordinarily determine the gross value of an order by multiplying the market price of the instrument by the quantity of that instrument being purchased or sold.

(2) However, *MIFIDPRU* 4.10.20R(5) permits (but does not require) a *firm* to calculate the value of an order by reference to the consideration paid or received by the *client* for the instruments (i.e. net of transaction costs), provided that such transaction costs are included in the gross value of the order and are not paid by the *client* to the *firm* separately.

(3) For example, Firm A executes an order for a *client* to buy 100 shares. The total cost of the order, including transaction costs, is £100. The *client* receives shares worth £88, after the *firm* uses £12 to cover transaction costs. Under the standard approach in *MIFIDPRU* 4.10.20R(2), the *firm* may record the value of the order in its *COH* as £100 (i.e. the gross cost of the order). The *firm* may, for example, choose this approach for reasons of simplicity and administrative convenience.

(4) Alternatively, in the example above, the *firm* may apply the approach under *MIFIDPRU* 4.10.20R(5) to record the value of

the order in its *COH* as £88 (i.e. net of transaction costs paid by the *client* in relation to the transaction).

(5) However, a *firm* cannot rely on *MIFIDPRU* 4.10.20R(5) to reduce the value of an order by transaction costs that are paid separately by the *client* to the *firm*. For example, Firm B executes an order for a *client* to buy 100 shares. The total cost of the order is £100. The *client* additionally pays £12 to Firm B for transaction costs. In this case, the *firm* must record the net value of the order under *MIFIDPRU* 4.10.20R(5) in its *COH* as £100 (and not £88), as the transaction costs have been paid separately.

4.10.22 G For *cash trades* relating to exchange-traded options, the amount paid or received under *MIFIDPRU* 4.10.20R(2) is the premium paid for the option.

[**Note:** article 20(2) of the *IFR*.]

4.10.23 R (1) By way of derogation from *MIFIDPRU* 4.10.20R(2), a *firm* that is receiving and transmitting an order that is a *cash trade* may apply the approach in this *rule* to determine the value of that order for the purposes of measuring *COH*.

(2) Where a *firm* chooses to apply the approach in this *rule*, the value of the order shall be determined by reference to:

(a) in the case of an order which specifies a fixed price or limit price at which the order should be executed, that price; or

(b) in the case of an order which does not specify a price, the market price of the relevant instrument at the end of the day on which the order is transmitted by the *firm*.

(3) A *firm* that chooses to apply the approach in this *rule* must do so either:

(a) in relation to all *cash trades* that the *firm* is receiving and transmitting; or

(b) only in relation to *cash trades* received and transmitted by the *firm* in respect of which the *firm* has not received timely information from the executing entity about the terms on which the order was executed.

(4) A *firm* that applies the approach in this *rule* must document the basis in (3) on which it has chosen to do so.

4.10.24 G (1) The effect of *MIFIDPRU* 4.10.23R is to permit *firms* that are receiving and transmitting orders that are *cash trades* to choose to determine the *COH* attributable to such orders using an alternative approach. Such *firms* may either:

(a) apply the standard approach in *MIFIDPRU* 4.10.20R(2) and use the price at which the relevant order was ultimately executed, once this has been confirmed by the entity that executes the order; or

(b) apply the alternative approach in *MIFIDPRU* 4.10.23R and use a deemed price that is determined by reference to the limit price of the order or, if there is no limit price, the end-of-day market price at the time at which the order is transmitted.

(2) However, a *firm* must not use the alternative approach in *MIFIDPRU* 4.10.23R for the purposes of regulatory arbitrage to reduce its *K-COH requirement*. In order to prevent this, a *firm* may only choose to apply the alternative approach either:

(a) in relation to all *cash trades* that the *firm* receives and transmits; or

(b) in relation to *cash trades* that the *firm* receives and transmits where the *firm* does not receive timely information from the broker about the terms on which the order was ultimately executed. In this case, the *firm* would need to apply the standard approach in *MIFIDPRU* 4.10.20R(2) in relation to all other *cash trades*. This is designed to ensure that the *firm* can record daily information for *COH* in circumstances where information about the ultimate execution of transmitted orders might otherwise be missing or might be significantly delayed.

4.10.25 R (1) For the purposes of *MIFIDPRU* 4.10.20R(4), a *firm* must adjust the notional amount of an interest rate derivative by multiplying that notional amount by the duration.

(2) For the purposes of (1), the duration shall be determined in accordance with the following formula:

Duration = time to maturity (in years) / 10

[**Note:** article 20(2), second subparagraph of the *IFR*.]

Interaction between K-COH requirement and K-AUM requirement

4.10.26 G *MIFIDPRU* 4.10.27G to *MIFIDPRU* 4.10.32G explain the circumstances in which a *firm* must include orders that arise in connection with *portfolio management* or *investment advice* in, or may exclude orders from, its measurement of *COH*.

4.10.27 G (1) The basic definition of *COH* includes:

(a) orders that the *firm* executes when providing execution services for a *client*; and

(b) orders that the *firm* has received from a *client* and transmitted to another entity for execution.

(2) The *rules* and *guidance* in *MIFIDPRU* 4.10.28R to 4.10.32G explain how this definition applies in particular scenarios and certain exclusions or modifications that may apply.

4.10.28 R A *firm* may exclude from its calculation of *COH* any orders that the *firm* generates in the course of providing either of the following in relation to a portfolio, if the relevant portfolio is included in the *firm's* calculation of its *K-AUM requirement*:

(1) *portfolio management*; or

(2) *investment advice of an ongoing nature*.

4.10.29 R (1) This *rule* applies where:

(a) *portfolio management* has been delegated to a *firm* by a *financial entity*; and

(b) as a result of the delegation in (a), the *firm* has excluded the delegated portfolio from its calculation in *AUM* in accordance with *MIFIDPRU* 4.7.9R.

(2) Where this *rule* applies, the *firm* in (1) must include in its measurement of *COH* any orders that the *firm* executes in the course of providing *portfolio management* in relation to the delegated portfolio.

(3) Where this *rule* applies, the *firm* in (1) is not required to include in its measurement of *COH*:

(a) any orders that the *firm* passes back to the delegating *financial entity* for execution (whether or not such orders are executed by that *financial entity* itself or are transmitted by the *financial entity* to another entity for execution); or

(b) any orders that the *firm* places with another entity for execution in the course of providing *portfolio management* in relation to the delegated portfolio.

4.10.30 G The exclusions in *MIFIDPRU* 4.7.9R, *MIFIDPRU* 4.10.28R and *MIFIDPRU* 4.10.29R(3) may result in a *firm* that carries on delegated *portfolio management* having no *K-AUM requirement* or *K-COH* *requirement* in relation to all or part of a delegated portfolio. Where one or more exclusions apply, a *firm* should still assess as part of its *ICARA process* whether the activity of providing delegated *portfolio management* may give rise to potential material harms that may need to be covered by additional financial resources. *Firms* should refer to the *rules* and *guidance* in *MIFIDPRU* 7 for additional information on the *ICARA process*.

4.10.31 G (1) *MIFIDPRU* 4.10.29R does not apply where a *financial entity* ("A") is carrying on *portfolio management* in relation to a portfolio and a *MIFIDPRU investment firm* ("B") is providing *investment advice of an ongoing nature* to A in relation to that portfolio. In this situation, A has not delegated *portfolio management* to B. Instead, A is providing the service of *portfolio management* to A's *client*, and B is providing the separate service of *investment advice* to A. If A is a *MIFIDPRU investment firm*, A will include the value of the relevant portfolio when calculating its *K-AUM requirement*. B will calculate its own *K-AUM requirement* in relation to the same portfolio.

(2) Although *MIFIDPRU* 4.10.29R does not apply in this scenario, B may benefit from the separate exclusion in *MIFIDPRU* 4.10.28R(2) and therefore would not be required to include any orders that result from its ongoing *investment advice* within B's calculation of *COH*, as B will be calculating a *K-AUM requirement* in relation to the relevant portfolio.

4.10.32 G When measuring *COH* for the purposes of *MIFIDPRU* 4.10.19R, a *firm* must include:

(1) orders that the *firm* executes, or receives and transmits, as a result of providing *investment advice* (other than *investment advice of an ongoing nature*, if the *firm* calculates a *K-AUM requirement* in relation to such advice) to a *client* and subsequently receiving instructions from that *client* to transmit or execute the relevant order; and

(2) orders that a *firm* receives from another *firm* ("X"), where:

(a) X is providing *investment advice* (including *investment advice of an ongoing nature*) to a *client*;

(b) as a result of the advice in (a), the *client* instructs X to place an order with the *firm*; and

(c) the *firm* executes or receives and transmits the order received from X.

[**Note:** article 20(2), fourth subparagraph of the *IFR*.]

Firms with less than 6 months data on COH

4.10.33 R (1) This *rule* applies where a *firm* has been handling *client* orders:

(a) for less than 6 *months*; or

(b) for 6 *months* or longer, but has been classified as a *non-SNI MIFIDPRU investment firm* for less than 6 *months*.

(2) For the purposes of its calculation of *average COH* under *MIFIDPRU* 4.10.19R, a *firm* must use:

(a) historical data for the period in *MIFIDPRU* 4.10.19R as soon as such data becomes available; or

(b) such other amounts as the *FCA* may specify to replace any missing data points, based on the business projections that the *firm* submitted to the *FCA* when obtaining *permission* to perform the relevant activities.

[**Note:** article 20(3) of the *IFR*.]

… …

4.13 K-CMG requirement

… …

4.13.11 G The *FCA* may revoke a *K-CMG permission* in respect of a *portfolio* where one or more of the conditions in *MIFIDPRU* 4.13.9R ceases to be met in relation to that *portfolio*. The *FCA* would expect to review the appropriateness of any *K-CMG permissions* as part of any *SREP* it undertakes in relation to the *firm* in accordance with *MIFIDPRU* 7.

…

4.15 K-DTF requirement

4.15.1 R ~~(1)~~ Subject to *MIFIDPRU* 4.15.10R, ~~The~~ the *K-DTF requirement* of a *MIFIDPRU investment firm* is equal to the sum of:

~~(a)~~(1) 0.1% of ~~*DTF*~~ *average DTF* attributable to *cash trades*; and

~~(b)~~(2) 0.01% of ~~*DTF*~~ *average DTF* attributable to *derivatives trades*.

~~(2)~~ ~~A *firm* must calculate its *DTF* in accordance with the *rules* in this section.~~

4.15.2 G (1) The definition of *DTF* includes transactions that a *firm* enters into when *dealing on own account* or when executing client orders in the *firm's* own name.

(2) A *firm* that has *permission* to *operate an organised trading facility* may engage in:

(a) *matched principal trading* in certain types of *financial instruments* with *client* consent, in accordance with *MAR* 5A.3.5R(1); and/or

(b) *dealing on own account* in illiquid *sovereign debt* instruments in accordance with *MAR* 5A.3.5R(2).

Where a *firm* engages in either activity, it must include those transactions in the ~~calculation~~ measurement of its *DTF*.

(3) Except for the transactions in (2), *DTF* does not include orders that a *firm* handles in the course of *operating an organised trading facility*. However, *DTF* will include transactions entered into by a *firm* in its own name through an *organised trading facility* where the *firm* is not operating that *organised trading facility*.

… …

4.15.4 R ~~(1)~~ A *firm* must calculate the amount of its ~~*DTF*~~ *average DTF* ~~as~~ by:

~~(a)~~(1) ~~the rolling average of the value of the total *daily trading flow*;~~ taking the total *DTF* as measured throughout each *business day* in each of the previous 9 *months*;

~~(b)~~(2) ~~measured throughout each *business day* over the previous 9 *months*;~~ excluding the daily values for the most recent 3 *months*; and

~~(c)~~(3) ~~excluding the most recent 3 *months*,~~ calculating the arithmetic mean of the daily values for the remaining 6 *months*.

~~(2)~~ ~~A *firm* must calculate the rolling average in (1) as the arithmetic mean of the daily values for the remaining 6 *months*, after the values in (1)(c) have been excluded.~~

…

4.15.8 G When ~~calculating~~ measuring *DTF* for the purposes of *MIFIDPRU* 4.15.4R, a *firm* must:

(1) include transactions executed by a *firm* in its own name either for itself or on behalf of a *client*; and

(2) exclude transactions executed by the *firm* for the purpose of providing *portfolio management* services on behalf of investment funds.

4.15.9 R (1) This *rule* applies where a *firm* has had a *daily trading flow* for less than 9 *months*.

(2) For the purposes of its calculation of *average DTF* under *MIFIDPRU* 4.15.4R, a *firm* must use:

(a) historical data for the relevant period as soon as such data becomes available; or

(b) such other amounts as the *FCA* may specify to replace any missing data points, based on the business projections that the *firm* submitted to the *FCA* when obtaining *permission* to perform the relevant activities.

Adjusted coefficient in stressed market conditions

4.15.10 R (1) This *rule* applies where a *firm's* measurement of its *DTF* under *MIFIDPRU* 4.15.4R includes a proportion of *daily trading flow* that occurred on a trading segment of a *trading venue* to which stressed market conditions (as defined in article 6 of the *Market Making RTS*) applied.

(2) Where this *rule* applies, a *firm* may apply the following adjusted coefficients:

(a) for *cash trades*, a coefficient determined in accordance with (3) in substitution for the relevant coefficient in *MIFIDPRU* 4.15.1R(1); or

(b) for *derivatives trades*, a coefficient determined in accordance with (4) in substitution for the relevant coefficient in *MIFIDPRU* 4.15.1R(2).

(3) For *cash trades*, the adjusted coefficient must be determined by using the following formula:

CadjCash = C * (DTFexcl/DTFincl)

where:

(a) CadjCash = the adjusted coefficient in (2)(a);

(b) C = the original coefficient in *MIFIDPRU* 4.15.1R(1);

(c) DTFexcl = the *average DTF* of *cash trades* calculated in accordance with *MIFIDPRU* 4.15.4R, excluding the value of any *cash trade* that occurred on a trading segment of a *trading venue* between the time at which the *trading venue* determined that:

(i) stressed market conditions began to apply; and

(ii) stressed market conditions ceased to apply;

(d) DTFincl = the *average DTF* of all *cash trades* calculated in accordance with *MIFIDPRU* 4.15.4R.

(4) For *derivative trades*, the adjusted coefficient must be determined by using the following formula:

CadjDer = C * (DTFexcl/DTFincl)

where:

(a) CadjDer = the adjusted coefficient in (2)(b);

(b) C = the original coefficient in *MIFIDPRU* 4.15.1R(2);

(c) DTFexcl = the *average DTF* of *derivative trades* calculated in accordance with *MIFIDPRU* 4.15.4R, excluding the value of any *derivative trade* that occurred on a trading segment of a *trading venue* between the time at which the *trading venue* determined that:

(i) stressed market conditions began to apply; and

(ii) stressed market conditions ceased to apply;

(d) DTFincl = the *average DTF* of all *derivative trades* calculated in accordance with *MIFIDPRU* 4.15.4R.

4.15.11 G (1) *MIFIDPRU* 4.15.10R allows (but does not require) a *firm* to apply a reduced coefficient for the purposes of determining its *K-DTF requirement* where part of the *firm's average DTF* for the relevant period is attributable to transactions that took place on a segment of a *trading venue* to which stressed market conditions applied. The relevant coefficient must be calculated separately for *cash trades* and *derivatives trades*.

(2) *MIFIDPRU* 4.15.10R allows a *firm* to substitute a reduced coefficient that applies to the *firm's average DTF* for the relevant calculation period. The size of the reduction is proportional to the value of trades that were placed on a segment of a *trading venue* during stressed market conditions within the calculation period, relative to the overall value of trades entered into by the *firm* during that period.

4.15.12 G (1) The following is an example of how the adjusted coefficient in *MIFIDPRU* 4.15.10R applies.

(2) A *firm* executes total *cash trades* in its own name worth £9,600m during the 6-*month* calculation period for determining *average DTF* in *MIFIDPRU* 4.15.4R(3). That 6-*month* period includes 128 *business days*.

(3) The total £9,600m of *cash trades* includes £375m of *cash trades* that were executed on *trading venues* during stressed market conditions (as defined in article 6 of the *Market Making RTS*).

(4) In this example:

DTFincl =	£9,600m / 128 days = £75m
DTFexcl =	(£9,600m - £375m) / 128 days = £9,225m / 128 days = £72.07m
C =	0.1%
CadjCash =	0.1% x (72.07 / 75) = 0.1% x 0.961 = 0.0961%

(5) To calculate its *K-DTF requirement* for this calculation period, the *firm* would therefore multiply the full amount of its *average DTF* for the period by the adjusted coefficient (CadjCash). Therefore:

K-DTF requirement for *cash trades* = £75m x 0.0961% = £72,075

…

Application under MIFIDPRU 4.5.9R – permission to rebase fixed overhead requirement

4 Annex 10 R [*Editor’s note*: the form can be found at this address: https://www.fca.org.uk/publication/forms/[xxx]]

…

Insert the following new chapters, MIFIDPRU 6 and 7, after MIFIDPRU 5 (Concentration risk). The text is not underlined.

6 Basic liquid assets requirement

6.1 Application and purpose

Application

6.1.1 R This chapter applies to:

(1) a *MIFIDPRU investment firm*; and

(2) a *UK parent entity* that is required by *MIFIDPRU* 2.5.11R to comply with *MIFIDPRU* 6 on the basis of its *consolidated situation*.

6.1.2 R Where this chapter applies on the basis of the *consolidated situation* of the *UK parent entity*, any references to a "*firm*" or "*MIFIDPRU investment firm*" in this chapter are to be interpreted as references to the hypothetical single *MIFIDPRU investment firm* created under the *consolidated situation*.

6.1.3 G *MIFIDPRU* 2.5.47R and 2.5.48G contain additional *rules* and *guidance* on how a *UK parent entity* should apply the requirements in this chapter on a *consolidated basis*. A *UK parent entity* may apply for an exemption from the application of this chapter on a consolidated basis under *MIFIDPRU* 2.5.19R.

Purpose and interpretation

6.1.4 G This chapter contains:

(1) a *basic liquid assets requirement* for *MIFIDPRU investment firms* (*MIFIDPRU* 6.2); and

(2) *rules* and *guidance* on which assets count as *core liquid assets* for the purposes of the *basic liquid assets requirement* (*MIFIDPRU* 6.3).

6.1.5 G (1) Where this chapter applies to a *MIFIDPRU investment firm* on a solo basis, the *firm* must be able to comply with this chapter relying only on the *core liquid assets* it holds itself.

(2) The *FCA* does, however, recognise that there are circumstances in which it may be appropriate for a *firm* to rely on liquidity support provided by other entities within its group. Therefore, a *firm* that is subject to prudential consolidation may apply for an exemption from the application of this chapter on an individual basis under *MIFIDPRU* 2.3.2R(1).

6.1.6 G Requirements relating to a *MIFIDPRU investment firm's* systems and controls for the identification, monitoring and management of material potential harms that arise out of liquidity risk are contained in *MIFIDPRU* 7.

6.1.7 G The *basic liquid assets requirement* in this chapter is based on a proportion of a *firm's fixed overheads requirement* and any guarantees provided to *clients*. A *firm* may need to hold more *liquid assets* to comply with its *liquid assets threshold requirement* under *MIFIDPRU* 7.

6.2 Basic liquid assets requirement

6.2.1 R A *firm* must hold an amount of *core liquid assets* equal to the sum of:

(1) one third of the amount of its *fixed overhead requirement*; and

(2) 1.6 % of the total amount of any guarantees provided to *clients*.

[**Note:** article 43(1) and 45 of the *IFR*.]

6.2.2 R Where a *firm* calculates a total amount for guarantees under *MIFIDPRU* 6.2.1R(2), it must:

(1) calculate the total value of guarantees that the *firm* has outstanding at the end of each *business day*; or

(2) calculate an average value for the guarantees that the *firm* has had outstanding over an appropriate time period, which must be updated at regular, appropriate intervals.

6.2.3 G (1) *MIFIDPRU* 6.2.2R(2) is intended to allow a *firm* to smooth out its liquidity requirement for guarantees, where the value of its outstanding guarantees fluctuates on a daily basis.

(2) The time period for calculating and updating this amount is likely to be appropriate if it produces an average value that is representative of the overall liquidity risk arising out of the provision of guarantees to *clients*.

6.2.4 G To illustrate the approach in *MIFIDPRU* 6.2.2R(2):

(1) a *firm* that executes orders on behalf of a *client* may guarantee the settlement of any resulting transactions between the *client* and a third party;

(2) in this case, it may be appropriate for the *firm* to use the principles for calculating *average COH* to calculate an average value for the guarantees that the *firm* has had outstanding over an appropriate time period;

(3) *average COH* is calculated as the arithmetic mean of historic daily *COH* values. A *firm* could use the arithmetic mean of historic daily values for outstanding guarantees to calculate its amount for guarantees;

(4) *average COH* is calculated by reference to the historic three month period beginning six months ago (i.e. excluding the three most recent months). A *firm* could calculate its amount for guarantees by reference to the same time period, if this produces an average value for guarantees that is representative of the overall liquidity risk in these guarantees; and

(5) a *firm* could update this calculation monthly, in line with the requirement to update *average COH* in *MIFIDPRU* 4, if this produces a value that is representative of the overall liquidity risk.

6.3 Core liquid assets

6.3.1 R Subject to *MIFIDPRU* 6.3.3R to 6.3.5R, a *core liquid asset* means any of the following, when denominated in pound sterling:

(1) coins and banknotes;

(2) short-term deposits at a *UK-authorised credit institution*;

(3) assets representing claims on or guaranteed by the UK government or the Bank of England;

(4) units or shares in a *short-term MMF*;

(5) units or shares in a *third country* fund that is comparable to a *short-term MMF*; and

(6) *trade receivables*, if the conditions in *MIFIDPRU* 6.3.3R are met.

6.3.2 G When assessing whether a *third country* fund is comparable to a *short-term MMF*, a *firm* should consider factors such as:

(1) whether the restrictions on instruments eligible for inclusion in the fund are comparable to the restrictions on instruments in article 10(1) of the *Money Market Funds Regulation*; and

(2) whether the fund is subject to requirements concerning portfolio diversification and risk management which are comparable to the requirements applicable to *short-term MMFs* in the *Money Market Funds Regulation*.

6.3.3 R A *firm* may treat *trade receivables* as *core liquid assets* if:

(1) the *firm* is:

(a) an *SNI MIFIDPRU investment firm*; or

(b) a *MIFIDPRU investment firm* that does not have permission to carry on:

(i) *dealing on own account*; or

(ii) underwriting of *financial instruments* and/or placing of *financial instruments* on a firm commitment basis;

(2) they are receivable within 30 *days*;

(3) they account for no more than one third of the requirement based upon the *fixed overheads requirement* in *MIFIDPRU* 6.2.1R(1);

(4) they are not used to meet the requirement for guarantees in *MIFIDPRU* 6.2.1R(2); and

(5) they are subject to a minimum haircut of 50%.

[**Note:** article 43(3) of the *IFR*.]

6.3.4 R (1) If a *firm's relevant expenditure* or guarantees are incurred in a currency other than pound sterling, the *firm* may also treat the following assets as *liquid assets*, when denominated in that currency:

(a) coins and banknotes;

(b) short-term deposits at a *credit institution*;

(c) assets representing claims on or guaranteed by a central bank or government in a *third country*;

(d) units or shares in a *short-term MMF*;

(e) units or shares in a *third country* fund that is comparable to a *short-term MMF*; and

(f) *trade receivables*, if the conditions in *MIFIDPRU* 6.3.3R are met.

(2) The assets in (1) must not account for more than the proportion of fixed overheads or guarantees that the *firm* incurs in that currency.

(3) This *rule* is subject to *MIFIDPRU* 6.3.5R.

6.3.5 R A *firm* must not treat any of the following as a *core liquid asset*:

(1) any asset that belongs to a *client*; and

(2) any other asset that is encumbered.

6.3.6 G (1) For the purposes of *MIFIDPRU* 6.3.5R(1), an asset may belong to a *client* whether or not the asset is held in the *firm's* own name. Examples of assets belonging to a *client* include money or other assets held under the *FCA's client asset rules*.

(2) For the purposes of *MIFIDPRU* 6.3.5R(2), an asset may be encumbered if it is pledged as security or collateral, or subject to some other legal restriction (for example, due to regulatory or contractual requirements) which affects the *firm's* ability to liquidate, sell, transfer, or assign the asset.

7 Governance and risk management

7.1 Application

7.1.1 G (1) *MIFIDPRU* 7 is relevant to the following:

(a) a *MIFIDPRU investment firm*;

(b) a *UK parent entity* of an *investment firm group* to which consolidation applies under *MIFIDPRU* 2.5; and

(c) a *parent undertaking* that operates a *group ICARA process* in accordance with *MIFIDPRU* 7.9.5R.

(2) *MIFIDPRU* 7.1.3R explains the detailed application of the different sections of *MIFIDPRU* 7.

7.1.2 G The following table summarises the content of *MIFIDPRU* 7:

Section	Summary of content
MIFIDPRU 7.2	General requirements relating to a *firm's* governance arrangements
MIFIDPRU 7.3	Requirements relating to risk, remuneration and nomination committees
MIFIDPRU 7.4	The *overall financial adequacy rule* and a *firm's* baseline obligations in relation to the *ICARA process*
MIFIDPRU 7.5	The requirements of the *ICARA process* relating to capital and liquidity planning, stress testing and wind-down planning
MIFIDPRU 7.6	*Rules* and *guidance* explaining how a *firm* should assess and monitor the adequacy of its *own funds*
MIFIDPRU 7.7	*Rules* and *guidance* explaining how a *firm* should assess and monitor the adequacy of its *liquid assets*
MIFIDPRU 7.8	Requirements relating to the periodic review of the *ICARA process* and record keeping requirements
MIFIDPRU 7.9	Requirements for *firms* to monitor *group* risk and *rules* explaining when an *investment firm group* may operate a *group*-level *ICARA process*

MIFIDPRU 7.10	*Guidance* explaining the *FCA's* general approach to the *SREP*
MIFIDPRU 7 Annex 1G	General *guidance* on assessing potential harms that is potentially relevant to all *MIFIDPRU investment firms*
MIFIDPRU 7 Annex 2G	Additional *guidance* on assessing potential harms that is relevant for *MIFIDPRU investment firms dealing on own account* and *firms* with significant investments on their balance sheet
MIFIDPRU 7 Annex 3R to 6R	Notification forms
MIFIDPRU 7 Annex 7G	Table mapping the *rules* in *MIFIDPRU* 7 about the *ICARA process* to their associated *guidance* provisions

7.1.3 R *MIFIDPRU* 7 applies as specified in the following table:

Section of *MIFIDPRU* 7	**Application to *SNI MIFIDPRU investment firms***	**Application to *non-SNI MIFIDPRU investment firms***	**Application at the level of an *investment firm group***
MIFIDPRU 7.2 (Senior management and systems and controls)	Applies	Applies	Applies to the *UK parent entity* of an *investment firm group* to which consolidation applies under *MIFIDPRU* 2.5
MIFIDPRU 7.3 (Risk, remuneration and nomination committees)	Does not apply	Applies if the *firm* does not qualify for the exclusion in *MIFIDPRU* 7.1.4R	Does not apply
MIFIDPRU 7.4 (*Overall financial adequacy rule* and baseline	Applies	Applies	Applies if the *investment firm group* is operating a *group ICARA process*

ICARA obligations)			
MIFIDPRU 7.5 (Capital and liquidity planning, stress testing and wind-down planning)	Applies	Applies	Applies if the *investment firm group* is operating a *group ICARA process*
MIFIDPRU 7.6 (Assessing adequacy of *own funds*)	Applies	Applies	Applies if the *investment firm group* is operating a *group ICARA process*
MIFIDPRU 7.7 (Assessing adequacy of *liquid assets*)	Applies	Applies	Applies if the *investment firm group* is operating a *group ICARA process*
MIFIDPRU 7.8 (Periodic review of the *ICARA process* and record keeping)	Applies	Applies	Applies if the *investment firm group* is operating a *group ICARA process*
MIFIDPRU 7.9 (Group risks and the *group ICARA process*)	Applies	Applies	Applies if the *investment firm group* is operating a *group ICARA process*
MIFIDPRU 7.10 (The *FCA's* general approach to the *SREP*)	Applies as *guidance*	Applies as *guidance*	Applies as *guidance*

7.1.4 R (1) *MIFIDPRU* 7.3 (Risk, remuneration and nomination committees) does not apply to a *non-SNI MIFIDPRU investment firm*:

(a) where the value of the *firm's* on- and off-balance sheet assets over the preceding 4-year period is a rolling average of £100 million or less; or

(b) where:

(i) the value of the *firm's* on- and off-balance sheet assets over the preceding 4-year period is a rolling average of £300 million or less; and

(ii) the conditions in (2) are satisfied.

(2) The conditions referred to in (1)(b)(ii) are:

(a) the size of the *firm's* on- and off-balance sheet *trading book* business is equal to or less than £150 million; and

(b) the size of the *firm's* on- and off-balance sheet derivatives business is equal to or less than £100 million.

(3) For the purposes of paragraph (1), paragraph (4) applies where a *non-SNI MIFIDPRU investment firm* does not have data covering the 4-year periods referred to in that paragraph.

(4) Where this *rule* applies, a *non-SNI MIFIDPRU investment firm* must calculate the rolling averages referred to in paragraph (3) over the period for which they have data.

7.1.5 G For the purposes of *MIFIDPRU* 7.1.4R(3), the *FCA* expects *non-SNI MIFIDPRU investment firms* to have insufficient data for a period only where they did not carry on any *MiFID business* during that period.

7.1.6 R (1) The amounts referred to in *MIFIDPRU* 7.1.4R must be calculated on an individual basis.

(2) The value of the on- and off-balance sheet assets in *MIFIDPRU* 7.1.4R(1)(a) and (b) must be the arithmetic mean of the assets over the preceding 4 years.

7.1.7 R (1) When calculating the amounts referred to in *MIFIDPRU* 7.1.4R, *firms* should use their total gross assets, total gross trading book assets and total gross market value of their derivatives business.

(2) Any amounts in foreign currencies should be converted into sterling using the relevant conversion rate.

(3) A *firm* must determine the conversion rate in (2) by reference to an appropriate market rate and should record which rate was chosen.

7.1.8 G The *FCA* considers that an example of an appropriate market rate for the purposes of *MIFIDPRU* 7.1.7R(3) would be the relevant daily spot exchange rate against sterling published by the Bank of England.

7.1.9 R (1) This *rule* applies to a *non-SNI MIFIDPRU investment firm* that does not fall within either *MIFIDPRU* 7.1.4R(1)(a) or (b) but subsequently satisfies the conditions to do so.

(2) *MIFIDPRU* 7.3 (Risk, remuneration and nomination committees) ceases to apply to the *firm* in (1) if:

(a) the *firm* has met the necessary conditions to fall within either *MIFIDPRU* 7.1.4R(1)(a) or (b) for a continuous period of at least 6 *months* (or such longer period as may have elapsed before the *firm* submits the notification in (b)); and

(b) the *firm* has notified the *FCA* that it has met the conditions in (a).

(3) The notification in (2)(b) must be submitted via the *online notification and application system* using the form in *MIFIDPRU* 7Annex 3R.

7.1.10 G The effect of *MIFIDPRU* 7.1.9R(2)(a) is that *firms* may move between meeting the conditions in *MIFIDPRU* 7.1.4R(3)(a) and (b) during the 6-*month* period.

7.1.11 R Where a *non-SNI MIFIDPRU investment firm* previously met the conditions necessary for it to fall within *MIFIDPRU* 7.1.4R(1)(a) or (b) but no longer does so, it must comply with the provisions in *MIFIDPRU* 7.3 within 6 *months* from the date on which the *firm* ceased to meet the conditions.

7.1.12 R (1) Where a *non-SNI MIFIDPRU investment firm* ceases to meet the conditions necessary for it to fall within *MIFIDPRU* 7.1.4R(1)(a) or (b), it must promptly notify the *FCA*.

(2) The notification in (1) must be submitted via the *online notification and application system* using the form in *MIFIDPRU* 7 Annex 3R.

7.1.13 G Where a *firm* ceases to meet the conditions necessary for it to fall within *MIFIDPRU* 7.1.4R(1)(a) or (b), but subsequently meets the conditions again within a period of 3 *months*, the *firm* will still be subject to *MIFIDPRU* 7.3 6 *months* after the date on which it first ceased to meet the conditions. The *firm* will only cease to be subject to *MIFIDPRU* 7.3 where it meets the conditions in *MIFIDPRU* 7.1.9R.

7.2 Senior management and systems and controls

Internal governance

7.2.1 R (1) A *MIFIDPRU investment firm* must have robust governance arrangements, including:

(a) a clear organisational structure with well defined, transparent and consistent lines of responsibility;

(b) effective processes to identify, manage, monitor and report the risks the *firm* is or might be exposed to, or pose or might pose to others; and

(c) adequate internal control mechanisms, including sound administration and accounting procedures.

(2) The arrangements referred to in (1) must:

(a) be appropriate and proportionate to the nature, scale and complexity of the risks inherent in the business model and the activities of the *firm*; and

(b) be compatible with the requirements in the *FCA Handbook* relating to risk management and internal governance, for example those in *MIFIDPRU* 7 and *SYSC*, that apply to the *firm*.

7.2.2 G When establishing and maintaining the arrangements referred to in *MIFIDPRU* 7.2.1R(1), a *firm* should consider at least the following:

(1) the requirements that apply to the *firm* under *MIFIDPRU* 7 and *SYSC* 19G (MIFIDPRU Remuneration Code);

(2) the legal structure of the *firm*, including its ownership and funding structure;

(3) whether the *firm* is part of a *group*;

(4) the type of activities for which the *firm* is authorised, including the complexity and volume of those activities;

(5) the business model and strategy of the *firm*, including its risk strategy, risk appetite and risk profile;

(6) the types of client the *firm* has;

(7) the outsourced functions and distribution channels of the *firm*; and

(8) the *firm's* existing IT systems, including continuity systems.

7.3 Risk, remuneration and nomination committees

Risk committee

7.3.1 R (1) A *non-SNI MIFIDPRU investment firm* to which this *rule* applies must establish a risk committee.

(2) Subject to (3), a *firm* must ensure that:

(a) at least fifty percent of the members of the risk committee are members of the *management body* who do not perform any executive function in the *firm*; and

(b) the chair of the risk committee is a member of the *management body* who does not perform any executive function in the *firm*.

(3) The requirements in (2) do not apply to a *firm* that, solely because of its legal structure, cannot have members of the *management body* who do not perform any executive function in the *firm*.

(4) Members of the risk committee must have the appropriate knowledge, skills and expertise to fully understand, manage and monitor the risk strategy and the risk appetite of the *firm*.

(5) The risk committee must advise the *management body* on the *firm's* overall current and future risk appetite and strategy and assist the *management body* in overseeing the implementation of that strategy by *senior management*.

(6) Notwithstanding the role of the risk committee, the *management body* of a *firm* has overall responsibility for the *firm's* risk strategies and policies.

7.3.2 G (1) *MIFIDPRU* 7.3.1R(2) only applies to *firms* that are required to establish a risk committee under *MIFIDPRU* 7.3.1R(1).

(2) The chair may be included for the purposes of calculating the fifty percent referred to in *MIFIDPRU* 7.3.1R(2)(a).

(3) Where a *firm* has established a risk committee, the *FCA* expects that its responsibilities will typically include:

(a) providing advice to the *firm's management body* on risk strategy, including the oversight of current risk exposures of the *firm*, with particular, but not exclusive, emphasis on prudential risks;

(b) developing proposals for consideration by the *management body* in respect of overall risk appetite and tolerance, as well as the metrics to be used to monitor the *firm's* risk management performance;

(c) oversight and challenge of the design and execution of stress and scenario testing;

(d) oversight and challenge of the day-to-day risk management and the executive's oversight arrangements;

(e) oversight and challenge of due diligence on risk issues relating to material transactions and strategic proposals that are subject to approval by the *management body*;

(f) providing advice to the *firm's remuneration* committee, as appropriate, in relation to the development, implementation and review of remuneration policies and practices that are consistent with, and promote, effective risk management;

(g) providing advice, oversight and challenge necessary to embed and maintain a supportive risk culture throughout the *firm*.

Remuneration committee

7.3.3 R (1) A *non-SNI MIFIDPRU investment firm* to which this *rule* applies must establish a *remuneration* committee.

(2) Subject to (3), a *firm* must ensure that:

(a) at least fifty percent of the members of the *remuneration* committee are members of the *management body* who do not perform any executive function in the *firm*; and

(b) the chair of the *remuneration* committee is a member of the *management body* who does not perform any executive function in the *firm*.

(3) The requirements in (2) do not apply to a *firm* that, solely because of its legal structure, cannot have members of the *management body* who do not perform any executive function in the *firm*.

(4) A *firm* must ensure that the *remuneration* committee is constituted in a way that enables it to exercise competent and independent judgment on *remuneration* policies and practices and the incentives created for managing risk, capital and liquidity.

(5) The *remuneration* committee must be responsible for preparing decisions regarding *remuneration*, including decisions which have implications for the risk and risk management of the *firm* and which are to be taken by the *management body*.

(6) When preparing such decisions, the *remuneration* committee must take into account the public interest and the long-term interests of shareholders, investors and other stakeholders in the *firm*.

7.3.4 G (1) *MIFIDPRU* 7.3.3R(2) only applies to *firms* that are required to establish a *remuneration* committee under *MIFIDPRU* 7.3.3R(1).

(2) The chair may be included for the purposes of calculating the fifty percent referred to in *MIFIDPRU* 7.3.3R(2)(a).

Nomination committee

7.3.5 R (1) A *non-SNI MIFIDPRU investment firm* to which this *rule* applies must establish a nomination committee.

(2) Subject to (3), a *firm* must ensure that:

(a) at least fifty percent of the members of the nomination committee are members of the *management body* who do not perform any executive function in the *firm*; and

(b) the chair of the nomination committee is a member of the *management body* who does not perform any executive function in the *firm*.

(3) The requirements in (2) do not apply to a *firm* that, solely because of its legal structure, cannot have members of the *management body* who do not perform any executive function in the *firm*.

(4) A *firm* must ensure that:

(a) the nomination committee is able to use any forms of resources the nomination committee deems appropriate, including external advice; and

(b) the nomination committee receives appropriate funding.

7.3.6 G (1) *MIFIDPRU* 7.3.5R(2) only applies to *firms* that are required to establish a nomination committee under *MIFIDPRU* 7.3.5R(1).

(2) The chair may be included for the purposes of calculating the fifty percent referred to in *MIFIDPRU* 7.3.5R(2)(a).

Establishing committees at group level

7.3.7 G (1) A *firm* may apply to the *FCA* for a modification under section 138A of the *Act* to permit the *firm* to establish a risk committee, *remuneration* committee or nomination committee at *group* level instead of complying with the requirement on an individual basis.

(2) The *FCA* may grant a modification under section 138A of the *Act* for these purposes only where it is satisfied that:

(a) compliance by the *firm* with the requirement to establish a committee on an individual basis would be unduly burdensome or would not achieve the purpose for which the *rules* were made; and

(b) granting the modification would not adversely affect the advancement of any of the *FCA's* objectives.

(3) To be satisfied that granting the modification would not affect the advancement of any of the *FCA's* objectives under (2)(b), the *FCA* would normally expect the *firm* to demonstrate that the committee established at *group* level:

(a) meets the composition requirements in *MIFIDPRU* 7.3.1R(2), *MIFIDPRU* 7.3.3R(2) or *MIFIDPRU* 7.3.5R(2), as applicable; and

(b) has members with the appropriate knowledge, skills and expertise in relation to the *firm* subject to the requirement to establish a committee.

7.4 Internal capital adequacy and risk assessment (ICARA) process: overview and baseline obligations

7.4.1 R This section applies to a *MIFIDPRU investment firm*.

Purpose

7.4.2 G *MIFIDPRU* 7.4 to *MIFIDPRU* 7.9 contain *rules* and *guidance* which supplement the overarching requirements for *MIFIDPRU investment firms* under:

(1) the appropriate resources *threshold condition* in Schedule 6 to the *Act* (as explained in *COND* 2.4) under which a *firm* must have appropriate resources in relation to the *regulated activities* that it carries on; and

(2) *Principle* 4 (Financial prudence) under which a *firm* must maintain adequate financial resources.

7.4.3 G (1) The overall purpose of the *rules* in *MIFIDPRU* 7.4 to *MIFIDPRU* 7.9, taken together with the other requirements in *MIFIDPRU*, is to ensure that a *MIFIDPRU investment firm*:

(a) has appropriate systems and controls in place to identify, monitor and, where proportionate, reduce all potential material harms that may result from the ongoing operation of its business or winding down its business; and

(b) holds financial resources that are adequate for the business it undertakes.

(2) The requirement for adequate financial resources is designed to achieve two key outcomes for *MIFIDPRU investment firms*:

(a) to enable a *firm* to remain financially viable throughout the economic cycle, with the ability to address any potential material harms that may result from its ongoing activities (including both *regulated activities* and *unregulated activities*); and

(b) to enable the *firm* to conduct an orderly wind-down while minimising harm to *consumers* or to other market participants, and without threatening the integrity of the wider *UK* financial system.

(3) The *rules* and *guidance* in *MIFIDPRU* 7.4 to *MIFIDPRU* 7.9 build upon the *FCA's* general approach to assessing the adequacy of financial resources explained in Finalised Guidance FG20/1. *Firms* should also refer to that *guidance* when considering their obligations under those sections of *MIFIDPRU*.

7.4.4 G The *FCA* recognises that:

(1) it will not be possible for the *FCA* or *firms* to eliminate all potential risks and sources of harm;

(2) there is a vast range of harms that might theoretically materialise, but the *FCA* and *firms* should focus on material harms, adopting a proportionate and risk-based approach to each *firm's* business and operating model; and

(3) some *firms* may still fail, but the *FCA* and *firms* should aim to ensure that any wind-down of those *firms* occurs in an orderly manner, minimising the impact on *consumers* and the wider market.

Proportionality and application to different business models

7.4.5 G Although all *MIFIDPRU investment firms* are subject to the appropriate resources *threshold condition* and *Principle* 4, the practical steps that a *firm* must take to meet these requirements will vary according to the *firm's* business model and operating model. Therefore, the *FCA* expects that a large or complex *firm* will generally need to take a more detailed approach to the monitoring and management of a wider range of potential harms than a smaller *firm* carrying on simpler activities.

7.4.6 G (1) *MIFIDPRU* 7.4 to *MIFIDPRU* 7.8 contain a set of core requirements that the *FCA* expects every *MIFIDPRU investment firm* to incorporate into its *ICARA process*. This does not mean that the manner in which each *firm* implements these core requirements will be identical. When considering the appropriate way to satisfy these core requirements, a *firm* should focus on the potential material harms that may arise:

(a) from the ongoing operation of its business; and

(b) during a wind-down of its business.

(2) *MIFIDPRU* 7.5 to *MIFIDPRU* 7.8 also contain some additional requirements that the *FCA* would expect larger or more complex *MIFIDPRU investment firms* to incorporate into their *ICARA processes*. Again, the precise manner in which these additional requirements are implemented must take into account the *firm's* business model and operating model and its potential to cause material harms.

Overall financial adequacy rule

7.4.7 R (1) A *firm* must, at all times, hold *own funds* and *liquid assets* which are adequate, both as to their amount and their quality, to ensure that:

(a) the *firm* is able to remain financially viable throughout the economic cycle, with the ability to address any material potential harm that may result from its ongoing activities; and

(b) the *firm's* business can be wound down in an orderly manner, minimising harm to *consumers* or to other market participants.

(2) The requirement in (1) is known as the *overall financial adequacy rule*.

7.4.8 G (1) The *overall financial adequacy rule* establishes the standard that the *FCA* will apply to determine if a *MIFIDPRU investment firm* has adequate financial resources. The amount and quality of *own funds* and *liquid assets* that each *firm* must hold will vary according to its business model and operating model, the environment in which it operates and the nature of its internal systems and controls.

(2) The remainder of this section explains the basic requirements of the *ICARA process*. The *ICARA process* is the collective term for the internal systems and controls that a *firm* must operate to identify and manage potential material harms that may arise from the operation of its business, and to ensure that its operations can be wound down in an orderly manner.

(3) The *firm* should use the *ICARA process* to identify whether it is complying with the *overall financial adequacy rule*. The focus of the *ICARA process* is on identifying and managing risks that may result in material harms. Depending on the nature of the potential harms identified, it may be that the only realistic option to manage

them and to comply with the *overall financial adequacy rule* is to hold additional *own funds* or additional *liquid assets* above the *firm's own funds requirement* or *basic liquid assets requirement* respectively. However, in other cases, the *FCA* recognises that there may be more appropriate or effective ways to manage the potential harms. *MIFIDPRU* 7.4.16G contains further *guidance* on reducing the risk of material potential harms.

(4) *MIFIDPRU* 7.6 contains specific *rules* and *guidance* about how a *firm* should use the *ICARA process* to assess the *own funds* that the *firm* requires to comply with the *overall financial adequacy rule*.

(5) *MIFIDPRU* 7.7 contains specific *rules* and *guidance* about how a *firm* should use the *ICARA process* to assess the *liquid assets* that the *firm* requires to comply with the *overall financial adequacy rule*.

(6) *MIFIDPRU* 7.9 contains *guidance* on how the *FCA* will normally conduct a *SREP* on a *firm's ICARA process* or may conduct a thematic review of a sector in which multiple *firms* are active. Where the *FCA* considers that the *firm's ICARA process* has not adequately identified and managed the risks of material harm occurring, the *FCA* may require the *firm* to take corrective action. In appropriate cases, this may include requiring the *firm* to hold additional *own funds* or *liquid assets* to ensure that the *firm* is complying with the *overall financial adequacy rule*. The *FCA* may take supervisory action in connection with the prudential requirements of a *MIFIDPRU investment firm* outside the context of a *SREP* where it considers it necessary or desirable to do so. Where the *FCA* has conducted a sectoral review, it may impose additional requirements on some or all *firms* that are active in the relevant sector.

ICARA process: baseline obligations

7.4.9 R (1) A *firm* must have in place appropriate systems and controls to identify, monitor and, if proportionate, reduce all material potential harms:

(a) that the ongoing operation of the *firm's* business might cause to:

(i) the *firm's clients* and counterparties;

(ii) the markets in which the *firm* operates; and

(iii) the *firm* itself; and

(b) that might result from winding down the *firm's* business, in order to ensure that the *firm* can be wound down in an orderly manner.

(2) If any material potential harms remain after a *firm* has implemented the systems and controls in (1), the *firm* must assess whether to:

(a) hold additional *own funds* to address those harms in accordance with *MIFIDPRU* 7.6.2R; and

(b) hold additional *liquid assets* to address those harms in accordance with *MIFIDPRU* 7.7.2R.

(3) The requirements in this *rule* apply to a *firm's* entire business, including:

(a) all *regulated activities*, irrespective of whether they constitute *MiFID business*; and

(b) any *unregulated activities*.

(4) The systems, controls and procedures operated by a *firm* to comply with the requirements in this *rule* are known as the *ICARA process*.

[**Note:** articles 24(1) and 29(1) of the *IFD*.]

7.4.10 R A *firm's ICARA process* must be proportionate to the nature, scale and complexity of the business carried on by the *firm*.

[**Note:** article 24(2), first paragraph of the *IFD*.]

7.4.11 R A *firm* must ensure that its *ICARA process* complies with the applicable requirements in *MIFIDPRU* 7.4 to *MIFIDPRU* 7.8 in a consistent and coherent manner.

7.4.12 G (1) *MIFIDPRU* 7.4.11R requires a *firm* to ensure that the inputs to, analyses applied by, and conclusions arising from, its *ICARA process* are properly linked and reflect a consistent and coherent analysis of the *firm's* business and operating model.

(2) Without prejudice to the generality of *MIFIDPRU* 7.4.11R, the *FCA* would consider the following to be examples of consistency and coherence required by the *ICARA process*:

(a) the potential material harms that the *firm* identifies under *MIFIDPRU* 7.4.13R are consistent with the *firm's* articulation of its business model and strategy under *MIFIDPRU* 7.5.2R(1) and with the *firm's* stated risk appetite under *MIFIDPRU* 7.5.2R(2);

(b) the *firm's* analysis under *MIFIDPRU* 7.5.2R(4) of the *own funds* and *liquid assets* that are necessary to comply with the *overall financial adequacy rule* is consistent with:

(i) the potential impact of the potential material harms that the *firm* identifies under *MIFIDPRU* 7.4.13R;

(ii) the *firm's* projections of its future requirements under *MIFIDPRU* 7.5.2R(4); and

(iii) the impact of the stressed scenarios that the *firm* has identified under *MIFIDPRU* 7.5.2R(5);

(c) the potential recovery actions specified by the *firm* under *MIFIDPRU* 7.5.5R(2) are consistent with the *firm's* projections of its future requirements under *MIFIDPRU* 7.5.2R(4) and the potential stressed scenarios that the *firm* has identified under *MIFIDPRU* 7.5.2R(5);

(d) the *firm's* wind-down planning under *MIFIDPRU* 7.5.7R is consistent with the levels of *own funds* and *liquid assets* that the *firm* has assessed would be necessary to wind-down the *firm* for the purposes of the *overall financial adequacy rule* and with the *firm's* assessment of the potential harms that might result from winding down its business under *MIFIDPRU* 7.4.13R; and

(e) the *firms'* wind-down planning is consistent with the potential recovery actions specified by the *firm* under *MIFIDPRU* 7.5.5R(2) and the circumstances in which the *firm* has concluded that no further recovery actions would be feasible or desirable.

ICARA process: identifying harms

7.4.13 R As part of its *ICARA process*, a *firm* must assess its business model and identify all material harms that could result from:

(1) the ongoing operation of the *firm's* business; and

(2) the winding-down of the *firm's* business.

7.4.14 G When assessing potential material harms for the purpose of *MIFIDPRU* 7.4.13R, the *FCA* considers that the following non-exhaustive considerations will be relevant:

(1) the level of detail required in the assessment is likely to vary depending on the complexity of the business and operating model. More complex business and operating models are generally likely to involve a wider range of potential material harms and so will generally require a more detailed assessment;

(2) the obligation under *MIFIDPRU* 7.4.13R is to identify all material harms that could result from the *firm's* business, even if those harms can be appropriately mitigated. It is important that a *firm*

starts by identifying all potential material harms that could arise from its business and operating model. The issue of how the identified harms can be mitigated should be considered separately afterwards, including assessing under *MIFIDPRU* 7.6 and 7.7 whether the *firm* should hold additional *own funds* and *liquid assets*;

(3) the potential for harm may evolve throughout the course of an economic cycle. Therefore, the assessment should consider how the risk of harm may develop in the future, rather than simply performing a static assessment based on current economic circumstances;

(4) risks to the *firm* itself may result in an increased risk of harm to the *firm's clients* or counterparties and therefore should form part of the assessment. For example, if the *firm* is affected by a significant disruption or suffers a significant loss, this may prevent the *firm* from providing important services to *clients* or from being able to meet its liabilities to counterparties. Significant and unexpected financial losses sustained by a *firm* may also decrease the financial resources available to the *firm* to address other potential harms and may increase the risk of disorderly wind-down and sudden disruption of services to the *firm's clients*; and

(5) *firms* should refer to the guidance in Finalised Guidance FG20/1 on "Identifying and assessing the risk of harm" when assessing the impact of potential harms.

7.4.15 G (1) *MIFIDPRU* 7 Annex 1 contains additional *guidance* on identifying potential material harms that the *FCA* considers will generally be relevant to the business models of most *firms*.

(2) *MIFIDPRU* 7 Annex 2 contains additional *guidance* on identifying potential material harms that the *FCA* considers is likely to be relevant to *firms* that *deal on own account* or hold significant investments on their balance sheets. This *guidance* is intended to apply in addition to the general *guidance* in *MIFIDPRU* 7 Annex 1.

(3) The *FCA* may issue further *guidance* or publish additional information in the future to reflect its observations of how *firms* are implementing the *ICARA process* or to take into account developments in relation to particular products or sectors. *Firms* should have regard to any additional *guidance* or information that the *FCA* may publish when applying the requirements in this section.

ICARA process: risk mitigation

7.4.16 G (1) The *ICARA process* is an internal risk management process that a *MIFIDPRU investment firm* must operate on an ongoing basis. As part of that process, the *FCA* expects that a *firm* will consider whether the risk of material potential harms can be reduced through proportionate measures (other than holding additional financial resources) and, if so, whether it is appropriate to implement such measures. The nature of any potential measures will vary depending on the *firm's* business and operating model. Examples may include implementing additional internal systems and controls, strengthening governance and oversight processes or changing the manner in which the *firm* conducts certain business. A *firm* will need to form a judgement about what is appropriate and proportionate in its particular circumstances. That judgement will be informed by the *firm's* risk appetite.

(2) A *firm* will need to assess whether it should hold additional *own funds* or additional *liquid assets* to mitigate any material potential harms that it has identified. This may be the case where the *firm* cannot identify other appropriate, proportionate measures to mitigate harms, or where it has applied such measures, but a residual risk of material harm remains. Any such assessment must be realistic and based on severe but plausible assumptions.

7.5 ICARA process: capital and liquidity planning, stress testing, wind-down planning and recovery planning

7.5.1 R This section applies to a *MIFIDPRU investment firm*.

Business model assessment and capital and liquidity planning

7.5.2 R As part of its *ICARA process*, a *firm* must:

(1) have a clearly articulated business model and strategy;

(2) have a clearly articulated risk appetite that is consistent with the business model and strategy identified under (1);

(3) identify any material risks of misalignment between the *firm's* business model and operating model and the interests of its *clients* and the wider financial markets, and evaluate whether those risks have been adequately mitigated;

(4) consider on a forward-looking basis the *own funds* and *liquid assets* that will be required to meet the *overall financial adequacy rule*, taking into account any planned future growth; and

(5) consider relevant severe but plausible stresses that could affect the *firm's* business and consider whether the *firm* would still have sufficient *own funds* and *liquid assets* to meet the *overall financial adequacy rule*.

Stress testing and reverse stress testing requirement

7.5.3 G *MIFIDPRU* 7.5.2R(5) requires a *firm* to use stress testing to identify whether it holds sufficient *own funds* and *liquid assets*. *Firms* should refer to Finalised Guidance FG20/1 for specific guidance on the *FCA's* expectations in relation to stress testing.

7.5.4 G (1) As part of their business model assessment and capital and liquidity planning under *MIFIDPRU* 7.5.2R, the *FCA* expects that *firms* with larger or more complex businesses will also undertake:

(a) more in-depth stress testing of their business model and strategy; and

(b) reverse stress testing.

(2) Such *firms* should refer to *MIFIDPRU* 7 Annex 1.15G to *MIFIDPRU* 7 Annex 1.20G for additional information about the *FCA's* expectations in relation to more in-depth stress testing and reverse stress testing.

Recovery actions

7.5.5 R As part of its *ICARA process*, a *firm* must:

(1) identify levels of *own funds* and *liquid assets* that the *firm* considers, if reached, may indicate that there is a credible risk that the *firm* will breach its *threshold requirements*; and

(2) identify potential recovery actions that the *firm* would expect to take:

(a) to avoid a breach of the *firm's threshold requirements* where the *firm's own funds* or *liquid assets* fall below the levels identified in (1); and

(b) to restore compliance with its *threshold requirements* if the *firm* were to breach its *threshold requirements* during a period of financial difficulty.

7.5.6 G (1) The *FCA* considers that when a *firm* is considering potential recovery actions that the *firm* might take for the purposes of *MIFIDPRU* 7.5.5R, the following non-exhaustive list of considerations may be relevant:

(a) the governance arrangements of the *firm*, and in particular which *individuals* will be responsible for taking the relevant decisions within the required timeframe;

(b) the key business lines operated by the *firm* and the critical functions that the *firm* will need to maintain, and the steps necessary to ensure that these can continue to operate;

(c) the level of *own funds* and *liquid assets* that the *firm* is likely to need to restore compliance with the *threshold requirements*;

(d) the options available to the *firm* to raise additional *own funds* or *liquid assets*;

(e) the options available to the *firm* to conserve existing *own funds* or *liquid assets*;

(f) any significant risks that may arise in connection with proposed recovery actions; and

(g) any material impediments that may exist to implementing proposed recovery actions and whether these can be resolved or mitigated.

(2) The *FCA* expects that a *firm* will adopt a proportionate approach to identifying potential recovery actions, taking into account the nature, scale and complexity of the *firm's* business and operating model. The actions that the *firm* proposes must be credible and justifiable, taking into account the circumstances in which such actions may be likely to be required.

Wind-down planning and wind-down triggers

7.5.7 R As part of its *ICARA process*, a *firm* must:

(1) identify the steps and resources that would be required to ensure the orderly wind-down and termination of the *firm's* business over a realistic timescale; and

(2) evaluate the potential harms arising from winding down the *firm's* business and identify how to mitigate them.

[**Note:** articles 24 and 29(2) of the *IFD*.]

7.5.8 G When carrying out a wind-down planning assessment under *MIFIDPRU* 7.5.7R and determining the timeline and any required actions, a *firm* should refer to the guidance in the *FCA's* Wind-Down Planning Guide and in Finalised Guidance FG20/1.

7.5.9 R (1) A *firm* must use its wind-down analysis under *MIFIDPRU* 7.5.7R to assess the amount of *own funds* and *liquid assets* that would be required to ensure an orderly wind-down of its business for the purposes of the *overall financial adequacy rule*.

(2) The *firm's* assessment in (1) must not result in amounts that are lower than:

(a) in the case of *own funds*, the *firm's fixed overheads requirement*; and

(b) in the case of *liquid assets*, the *firm's basic liquid assets requirement*.

7.5.10 G (1) The *overall financial adequacy rule* requires a *MIFIDPRU investment firm* to hold sufficient *own funds* and *liquid assets* to ensure that it can wind down its business in an orderly manner (as well as to operate its business on an ongoing basis). *MIFIDPRU* 7.5.9R requires a *firm* to use its wind-down analysis to assess the appropriate level of *own funds* and *liquid assets* for these purposes.

(2) A *firm's* assessment of the amounts that it needs to hold under the *overall financial adequacy rule* to ensure that it can be wound down in an orderly manner must never be lower than its *wind-down triggers*. The *firm* may conclude, however, that it would require amounts that are higher than these minimum amounts in order to ensure an orderly wind-down.

(3) In appropriate cases, the *FCA* may consider that either or both of a *firm's wind-down triggers* should be set at a higher level. In such cases, the *FCA* may invite a *firm* to apply for a *requirement* in accordance with section 55L(5) of the *Act*, or may impose a *requirement* on the *FCA's* own initiative in accordance with section 55L(3) of the *Act*, for the *firm* to use an alternative *wind-down trigger* for these purposes.

(4) If the *firm's own funds* fall below the *own funds wind-down trigger* or if the *firm's liquid assets* fall below the *liquid assets wind-down trigger*, the *FCA* would normally expect that the *firm* would commence winding down, unless the *firm's governing body* has determined that there is an imminent and credible likelihood of recovery. The potential supervisory actions that the *FCA* may decide to take in such circumstances are explained in further detail in *MIFIDPRU* 7.6 in relation to the *own funds wind-down trigger* and *MIFIDPRU* 7.7 in relation to the *liquid assets wind-down trigger*.

(5) Where a *firm's own funds* or *liquid assets* fall below the level that is required to ensure an orderly wind-down of the *firm*, this will be a breach of the *overall financial adequacy rule*. However, as explained further in *MIFIDPRU* 7.6 in relation to *own funds* and *MIFIDPRU* 7.7 in relation to *liquid assets*, this does not mean that the *FCA* expects a *firm* to commence winding down immediately upon breaching the *overall financial adequacy rule*. It is only when the *firm* breaches one or both of the *wind-down triggers* that there is a general presumption that the *firm* should wind-down. Where the *firm* has breached the *overall financial adequacy rule* but continues to hold *own funds* and *liquid assets* that exceed the *wind-*

down triggers, the *FCA* would typically expect to take the intervention measures set out in *MIFIDPRU* 7.6.15G and *MIFIDPRU* 7.7.16G, as appropriate. However, there may be specific cases where the *firm's* financial position and the projections of its likely future financial resources mean that commencing a wind-down would be appropriate, even though the *firm* has not yet breached the *wind-down triggers*. The *FCA* will consider the appropriate supervisory actions in such cases according to their particular facts.

7.6 ICARA process: assessing and monitoring the adequacy of own funds

7.6.1 R This section applies to a *MIFIDPRU investment firm*.

7.6.2 R As part of its *ICARA process*, a *firm* must produce a reasonable estimate of the *own funds* it needs to hold to address:

(1) any potential material harms that the *firm* has identified under *MIFIDPRU* 7.4.13R and in relation to which it has not taken any measures to reduce the impact of such harms under *MIFIDPRU* 7.4.9R; and

(2) any residual potential material harms that remain after the *firm* has taken measures to reduce the impact of such harms under *MIFIDPRU* 7.4.9R.

7.6.3 R (1) A *firm* must assess whether, as a result of its analysis under *MIFIDPRU* 7.6.2R, it should hold additional *own funds* in excess of its *own funds requirement* to comply with the *overall financial adequacy rule*.

(2) When carrying out the assessment in (1), a *firm* must not:

(a) determine that it needs a lower level of *own funds* for an activity or harm than is required by a *rule* in *MIFIDPRU* 4 (Own funds requirements) or *MIFIDPRU* 5 (Concentration risk); or

(b) use components of the *own funds requirement* to cover potential material harms that cannot reasonably be attributed to that component.

7.6.4 G (1) The *overall financial adequacy rule* requires a *firm* to hold adequate *own funds* to ensure that:

(a) the *firm* is able to remain financially viable throughout the economic cycle, with the ability to address any potential material harms that may result from its ongoing activities; and

(b) the *firm's* business can be wound down in an orderly manner.

(2) In order to comply with the *overall financial adequacy rule*, a *firm* must therefore hold the higher of:

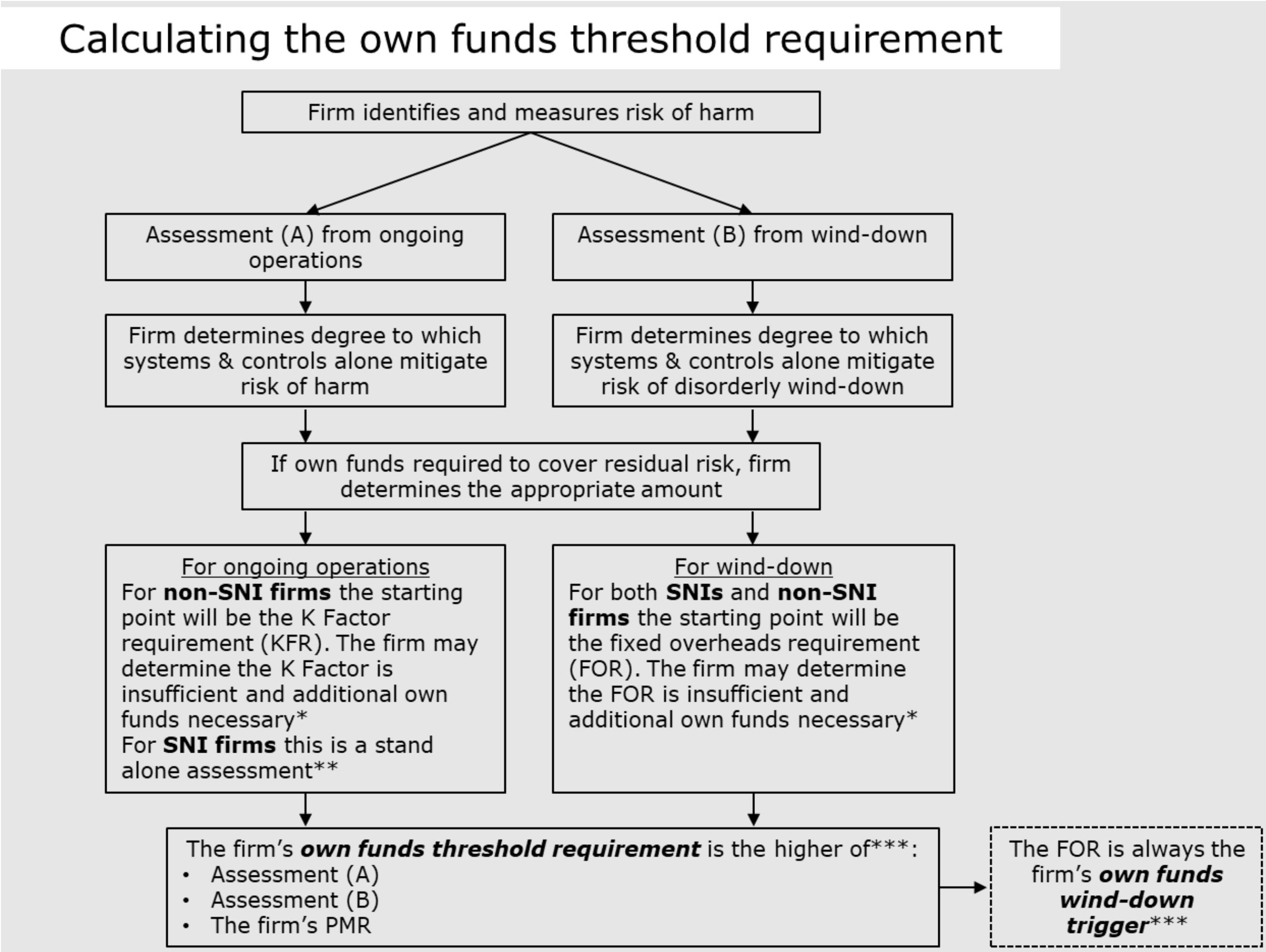
(a) the amount of *own funds* that the *firm* requires at any given point in time to fund its ongoing business operations, taking into account potential periods of financial stress during the economic cycle; and

(b) the amount of *own funds* that a *firm* would need to hold to ensure that the *firm* can be wound down in an orderly manner.

(3) The *own funds threshold requirement* is the amount of *own funds* that a *firm* needs to hold at any given time to comply with the *overall financial adequacy rule*.

(4) The *firm's* analysis of potential material harms under *MIFIDPRU* 7.6.2R is particularly relevant when it is considering the level of *own funds* that are necessary for the ongoing operation of its business, but will also be relevant when considering how the *firm* should address potential material harms as part of an orderly wind-down.

(5) The following diagram summarises the process that a *firm* should undertake to determine its *own funds threshold requirement*:



*	The *own funds threshold requirement* cannot be lower than the *K-factor requirement* or the *fixed overheads requirement*.
**	The *K-factor requirement* does not apply to *SNI MIFIDPRU investment firms* and the *permanent minimum capital requirement* (PMR) is not linked to harm.
***	Unless otherwise specified by the *FCA*.

7.6.5 R (1) Unless (2) applies, a *firm* must meet its *own funds threshold requirement* with *own funds* that satisfy the following conditions:

(a) subject to (b), at least 75% of the *own funds threshold requirement* must be met with any combination of *common equity tier 1 capital* and *additional tier 1 capital*; and

(b) at least 56% of the *own funds threshold requirement* must be met with *common equity tier 1 capital*.

(2) The *FCA* may specify an alternative combination of *own funds* for the purpose of (1) in a *requirement* applied to the *firm*.

7.6.6 G (1) *MIFIDPRU* 7.6.7G and 7.6.8G explain the approach that the *FCA* expects a *non-SNI MIFIDPRU investment firm* would apply to carry out the assessment in *MIFIDPRU* 7.6.3R.

(2) *MIFIDPRU* 7.6.9G explains the approach that the *FCA* expects an *SNI MIFIDPRU investment firm* would apply to carry out the assessment in *MIFIDPRU* 7.6.3R.

(3) *MIFIDPRU* 7.6.10G explains the approach that the *FCA* would expect all *MIFIDPRU investment firms* to apply when assessing its *own funds threshold requirement*.

7.6.7 G (1) *MIFIDPRU* 4 and 5 explain how a *firm* must determine its *own funds requirement*. Where, as part of its *ICARA process*, a *firm* has identified potential material harms that cannot be fully mitigated, the *firm* should first consider the extent to which the impact of the residual harm on *own funds* is covered (wholly or partly) by the framework in *MIFIDPRU* 4 and 5.

(2) Example 1: If the potential material harm arises from the ordinary course of the *firm's portfolio management* business, a *non-SNI MIFIDPRU investment firm* should consider the potential impact of the harm by comparison with the *firm's K-AUM requirement*. If the harm is a harm that might typically arise from *portfolio management*, the *firm* may treat the harm as covered by the *K-AUM requirement*. However, if the harm is unusual in nature or might be particularly severe (for example, fraud or other irregularities), it would be unreasonable for the *firm* to treat the harm as fully covered by the *K-AUM requirement*. This is because the *K-AUM requirement* is designed to address typical harms from ordinary *portfolio management*, and not every conceivable material harm that might result from such activity.

(3) Example 2: If the potential material harm arises from the ordinary course of the *firm* investing its own proprietary capital in positions allocated to the *trading book*, a *non-SNI MIFIDPRU firm* should consider the nature of that harm. For example, if the harm relates to the ordinary operational aspects of *dealing on own account*, the *firm* may treat the harm as covered by the *K-DTF requirement*, unless the harm is unusual or particularly severe. If the harm arises from adverse market movements in relation to the *firm's trading book* positions, the *firm* may treat the harm as covered by the *K-NPR requirement* (or *K-CMG requirement* if the position arises in a *portfolio* for which the *firm* has received a *K-CMG permission*), unless the relevant positions have particular features that mean the harm may be unusual or particularly severe in nature.

(4) Example 3: Some components of the *K-factor requirement*, such as the *K-CON requirement*, reflect specific types of harm. In that case, the *firm* should consider the purpose of the relevant requirement. As the *K-CON requirement* is designed to address the potential harm arising from a *firm* having concentrated exposures to a counterparty or group of connected counterparties, a *non-SNI MIFIDPRU investment firm* should only compare a harm to the *K-CON requirement* where that harm arises from, or is connected to, such concentrated exposures.

(5) Example 4: When assessing harms that may occur during a wind-down of the *firm's* business, a *non-SNI MIFIDPRU investment firm* should consider the potential impact of the harm by comparison with its *fixed overheads requirement*. In that case, the *firm* should identify the likely costs of winding down the *firm* and the potential financial impact of any material harms that might occur while doing so and compare the aggregate amount with the *fixed overheads requirement*. This will allow such *firms* to determine if they are holding sufficient *own funds* to ensure an orderly wind-down, as required by the *overall financial adequacy rule*.

7.6.8 G (1) Some harms may not fit within the *own funds requirement* framework in *MIFIDPRU* 4 or 5 because they cannot reasonably be attributed to the activities or risks that the *rules* in those chapters are designed to address. Where those harms are potentially material in nature, a *non-SNI MIFIDPRU investment firm* will need to assess their potential financial impact separately and cannot treat those harms as covered (either wholly or partly) by a requirement under *MIFIDPRU* 4 or 5. This includes the potential material harms resulting from any *regulated activities* that do not constitute *MiFID business* and from any *unregulated activities*.

(2) Example 1: A *non-SNI MIFIDPRU investment firm* undertakes significant amounts of *corporate finance business*. The *K-factor requirement* does not include any components which are designed to address the potential harms arising from such business, as none of the *K-factor metrics* relate to *corporate finance business*. If the *firm* identifies potential material harms that may arise from its corporate finance activities, it cannot therefore compare that harm to any part of the *K-factor requirement*. In that case, the *firm* will need to assess the potential financial impact of that harm and will need to hold additional *own funds* to cover that impact.

(3) Example 2: A *non-SNI MIFIDPRU investment firm* holds *client money* in connection with *designated investment business* that is not *MiFID business*. The *K-CMH requirement* applies only to *MiFID client money*. If the *firm* identifies potential material harms that result from holding *client money* for non-*MiFID business*, it will therefore need to assess the potential financial impact of that harm and hold additional *own funds* to cover that impact. Similarly,

if there are material issues arising from currency mismatches in relation to *MiFID client money*, this may be a risk that is not adequately covered by the *K-CMH requirement*.

7.6.9 G (1) *SNI MIFIDPRU investment firms* are not subject to the *K-factor requirement*. In practice, this means that their *own funds requirement* is typically determined by the *fixed overheads requirement*, although for smaller *firms*, the *permanent minimum capital requirement* may be determinative.

(2) *SNI MIFIDPRU investment firms* should therefore identify all relevant potential material harms from their ongoing business operations that cannot be mitigated by other means and estimate their impact on the *firm's own funds*. They should then compare the aggregate financial impact on *own funds* with the *firm's fixed overheads requirement* (or, if higher, the *permanent minimum capital requirement*).

(3) Separately, *SNI MIFIDPRU investment firms* should also identify the likely costs of winding down the *firm* and the potential financial impact of any material harms that might occur while doing so and should compare the aggregate amount with the *fixed overheads requirement*. This will allow such *firms* to determine if they are holding sufficient *own funds* to ensure an orderly wind-down, as required by the *overall financial adequacy rule*.

(4) Where an *SNI MIFIDPRU investment firm* is close to exceeding one or more of the thresholds in *MIFIDPRU* 1.2.1R that would result in the *firm* being reclassified as a *non-SNI MIFIDPRU investment firm*, the *FCA* considers that the *firm* should begin to compare its assessment of the *own funds* that it needs to comply with the *overall financial adequacy rule* with the *K-factor requirement* that would apply to the *firm* if it were a *non-SNI MIFIDPRU investment firm*. The *guidance* in *MIFIDPRU* 7.6.7G and 7.6.8G will be relevant in such circumstances. This will ensure that the *firm* is better prepared to comply with the additional obligations in *MIFIDPRU* 4 and 5, and to ensure that its *ICARA process* is calibrated appropriately, at the point at which the *firm* becomes a *non-SNI MIFIDPRU investment firm*.

7.6.10 G (1) *MIFIDPRU* 7.6.7G to *MIFIDPRU* 7.6.9G explain the approach that a *firm* should take to determine if a potential harm is covered by the *firm's own funds requirement*. Where a *firm* has identified potential harms that are not covered by its *own funds requirement*, or are covered only partly by its *own funds requirement*, the *firm* should aggregate the estimated financial impact of those harms to determine the overall additional amount of *own funds* (i.e. above its *own funds requirement*) that the *firm* needs to comply with the *overall financial adequacy rule*.

(2) Where the *FCA* disagrees with a *firm's* assessment of the amount of *own funds* that is required by the *overall financial adequacy rule*, the *FCA* may provide individual *guidance* to that *firm* about the amount of *own funds* that the *FCA* considers is necessary to satisfy that *rule*. Alternatively, the *FCA* may apply a *requirement* to the *firm* that specifies an amount of *own funds* that the *firm* must hold for that purpose.

(3) The effect of *MIFIDPRU* 7.6.3R(2) is that a *firm* must not:

(a) determine that it needs a lower level of *own funds* for an activity or harm than is required by a component of the *own funds requirement* that addresses that risk or harm; or

(b) use components of the *own funds requirement* to cover harms that cannot be attributed to that component.

This is illustrated by the example in (4).

(4) Example: A *non-SNI MIFIDPRU investment firm* carries on *portfolio management* and determines that its *K-AUM requirement* is £50,000. However, the *firm* estimates that the actual financial impact of potential harm that may result from its *portfolio management* activities is only £30,000. The *firm* also carries on corporate finance advisory business (which does not give rise to a *K-factor requirement*) and estimates that the financial impact of the potential harm arising from such business is £40,000. The *firm* should not conclude that its *own funds threshold requirement* is £70,000. This is because the *firm* is not permitted to:

(a) conclude that the amount of *own funds* that it holds in relation to its *portfolio management* activities is less than the *K-AUM requirement*. This means that the *firm* is not permitted to substitute its own estimate of £30,000 for the minimum *K-AUM requirement* of £50,000; or

(b) use part of the *K-AUM requirement* to cover potential material harms that do not arise in connection with *portfolio management*. This means that the *firm* cannot reallocate part of the *own funds* that should be held to cover the *K-AUM requirement* to cover risks arising from its corporate finance business.

(5) Instead, assuming that there are no other relevant potential materials harms to be taken into account, the *firm* should conclude that its *own funds threshold requirement* is £90,000, being the sum of the *K-AUM requirement* and the *firm's* estimate of the potential financial impact of harms arising from its corporate finance business.

Requirement to notify the FCA of certain levels of own funds

7.6.11 R (1) A *firm* must notify the *FCA* immediately in each case where its *own funds* fall below the level of the *firm's*:

(a) *early warning indicator*;

(b) *own funds threshold requirement*; or

(c) *own funds wind-down trigger*, or the *firm* considers that there is a reasonable likelihood that its *own funds* will fall below that level in the foreseeable future.

(2) A notification under (1) must include the following information:

(a) a clear statement of the current level of the *firm's own funds* in comparison to:

(i) its *own funds threshold requirement*; and

(ii) in the case of a notification under (1)(c), the *firm's own funds wind-down trigger*;

(b) an explanation of why the *firm's own funds* have reached the current level;

(c) in the case of a notification made under (1)(a), where the *firm* has identified that its *own funds* may fall below a level specified by the *firm* for the purposes of *MIFIDPRU* 7.5.5R(1), the recovery actions that the *firm* intends to take, as identified under *MIFIDPRU* 7.5.5R(2)(a) and 7.5.6G;

(d) in the case of a notification made under (1)(a), confirmation of whether the *firm* expects that its *own funds* could fall below its *own funds threshold requirement* in the foreseeable future and an explanation of why the *firm* has that expectation;

(e) in the case of a notification made under (1)(b), the recovery actions specified for the purposes of *MIFIDPRU* 7.5.5R(2)(b) and 7.5.6G that the *firm* has already taken or will take to restore compliance with its *own funds threshold requirement*; and

(f) in the case of a notification made under (1)(c), the *firm's* intentions in relation to activating its wind-down plan.

(3) A *firm* must submit the notification in (1) via the *online notification and application system* using the form in *MIFIDPRU* 7 Annex 4R.

7.6.12 G In appropriate cases, the *FCA* may consider that the *early warning indicator* should be set at an alternative level to 110% of the *firm's own funds threshold requirement*. In such cases, the *FCA* may invite a *firm* to apply for a *requirement* in accordance with section 55L(5) of the *Act*, or may impose a *requirement* on the *FCA's* own initiative in accordance with section 55L(3) of the *Act*, to provide for notification to the *FCA* if the *firm's own funds* reach the specified alternative level.

7.6.13 G (1) The notification requirement in *MIFIDPRU* 7.6.11R does not replace a *firm's* obligations under:

(a) *Principle* 11 to disclose appropriately to the *FCA* anything relating to the *firm* of which the *FCA* would reasonably expect notice; or

(b) the general notification requirements in *SUP* 15.3.

(2) Where a *firm* has submitted a notification in *MIFIDPRU* 7.6.11R, that notification will generally discharge a *firm's* obligations under *Principle* 11 and the general notification requirements in *SUP* 15.3 in relation to the matters contained in the notification. However, a *firm* must still consider whether the *FCA* should be notified of developments before any of the notification indicators in *MIFIDPRU* 7.6.11R occur. In addition, *Principle* 11 and *SUP* 15.3 may require a *firm* to notify the *FCA* of additional material information that is not specifically referenced in *MIFIDPRU* 7.6.11R.

(3) *MIFIDPRU investment firms* are reminded, in particular, that the *FCA* would generally expect to be notified at an early stage of any significant event which creates a material risk of a *firm* ceasing to hold adequate financial resources, even if the impact of that event has not yet fully materialised.

FCA approach to intervention in relation to own funds

7.6.14 G (1) The table in *MIFIDPRU* 7.6.15G explains the interventions that the *FCA* would generally expect to make where there is evidence that a *MIFIDPRU investment firm* may be at risk of breaching the requirements that apply to its *own funds*. The table sets out the points at which the *FCA* would normally intervene and what actions it would normally take.

(2) The *FCA* would generally expect that the interventions in the table would be cumulative – i.e. in a declining prudential situation, as the *firm* hits each intervention point in turn, the *FCA* would take some or all of the actions associated with that particular point. The actions are intended to be proportionate and progressively stronger responses to address the prudential concerns raised by each intervention point.

(3) However, if the *firm* experiences a sudden adverse event which causes the *firm* to hit multiple intervention points simultaneously, the *FCA* may immediately take the actions associated with the most severe point.

(4) The actions specified in the table are without prejudice to the possibility of the *FCA* taking alternative or additional actions in appropriate cases. The purpose of the table is to provide greater clarity for *firms* on the *FCA's* general expectations and approach to interventions, to assist *firms'* own planning and responses.

7.6.15 G This table belongs to *MIFIDPRU* 7.6.14G.

Intervention point	**Purpose**	**Potential *FCA* supervisory actions**
Early warning indicator: When the *early warning indicator* is triggered, the *firm* must notify the *FCA* under *MIFIDPRU* 7.6.11R(1)(a)	This is intended as an early warning to the *FCA* that the *firm* may be at risk of breaching its *own funds threshold requirement*. This will allow the *firm* and the *FCA* to consider any preventative action that may be appropriate.	Where the notification is not the expected result of planned action by the *firm*, the *FCA* would normally expect the following to occur: (a) a dialogue between the *FCA* and the *firm* based on the information provided in the notification to understand the reason for the decline in the *firm's own funds* and the *firm's* future plans; and (b) enhanced monitoring and supervision of the *firm* by the *FCA*. If, having considered the information provided by the *firm* about its proposed actions, the *FCA* reasonably considers that the *firm* may breach its *own funds threshold requirement* in the foreseeable future, the *FCA* may consider the following additional actions: (c) requesting the *firm* to cease making discretionary distributions of capital, loans to affiliated entities, payments of dividends or payments of variable remuneration;

		(d) requesting the *firm* to take some or all of the recovery actions identified by the *firm* under *MIFIDPRU* 7.5.5R(2) and 7.5.6G; (e) requesting the *firm* to report additional information to the *FCA*; (f) requesting the *firm* to improve its internal risk management and systems and controls; (g) requesting the *firm* to cease making acquisitions; or (h) where appropriate, inviting the *firm* to apply for a *requirement* under section 55L(5) of the *Act*, or imposing a *requirement* on the *FCA's* own initiative under section 55L(3) of the *Act*, in relation to (c) – (g) above.
Threshold requirement notification: *Firm* holding insufficient *own funds* to meet its *own funds threshold requirement*	In the *FCA's* view, where a *firm* is failing to hold sufficient *own funds* to comply with its *own funds threshold requirement*, the *firm* will be failing to meet the appropriate resources *threshold condition*. This trigger is intended to prompt the *firm* and the *FCA* to address the breach of *threshold conditions* in a timely manner. Where appropriate, the focus should be on recovery of the	The *FCA* would normally expect that: (a) the *firm* will have taken any relevant recovery actions identified by the *firm* under *MIFIDPRU* 7.5.5R(2)(a) and 7.5.6G before breaching its *own funds threshold requirement* and will be preparing to take, or will have taken, any relevant recovery actions identified under *MIFIDPRU* 7.5.5R(2)(b); and (b) the *firm* will cease making discretionary distributions of capital, loans to affiliated entities, payments of dividends or payments of variable remuneration. If, having considered the information provided by the *firm* about its proposed actions, the *FCA* reasonably considers that the *firm* may fail to restore its *own*

	firm (unless the *firm* chooses to exit the market by voluntarily winding down). However, any proposed actions for recovery must be credible and achievable within a reasonable and realistic timeframe.	*funds* to the level required by the *own funds threshold requirement* within a reasonable timeframe, the *FCA* may consider the following additional actions: (c) requesting that the *firm* cease taking on new business; (d) requesting the *firm* to report additional information to the *FCA*; (e) requesting that the *firm's parent undertaking* provides additional *own funds* for the *firm*; (f) where appropriate, inviting the *firm* or its *parent undertaking* to apply for a *requirement* under section 55L(5) or [section 143K(1)][4] of the *Act*, or imposing a *requirement* on the *FCA's* own initiative under section 55L(3) or [section 143K(2)] of the *Act*, in relation to (a) – (e) above; or (g) where appropriate, inviting the *firm* to apply for variation or cancellation of *permission* under section 55H of the *Act*, or varying or cancelling the *firm's permission* on the *FCA's* own initiative under section 55J of the *Act*. The *FCA* would also expect the *firm* to consider whether it is appropriate to trigger the *firm's* wind-down plan under *MIFIDPRU* 7.5.7R in order to ensure an orderly wind-down of its business. This may be the case where the *firm's* identified wind-down actions will require a reasonable length

[4] *Editor's note*: References in this chapter to section 143K of the Financial Services and Markets Act 2000 are to that section as it would be inserted by the Financial Services Bill, in the form in which it was introduced to the House of Lords on 14 January 2021. These references may change if the Bill is amended during the parliamentary process.

		of time to execute, such as where the *firm* will need to transfer customers or close out its own positions.
Wind-down trigger notification: *Firm's own funds* fall below its *own funds wind-down trigger*	The *own funds wind-down trigger* is intended to specify a level of *own funds* that is sufficient to ensure an orderly wind-down of the *firm*. Where the *firm's own funds requirement* is determined by the *fixed overheads requirement* and the *firm* has not identified that it needs to hold additional *own funds* to comply with the *overall financial adequacy rule*, the *own funds wind-down trigger* may be equal to the *firm's own funds threshold requirement*. In that case, the *FCA* may proceed directly to applying the interventions in this row, rather than those specified for a breach of the *own funds threshold requirement* above. In order to maximise the potential for an orderly wind-down, the *FCA* expects that *firms* that breach this trigger should	The *FCA* would normally expect the following to occur: (a) the *firm's governing body* will make a formal decision to initiate the *firm's* wind-down plan, unless the *governing body* has a reasonable basis for determining that there is an imminent and credible likelihood of the *firm's* recovery; and (b) where the *firm* decides to initiate its wind-down plan, the *FCA* will invite the *firm* to apply for a *requirement* under section 55L(5) of the *Act*, or will impose a *requirement* on the *FCA's* own initiative under section 55L(3) of the *Act*, that prevents the *firm* from taking on any new business. The *FCA* may consider the following additional actions if it has concerns that without such actions, the potential risk of harm to consumers or the markets is likely to increase: (c) taking appropriate action to protect any *client money* or *client* assets, including, where appropriate, inviting the *firm* to apply for a *requirement* under section 55L(5) of the *Act*, or imposing a *requirement* on the *FCA's* own initiative under section 55L(3) of the *Act*, to achieve any necessary protection; and (d) where appropriate, inviting the *firm* to apply for variation or cancellation of *permission* under section 55H of the *Act*, or varying or cancelling the *firm's*

	normally commence winding down immediately, unless the *firm's governing body* and the *FCA* determine that there is an imminent and credible likelihood of recovery.	*permission* on the *FCA's* own initiative under section 55J of the *Act*. If a *firm* refuses to commence an orderly wind-down despite its *governing body* or the *FCA* having concluded that there is no imminent and credible likelihood of recovery, the *FCA* will consider the full range of its supervisory powers. In particular, the *FCA* may use a combination of its own initiative powers under section 55L(3) and section 55J of the *Act* to: (e) prevent the *firm* from continuing to carry on any *regulated activities*; and (f) require the *firm* to take appropriate actions to ensure the fair treatment and appropriate protection of *clients* and counterparties during any run-off period for its existing regulated business.

7.7 ICARA process: assessing and monitoring the adequacy of liquid assets

7.7.1 R This section applies to a *MIFIDPRU investment firm*.

7.7.2 R (1) As part of its *ICARA process*, a *firm* must produce a reasonable estimate of the maximum amount of *liquid assets* that the *firm* would require to:

(a) fund its ongoing business operations during each quarter over the next 12 *months*; and

(b) ensure that the *firm* could be wound down in an orderly manner.

(2) The assessment in (1) must take into account any potential material harms that the *firm* has identified under *MIFIDPRU* 7.4.9R where the *firm* has been unable to reduce such harms appropriately through its systems and controls.

(3) Without prejudice to the ongoing nature of the *ICARA process*, the *firm* must update the analysis in (1) immediately following any material change in the *firm's* business model or operating model.

(4) In order to produce the estimate in (1), the *firm* must ensure that it has in place reliable management information systems to provide timely and forward-looking information on its liquidity position.

7.7.3 G (1) The *overall financial adequacy rule* requires a *firm* to hold adequate *liquid assets* to ensure that:

(a) the *firm* is able to remain financially viable throughout the economic cycle, with the ability to address any potential harm that may result from its ongoing activities; and

(b) the *firm's* business can be wound down in an orderly manner.

(2) In order to comply with the *overall financial adequacy rule*, a *firm* must therefore hold the sum of the *basic liquid assets requirement* and the higher of:

(a) the amount of *liquid assets* that the *firm* requires at any given point in time to fund its ongoing business operations, taking into account potential periods of financial stress during the economic cycle; or

(b) the additional amount of *liquid assets* that a *firm* would need to hold when commencing its wind-down process to ensure that the *firm* could be wound down in an orderly manner.

(3) The *firm* should use the analysis it produces under *MIFIDPRU* 7.7.2R to ensure that it is complying with the *overall financial adequacy rule*.

(4) The *liquid assets threshold requirement* is the amount of *liquid assets* that a *firm* needs to hold at any given time to comply with the *overall financial adequacy rule*.

7.7.4 G (1) When considering the *liquid assets* that are required to fund its ongoing business operations under *MIFIDPRU* 7.7.2R(1), a *firm* should consider, among other factors:

(a) the ordinary level of *liquid assets* that would typically be required to operate the *firm's* underlying business, taking into account any seasonal variations;

(b) any material harms that may realistically occur during the next 12 *months* and their potential impact on the *firm's* liquidity position;

(c) any *liquid assets* that a *firm* may need to use as collateral or to meet margining requirements; and

(d) any estimated gaps in funding, including during periods of severe but plausible stress.

(2) The *liquid assets* that a *firm* requires at any given time during the 12-*month* period in *MIFIDPRU* 7.7.2R(1) may fluctuate, depending on the timing of a *firm's* expected liabilities and the nature of its business. Therefore, a *firm* should divide the 12-*month* period into quarters and assess the highest amount of *liquid assets* that it would require at any given time in each quarter. The *FCA* accepts that forecasts of the *liquid assets* that a *firm* requires may become less accurate for later quarters, but expects *firms* to use a 12-*month* time horizon to ensure that adequate attention is given to potential harms and significant liquidity outflows that may occur during that period.

(3) As a *firm's* liquidity requirements are typically dynamic in nature, *MIFIDPRU* 7.7.2R requires a *firm* to update its *liquid assets* assessment where there has been a material change in the *firm's* business model or operating model. This ensures that the *firm* updates its liquidity analysis to reflect material changes in its circumstances that may affect the availability of *liquid assets* or the *firm's* liquidity requirements, while also assessing future needs over a rolling 12-*month* time horizon.

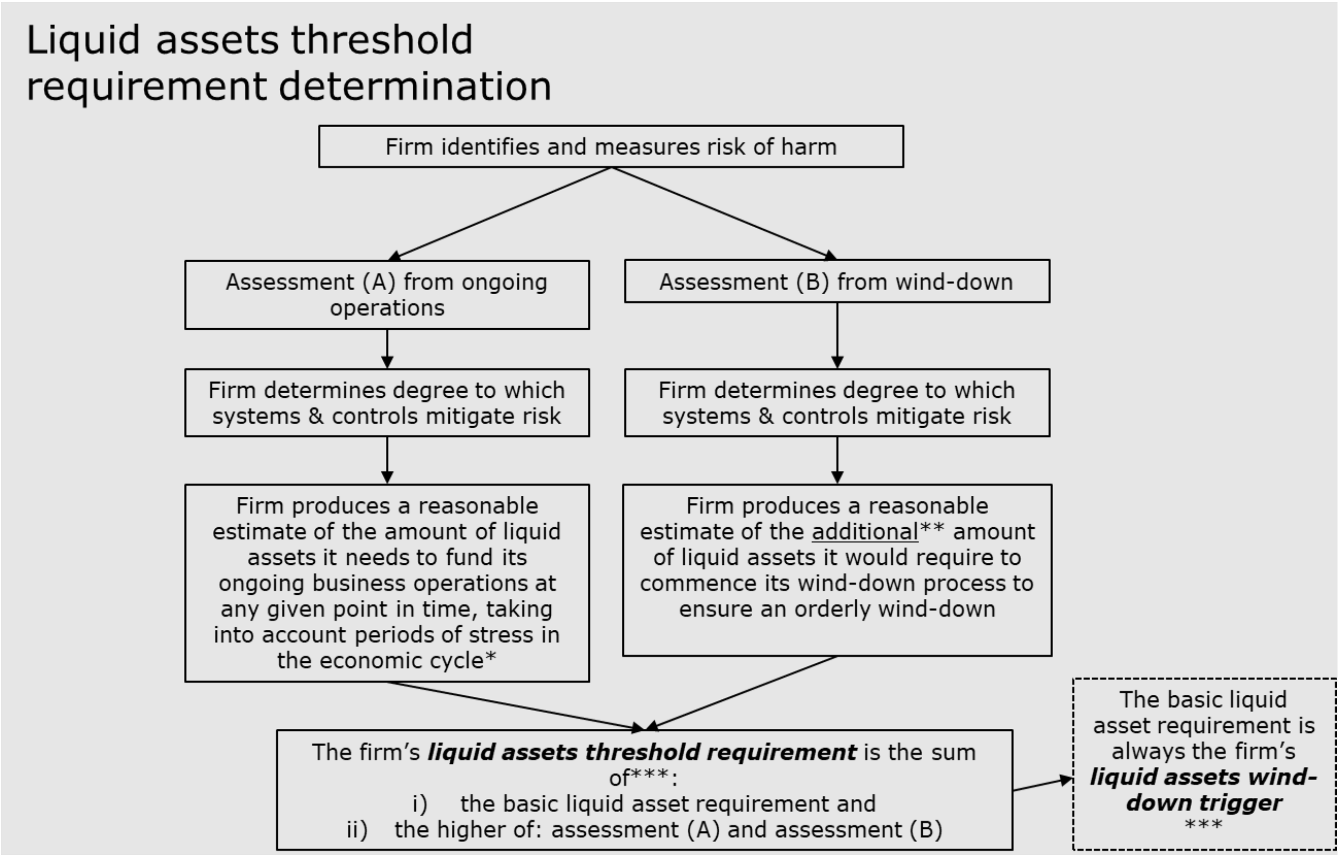
(4) As part of its reporting obligations under *MIFIDPRU* 9, a *firm* will need to report liquidity information to the *FCA* on a regular basis. The *FCA* will use this information to monitor both the *liquid assets* that the *firm* is holding and the *firm's* assessment of its *liquid assets threshold requirement*.

7.7.5 G (1) A *firm's basic liquid assets requirement* provides a minimum level of *core liquid assets* that the *firm* must maintain at all times. The purpose of the *basic liquid assets requirement* is to ensure that the *firm* always has a minimum stock of *liquid assets* to fund the initial stages of its wind-down process if wind-down becomes necessary. The *firm* cannot, therefore, use the value of the *core liquid assets* that it holds to meet the *basic liquid assets requirement* as *liquid assets* for the liquidity needs of its ongoing business.

(2) The *basic liquid assets requirement* may, however, be insufficient to provide the *liquid assets* that the *firm* has assessed would be necessary to facilitate an orderly wind-down as part of its wind-down planning under *MIFIDPRU* 7.5.7R. Therefore, the *firm* may identify that it needs to hold an additional amount of *liquid assets* to meet its funding needs as part of the wind-down process. This is not necessarily the whole amount of the *liquid assets* that would be required to fund the entire wind-down process, as in some circumstances, the *firm* may reasonably expect to generate

additional *liquid assets* during wind-down. However, the *firm* should identify if it could have a funding gap during the wind-down process that the *firm* needs to cover by holding more *liquid assets* at the point that wind-down begins.

(3) The following diagram summarises the process that a *firm* should undertake to determine its *liquid assets threshold requirement*:



* *Firms* are reminded that when they assess the amount of *liquid assets* they need for ongoing operations, they cannot use the value of the *core liquid assets* held to meet the *basic liquid assets requirement* to fund those operations.

** The *basic liquid assets requirement* may be insufficient to provide the *liquid assets* that the *firm* has assessed would be necessary to facilitate an orderly wind-down. Therefore, the *firm* may identify that it needs to hold an additional amount of *liquid assets* to meet its funding needs to commence its wind-down process.

*** Unless otherwise specified by the *FCA*.

7.7.6 R (1) Subject to (2) and (3), a *firm* may hold the *liquid assets* necessary to comply with its *liquid assets threshold requirement* in any combination of:

(a) any *core liquid asset*, except trade receivables under *MIFIDPRU* 6.3.2R; or

(b) any *non-core liquid asset*, as defined in *MIFIDPRU* 7.7.8R, provided that the *firm* applies an appropriate haircut in accordance with *MIFIDPRU* 7.7.9R.

(2) This *rule* does not apply in relation to the *liquid assets* that a *firm* is holding to meet its *basic liquid assets requirement*, which must be *core liquid assets*.

(3) A *firm* may only use a *non-core liquid asset* for the purpose in (1) if the *firm* is satisfied that the asset can easily and promptly be converted into cash, even in stressed market conditions.

7.7.7 G When considering whether a *non-core liquid asset* meets the requirement in *MIFIDPRU* 7.7.6R(3), a *firm* should take the following principles into account:

(1) low risk: assets that are less risky tend to have higher liquidity. High credit standing of the issuer and a low degree of subordination tends to increase an asset's liquidity. Low duration, low legal risk, low inflation risk and denomination in a convertible currency with low foreign exchange risk all tend to enhance an asset's liquidity;

(2) ease and certainty of valuation: an asset's liquidity tends to increase if market participants are more likely to agree on its valuation. Assets with more standardised, homogenous and simple structures tend to be more fungible, promoting liquidity. The pricing formula of a high-quality liquid asset should be easy to calculate and not depend on strong assumptions. The inputs into the pricing formula should also be publicly available. In practice, this should rule out the inclusion of most structured or exotic products;

(3) low correlation with risky assets: the stock of assets should not be subject to wrong-way (highly correlated) risk. For example, assets issued by financial institutions are more likely to be illiquid in times of liquidity stress in the financial sector;

(4) listed on a developed and recognised exchange: being listed tends to increase an asset's transparency and liquidity;

(5) active and sizable market: the asset should have an active market at all times. This means that:

(a) there should be historical evidence of market breadth and market depth. This could be demonstrated by low bid-ask spreads, high trading volumes, a large and diverse number of market participants, and the existence of a repo market. Diversity of market participants reduces market concentration and increases the reliability of the liquidity in the market; and

(b) there should be robust market infrastructure in place. The presence of multiple committed market makers increases liquidity as quotes will most likely be available for buying or selling the asset;

(6) low volatility: assets whose prices remain relatively stable and are less prone to sharp price declines over time will have a lower probability of triggering forced sales to meet liquidity requirements. Volatility of traded prices and spreads are simple proxy measures of market volatility. There should be historical evidence of relative stability of market terms (e.g. prices and haircuts) and volumes during stressed periods; and

(7) flight to quality: historically, the market has shown tendencies to move into these types of assets in a systemic crisis. The correlation between proxies of market liquidity and financial system stress is one simple measure that could be used.

7.7.8 R (1) Except as specified in (2), the following assets are eligible as *non-core liquid assets*:

(a) short-term deposits at a *credit institution* that does not have a *Part 4A permission* in the *UK* to *accept deposits*;

(b) assets representing claims on, or guaranteed by, multilateral development banks and international organisations;

(c) assets representing claims on, or guaranteed by, any *third country* central bank or government;

(d) *financial instruments*; and

(e) any other instrument eligible as collateral against the margin requirement of an *authorised central counterparty*.

(2) A *firm* must not treat any of the following as a *non-core liquid asset*:

(a) any asset that belongs to a *client*;

(b) any other asset that is encumbered; or

(c) any asset issued by the *firm* or any of its affiliated entities, except a short-term deposit with an affiliated *credit institution*.

7.7.9 G (1) For the purposes of *MIFIDPRU* 7.7.8R(2)(a), an asset may belong to a *client* whether or not the asset is held in the *firm's* own name.

Examples of assets belonging to a *client* include money or other assets held under the *FCA's client asset rules*.

(2) For the purposes of *MIFIDPRU* 7.7.8R(2)(b), an asset may be encumbered if it is pledged as security or collateral, or subject to some other legal restriction (for example, due to regulatory or contractual requirements) which affects the *firm's* ability to liquidate, sell, transfer, or assign the asset.

7.7.10 R A *firm* must apply an appropriate haircut to the value of a *non-core liquid asset* to reflect the potential loss of value when converting the asset into cash during stressed market conditions.

7.7.11 G The *FCA* considers that a minimum haircut of no less than that in the range specified in the table in *MIFIDPRU* 7.7.12G is likely to be appropriate for the purposes of *MIFIDPRU* 7.7.10R.

7.7.12 G This table belongs to *MIFIDPRU* 7.7.11G.

Non-core liquid asset	**Haircut**
Short-term deposits at a *credit institution* that does not have *permission* in the *UK* to *accept deposits*	0%
Assets representing claims on, or guaranteed by, multilateral development banks or international organisations	0%
Assets representing claims on, or guaranteed by, any *third country* central bank or government	0% - 50%
Regulated covered bonds, or comparable covered bonds regulated in a *third country*	7% - 30%
Asset-backed securities eligible for 'STS' designation under the *Securitisation Regulation*, and backed by residential loans, personal loans, leases or commercial loans for purposes other than commercial real estate development, or comparable asset-backed securities regulated in a *third country*	25% - 35%

High quality corporate debt securities	15% - 50%
Shares that form part of a major stock index	50%
Financial instruments not covered above for which there is a liquid market as defined in article 42(1)(17) of *MiFIR* or article 42(1)(17) of *EU MiFIR*	55%
Other instruments eligible as collateral against the margin requirement of an *authorised central counterparty*	25% - 55%

7.7.13 G For the purposes of *MIFIDPRU* 7.7.10R and 7.7.11G, in relation to shares or units in collective investment undertakings:

(1) where a *firm* is aware of the exposures underlying the *CIU*, it may look through to those underlying exposures to assign an appropriate haircut;

(2) where a *firm* is not aware of the exposures underlying the *CIU*, it should assume that the *CIU* invests, up to the maximum amount allowed under its mandate, in the highest risk assets permissible; and

(3) in either case, a *firm* should consider applying an additional haircut to reflect any additional loss of value that could result from the underlying exposures being held through a *CIU*.

Requirement to notify the FCA of certain levels of liquid assets

7.7.14 R (1) A *firm* must notify the *FCA* immediately in each case where:

(a) its *liquid assets* fall below its *liquid assets threshold requirement*; or

(b) its *liquid assets* fall below its *liquid assets wind-down trigger* or the *firm* considers that there is a reasonable likelihood that its *liquid assets* will fall below its *liquid assets wind-down trigger* in the foreseeable future.

(2) A notification under (1) must include the following information:

(a) a clear statement of the current level of the *firm's liquid assets* in comparison to:

(i) the *firm's liquid assets threshold requirement*; and

(ii) in the case of a notification under (1)(b), the *firm's liquid assets wind-down trigger*;

(b) an explanation of why the *firm's liquid assets* have reached the current level;

(c) in the case of a notification under (1)(a), an explanation of the recovery actions specified for the purposes of *MIFIDPRU* 7.5.5R(2)(b) and 7.5.6G that the *firm* has already taken or will take to restore compliance with its *liquid assets threshold requirement*; and

(d) in the case of a notification under (1)(b), the *firm's* intentions in relation to activating its wind-down plan.

(3) A *firm* must submit the notification in (1) via the *online notifications and applications system* using the form in *MIFIDPRU* 7 Annex 5R.

7.7.15 G (1) The notification requirement in *MIFIDPRU* 7.7.14R does not replace a *firm's* obligations under:

(a) *Principle* 11 to disclose appropriately to the *FCA* anything relating to the *firm* of which the *FCA* would reasonably expect notice; or

(b) the general notification requirements in *SUP* 15.3.

(2) Where a *firm* has submitted a notification in *MIFIDPRU* 7.7.14R, that notification will generally discharge a *firm's* obligations under *Principle* 11 and the general notification requirements in *SUP* 15.3 in relation to the matters contained in the notification. However, a *firm* must still consider whether the *FCA* should be notified of developments before any of the notification indicators in *MIFIDPRU* 7.7.14R occur. In addition, *Principle* 11 and *SUP* 15.3 may require a *firm* to notify the *FCA* of additional material information that is not specifically referenced in *MIFIDPRU* 7.7.14R.

(3) *MIFIDPRU investment firms* are reminded, in particular, that the *FCA* would generally expect to be notified at an early stage of any significant event which creates a material risk of a *firm* ceasing to hold adequate financial resources, even if the impact of that event has not yet fully materialised.

FCA approach to intervention in relation to liquid assets

7.7.16 G (1) The table in *MIFIDPRU* 7.7.17G explains the interventions that the *FCA* would generally expect to make where a *MIFIDPRU investment firm* has breached, or there is evidence that the *firm* may be at risk of breaching, its *liquid assets* requirements. The table sets out the points at which the *FCA* would normally intervene and what actions it would normally take. Note that unlike for *own funds*, there is no *early warning indicator* requirement in relation to *liquid assets*.

(2) The *FCA* would generally expect that the interventions in the table would be cumulative – i.e. in a declining prudential situation, as the *firm* hits each intervention point in turn, the *FCA* would take some or all of the actions associated with that particular point. The actions are intended to be proportionate and progressively stronger responses to address the prudential concerns raised by each intervention point.

(3) However, if the *firm* experiences a sudden adverse event which causes the *firm* to hit multiple intervention points simultaneously, the *FCA* may immediately take the actions associated with the most severe point.

(4) The actions specified in the table are without prejudice to the possibility of the *FCA* taking alternative or additional actions in appropriate cases. The purpose of the table is to provide greater clarity for *firms* on the *FCA's* general expectations and approach to interventions, to assist *firms'* own planning and responses.

7.7.17 G This table belongs to *MIFIDPRU* 7.7.16G.

Intervention point	**Purpose**	**Potential *FCA* supervisory actions**
Threshold requirement notification: *Firm* holding insufficient *liquid assets* to meet its *liquid assets threshold requirement*	The *liquid assets threshold requirement* is the amount of *liquid assets* that the *firm* needs at any given point in time to comply with the *overall financial adequacy rule*. The *FCA* will monitor a *firm's* assessment of its *liquid assets threshold requirement*	The *FCA* would normally expect that: (a) the *firm* will have considered taking the recovery actions identified under *MIFIDPRU* 7.5.5R(2)(a) and *MIFIDPRU* 7.5.6G before breaching its *liquid assets threshold requirement* and will be considering whether to take, or will have taken, any relevant recovery actions identified under *MIFIDPRU* 7.5.5R(2)(b);

	through the information that the *firm* provides under *MIFIDPRU* 9. This notification is intended to prompt the *firm* and the *FCA* to address the breach of *threshold conditions* in a timely manner. Where a *firm* has ceased to hold sufficient *liquid assets* to meet its *liquid assets threshold requirement*, the focus should be on restoring *liquid assets* to at least the level of the *liquid assets threshold requirement* and recovery of the *firm* (unless the *firm* chooses to exit the market by voluntarily winding down). However, any proposed actions for recovery must be credible and achievable within a reasonable and realistic timeframe	(b) the *firm's governing body* will regularly evaluate whether the *firm* should take additional actions to restore its level of *liquid assets* to at least the level of the *liquid assets threshold requirement*; and (c) the *firm* may be requested to report additional information to the *FCA*. If, having considered the information provided by the *firm* about its proposed actions, the *FCA* reasonably considers that the *firm* may fail to restore its *liquid assets* to the level required by the *liquid assets threshold requirement* within a reasonable timeframe, the *FCA* may consider the following actions: (d) requesting the *firm* to cease making discretionary payments; (e) requesting that the *firm* cease taking on new business; (f) requesting that the *firm's parent undertaking* provides additional *liquid assets* for the *firm*; (g) where appropriate, inviting the *firm* or its *parent undertaking* to apply for a *requirement* under section 55L(5) or [section 143K(1)] of the *Act*, or imposing a *requirement* on the *FCA's* own initiative under section 55L(3) or [section 143K(2)] of the *Act*, in relation to (a) – (f) above; or (h) where appropriate, inviting the *firm* to apply for variation or cancellation of *permission* under section 55H of the *Act*, or varying or cancelling the

		firm's permission on the *FCA's* own initiative under section 55J of the *Act*. The *FCA* would also expect the *firm* to consider whether it is appropriate to trigger the *firm's* wind-down plan under *MIFIDPRU* 7.5.7R in order to ensure an orderly wind-down of its business. This may be the case where the *firm's* identified wind-down actions will require a reasonable length of time to execute, such as where the *firm* will need to transfer customers or close out its own positions.
Wind-down trigger notification: *Firm's liquid assets* fall below its *liquid assets wind-down trigger*	The *liquid assets wind-down trigger* is an absolute minimum level of *liquid assets* that a *firm* must maintain at all times to provide the necessary financial resources to commence wind-down. This is equal to the *firm's basic liquid assets requirement* (or such higher amount as the *FCA* may have imposed for these purposes in a *requirement*). In order to maximise the potential for an orderly wind-down, the *FCA* expects that *firms* that breach this trigger should normally commence winding down immediately unless the *firm's governing body* and the *FCA*	The *FCA* would normally expect the following to occur: (a) the *firm's governing body* will make a formal decision to initiate the *firm's* wind-down plan, unless the *governing body* has a reasonable basis for determining that there is an imminent and credible likelihood of the *firm's* recovery; and (b) where the *firm* decides to initiate its wind-down plan, the *FCA* will invite the *firm* to apply for a *requirement* under section 55L(5) of the *Act*, or will impose a *requirement* on the *FCA's* own initiative under section 55L(3) of the *Act*, that prevents the *firm* from taking on any new business. The *FCA* may consider the following additional actions if it has concerns that without such actions, the potential risk of harm to consumers or the markets is likely to increase: (c) taking appropriate action to protect any *client money* or *client* assets, including, where appropriate, inviting the *firm* to apply for a *requirement* under

	determine that there is an imminent and credible likelihood of recovery.	section 55L(5) of the *Act*, or imposing a *requirement* on the *FCA's* own initiative under section 55L(3) of the *Act*, to achieve any necessary protection; and (d) where appropriate, inviting the *firm* to apply for variation or cancellation of *permission* under section 55H of the *Act*, or varying or cancelling the *firm's permission* on the *FCA's* own initiative under section 55J of the *Act*. If a *firm* refuses to commence an orderly wind-down despite its *governing body* or the *FCA* having concluded that there is no imminent and credible likelihood of recovery, the *FCA* will consider the full range of its supervisory powers. In particular, the *FCA* may use a combination of its own initiative powers under section 55L(3) and section 55J of the *Act* to: (e) prevent the *firm* from continuing to carry on any *regulated activities*; and (f) direct the *firm* to take appropriate actions to ensure the fair treatment and appropriate protection of *clients* and counterparties during any run-off period for its existing regulated business.

7.8 Reviewing and documenting the ICARA process

7.8.1 R This section applies to a *MIFIDPRU investment firm*.

7.8.2 R A *firm* must review the adequacy of its *ICARA process*:

(1) at least once every 12 *months*; and

(2) irrespective of any review carried out under (1), following any material change in the *firm's* business model or operating model.

[**Note:** article 24(2), first paragraph of the *IFD*.]

7.8.3 G A *firm* whose activities are significant in their nature, scale or complexity should consider whether it is appropriate to review the adequacy of its *ICARA process* more regularly than the minimum frequency specified in *MIFIDPRU* 7.8.2R(1). The *FCA* considers that in such cases, it may be more appropriate to review the *ICARA process* on a half-yearly basis.

7.8.4 G The effect of *MIFIDPRU* 7.8.2R(2) is that if there is a significant change in the *firm's* business model or operating model, the *firm* should not wait until the next scheduled review of its *ICARA process*, but should carry out a review promptly. For example, if a *firm* is launching a material new product or business line or is merging with another business, the *FCA* expects that the *firm* would, as part of its preparation for that event, analyse the impact on the *firm's ICARA process*. Similarly, if a *firm's* business undergoes a significant change due to external factors (for example, due to significant changes in the structure of a market sector), the *FCA* expects that a *firm* will consider the effects on the *firm's ICARA process* in a timely manner.

7.8.5 R (1) A *firm* must notify the *FCA* of the date on which the *firm* will submit *data item* MIF007 (ICARA assessment questionnaire) in accordance with:

(a) in the case of a *non-SNI MIFIDPRU investment firm*, *MIFIDPRU* 9.2.2R; and

(b) in the case of an *SNI MIFIDPRU investment firm*, *MIFIDPRU* 9.2.4R.

(2) The submission date that the *firm* notifies under (1) will continue to apply unless the *firm* notifies the *FCA* of a change of the submission date in accordance with (3).

(3) A *firm* may notify the *FCA* of a revised submission date for the purpose of (1), provided that the revised date will not result in the *FCA* not receiving *data item* MIF007 in relation to the *firm* for a period that exceeds 12 *months*.

(4) The notifications in (1) and (3) must be submitted via the *online notification and application system* using the form in *MIFIDPRU* 7 Annex 6R.

(5) Where, in accordance with *MIFIDPRU* 7.8.2R(1) and *MIFIDPRU* 7.8.3G, a *firm* reviews the adequacy of its *ICARA process* more frequently than annually, the requirements in (1) to (4) apply with the following modifications:

(a) the notification under (1) must specify each date on which the *firm* will submit *data item* MIF007 following the relevant reviews; and

(b) the references to "submission date" should be read as references to each submission date notified under (a).

(6) Notwithstanding (1) to (5):

(a) the *FCA* may direct a *firm* to submit *data item* MIF007 on a different date to ensure that the *FCA* has access to appropriate and timely information on the *firm's* financial position; and

(b) if the *FCA* gives a direction to a *firm* in accordance with (a), the *firm* must submit *data item* MIF007 to the *FCA* on the date specified in that direction until the *FCA* directs otherwise.

7.8.6 G (1) *Firms* may operate different internal arrangements for reviewing the adequacy of their *ICARA process*. When considering the timetable for such a review, a *firm* should take into account the following three dates:

(a) the date on which the underlying data used to carry out the review of the *ICARA process* was prepared (the "reference date");

(b) the date on which the *firm's* review of the *ICARA process* is carried out (the "review date"); and

(c) the date that the *firm* has notified to the *FCA* under *MIFIDPRU* 7.8.5R on which the *firm* will submit *data item* MIF007 to report on its review of the *ICARA process* (the "submission date").

(2) When choosing a submission date under *MIFIDPRU* 7.8.5R, the *FCA* would expect a *firm* to consider the following:

(a) the period between the reference date and the review date should be reasonable, taking into account the time that the *firm* is likely to need to carry out a robust assessment of its *ICARA process* to meet the requirements in this section and the importance of using relevant data for such purposes; and

(b) the period between the review date and the submission date should also be reasonable, taking into account the importance of the *FCA* receiving timely information in relation to the *firm* and the time that is likely to be necessary for the *firm* to complete *data item* MIF007 accurately and completely.

(3) The *FCA* expects *firms* to design their internal timetables for the review of their *ICARA processes* and the submission of *data item*

MIF007 in a reasonable way, reflecting the importance of proper internal risk management. In the first instance, the *FCA* has provided *firms* with flexibility under *MIFIDPRU* 7.8.5R to adopt a review and reporting timetable that fits best with the *firm's* internal processes. However, under *MIFIDPRU* 7.8.5R(5), the *FCA* may direct a *firm* to report on an alternative date if the *FCA* considers that the *firm's* proposed review and reporting timetable would not result in the *FCA* receiving the necessary information in an appropriate and timely manner.

(4) A *firm* can change the date on which it submits *data item* MIF007 by notifying the *FCA* in accordance with *MIFIDPRU* 7.8.5R(3). However, a *firm* is not permitted to specify a revised date that would result in the *firm* not submitting *data item* MIF007 to the *FCA* for more than 12 *months*. For example, a *firm* has a submission date of 1 April each year. The *firm* submits *data item* MIF007 on 1 April 2023. On 1 March 2024, the *firm* wishes to change its submission date to 31 December. The *firm* would not be permitted to change the submission date in this way, as the next submission date would be 31 December 2024, which would be more than 12 *months* after 1 April 2023. However, the *firm* could have notified the *FCA* on, for example, 1 December 2023 that it intended to change its submission date to 31 December. This is because the next submission of *data item* MIF007 would then have occurred on 31 December 2023, which would be within 12 *months* of the previous submission on 1 April 2023.

(5) As explained in *MIFIDPRU* 7.8.3G, a *firm* whose activities are significant in their nature, scale or complexity may conclude that it should review the adequacy of its *ICARA process* more frequently than the minimum annual review required under *MIFIDPRU* 7.8.2R(1). In that case, the *firm* must submit *data item* MIF007 after each review and must notify the *FCA* under *MIFIDPRU* 7.8.5R of the submission date for each *data item*. The *guidance* in this provision applies to each of those submission dates.

7.8.7 R Where a *firm* carries out a review of its *ICARA process* in accordance with *MIFIDPRU* 7.8.2R(2) following a change in its business model or operating model:

(1) the *firm* must submit *data item* MIF007 to the *FCA* within 20 *business days* of the *governing body* having approved the *ICARA document* resulting from that review in accordance with *MIFIDPRU* 7.8.9R; and

(2) the requirement in *MIFIDPRU* 7.8.5R to notify the *FCA* of the submission date of *data item* MIF007 does not apply to a *data item* submitted under (1).

7.8.8 R (1) A *firm* must document any review carried out under *MIFIDPRU* 7.8.2R.

(2) The documentation produced by the *firm* to comply with (1):

(a) may consist of multiple documents, provided that the interaction between them is clear, they are prepared on a consistent basis and they can all be provided to the *FCA* promptly upon request; and

(b) is collectively referred to as the *ICARA document*.

(3) The *ICARA document* must include the following:

(a) a clear description of the *firm's* business model and strategy and how it aligns with the *firm's* risk appetite;

(b) an explanation of the activities carried on by the *firm*, with a focus on the most material activities;

(c) where the *firm* has concluded that the *ICARA process* is fit for purpose, a clear explanation of why the *firm* reached this conclusion;

(d) where the *firm* has concluded that the *ICARA process* requires further improvement, a clear explanation of:

(i) the improvements needed;

(ii) the steps needed to make those improvements and the timescale for taking them; and

(iii) who within the *firm* is responsible for taking the steps in (ii);

(e) a clear explanation of any other changes to the *firm's* *ICARA process* that have occurred following the review and the reasons for those changes;

(f) an analysis of the effectiveness of the *firm's* risk management processes during the period covered by the review;

(g) a summary of the material harms identified by the *firm* under *MIFIDPRU* 7.4.13R and any steps taken to mitigate them;

(h) an overview of the business model assessment and capital and liquidity planning undertaken by the *firm* under *MIFIDPRU* 7.5.2R;

(i) a clear explanation of how the *firm* is complying with the *overall financial adequacy rule*, including a clear break-down of the following as at the review date:

(i) available *own funds*;

(ii) available *liquid assets*; and

(iii) the *firm's* assessment of its *threshold requirements*;

(j) a summary of any stress testing and reverse stress testing carried out by the *firm*;

(k) the levels of *own funds* and *liquid assets* that, if reached, the *firm* has identified under *MIFIDPRU* 7.5.5R(1) may indicate that there is a credible risk that the *firm* will breach its *threshold requirements*;

(l) the potential recovery actions that the *firm* has identified under *MIFIDPRU* 7.5.5R(2) and 7.5.6G; and

(m) an overview of the *firm's* wind-down planning under *MIFIDPRU* 7.5.7R, including:

(i) any required actions;

(ii) the anticipated timelines for actions to be taken; and

(iii) any key assumptions or qualifications.

Senior management responsibility for the ICARA process

7.8.9 R (1) The content of the *ICARA document* must be reviewed and approved by the *firm's governing body* within a reasonable period after the review under *MIFIDPRU* 7.8.2R has been completed.

(2) As part of its review under (1), the *governing body* must specifically review and approve the key assumptions underlying the *ICARA document*.

7.8.10 G (1) *Senior conduct rules staff members* are reminded of their obligations under *COCON* 2.2.2R to take reasonable steps to ensure that the business of the *firm* for which they are responsible complies with the relevant requirements and standards of the *regulatory system*.

(2) In particular, *COCON* 4.2.12G explains that *senior conduct rules staff members* should take reasonable steps to ensure that the business for which they are responsible:

(a) has operating procedures and systems with well-defined steps for complying with the detail of relevant requirements and standards of the *regulatory system*; and

(b) is run prudently.

(3) The *FCA* considers that the *ICARA process* is a key requirement of the *regulatory system* for *MIFIDPRU investment firms* and is an essential part of a *firm's* internal systems and procedures for ensuring that the *firm's* business is run prudently. Accordingly, the *FCA* expects that *senior conduct rules staff members* will take an active role in contributing to the analysis required under the *ICARA process* in respect of the business areas for which they are responsible and in embedding its requirements into those business areas.

(4) *Firms* and *senior conduct rules staff members* should refer to the provisions in *COCON*, and in particular the *guidance* in *COCON* 3 and *COCON* 4, for further information on the *FCA's* general approach to assessing compliance with the relevant conduct rules.

Record keeping requirements

7.8.11 R (1) A *firm* must keep adequate records of the following:

(a) its *ICARA document*; and

(b) the review and approval of the *ICARA document* by the *firm's governing body* under *MIFIDPRU* 7.8.9R.

(2) A *firm* must retain the records in (1) for at least 3 years from the date on which the relevant document was approved.

7.9 ICARA process: firms forming part of a group

7.9.1 G This section contains:

(1) a requirement for individual *MIFIDPRU investment firms* to take into account group risk as part of their *ICARA process*;

(2) *rules* and *guidance* on the extent to which an *investment firm group* may manage risks on a *group* basis and may operate a *group ICARA process*; and

(3) *rules* and *guidance* on the extent to which the position of multiple *MIFIDPRU investment firms* may be combined with a single *ICARA document*.

Analysis of group risk by individual firms

7.9.2 R Where a *MIFIDPRU investment firm* is a part of a *group*, the *firm's ICARA process* must take into account any material risks or potential harms that may result from the *firm's* relationship with other members of that *group* or the *group* as a whole.

7.9.3 G The requirement in *MIFIDPRU* 7.9.2R applies in relation to:

(1) any *group*, irrespective of whether that *group* is an *investment firm group*; and

(2) any relationship that the *firm* has with any member of that *group*, irrespective of whether the other entity is an *authorised person*.

Group ICARA process

7.9.4 G An *investment firm group* to which *MIFIDPRU* 2.5 (Prudential consolidation) applies is not required to operate an *ICARA process* on a *consolidated basis*.

7.9.5 R Subject to *MIFIDPRU* 7.9.7R, an *investment firm group* (whether or not it is subject to *MIFIDPRU* 2.5) may operate a *group ICARA process*, provided that the following conditions are satisfied:

(1) the *group ICARA process* is consistent with the manner in which the business of the *investment firm group*, and the risks arising from it, are operated and managed in practice;

(2) any assessment under the *group ICARA process* of *own funds* or *liquid assets* that are required to cover the identified risks is allocated between individual *firms* within the *investment firm group* on a reasonable basis and that basis is properly documented;

(3) each *MIFIDPRU investment firm* covered by the *group ICARA process* complies with the *overall financial adequacy rule* on an individual basis;

(4) each *MIFIDPRU investment firm* covered by the *group ICARA process* maintains a separate wind-down plan for the purposes of *MIFIDPRU* 7.5.7R and applies the *wind-down triggers* on an individual basis;

(5) the notification requirements in *MIFIDPRU* 7.6.11R and 7.7.13R apply in relation to each individual *MIFIDPRU investment firm* included within the *group ICARA process*, using the amounts determined in accordance with (2) to (4);

(6) the management of any risks on a *group* basis takes place within one of the following entities:

(a) a *MIFIDPRU investment firm* within the *investment firm group*; or

(b) the *UK parent entity* of the *investment firm group*;

(7) the *governing body* of the relevant entity in (6) has accepted overall responsibility for the *group ICARA process* and for ensuring compliance with this *rule*;

(8) the requirement in *MIFIDPRU* 7.8.9R for the *governing body* of an individual *MIFIDPRU investment firm* to approve the content of the *ICARA document* applies to the *governing body* of the relevant entity in (7); and

(9) each individual *MIFIDPRU investment firm* included within the *group ICARA process* submits *data item* MIF007 (ICARA assessment questionnaire) to the *FCA* on an individual basis, reflecting the position of that *firm* as it results from the conclusions of the *group ICARA process*.

7.9.6 R Except as specified in *MIFIDPRU* 7.9.5R, a *MIFIDPRU investment firm* that is included within a *group ICARA process* is not required to comply with the requirements in *MIFIDPRU* 7.4 to *MIFIDPRU* 7.8 on an individual basis.

7.9.7 R (1) An *investment firm group* must not:

(a) operate a *group ICARA process* if the *FCA* has directed the *investment firm group* that it must manage or assess the risks arising from its business on a different basis because one or more of the conditions in (2) applies in relation to that *investment firm group*; or

(b) include within a *group ICARA process* any *MIFIDPRU investment firm* that the *FCA* has directed to manage or assess the risks arising from its business on a different basis because one or more of the conditions in (2) applies in relation to that *firm*.

(2) The relevant conditions are that:

(a) there is a material risk that potential harms arising in relation to the *firm* or *investment firm group* would not be adequately captured through a *group ICARA process*;

(b) there is a material risk that a *group ICARA process* would result in excessive complexity that would interfere with the *FCA's* ability to supervise the compliance of the *investment firm group*, or any of the individual *MIFIDPRU investment firms* within it, with the applicable obligations under *MIFIDPRU* 7; or

(c) the *investment firm group* previously operated, or the *firm* was previously included within, a *group ICARA process* that did not meet the requirements in *MIFIDPRU* 7.9.

7.9.8 R Except as otherwise specified in *MIFIDPRU* 7.9.5R, a *group ICARA process* must comply with the requirements in *MIFIDPRU* 7.4 to *MIFIDPRU* 7.8 as if the references in those sections to a "*MIFIDPRU investment firm*" were references to the *investment firm group* operating that *group ICARA process*.

7.9.9 G (1) Under *MIFIDPRU* 7.9.7R, if an *investment firm group* is operating a *group ICARA process* that is inadequate to address the potential harms arising from its business, the *FCA* may direct all members of the *investment firm group*, or specific individual *MIFIDPRU investment firms* within it, to apply the *ICARA process* on an individual basis.

(2) In addition, a *group ICARA process* must satisfy the requirements in *MIFIDPRU* 7.9.5R on an ongoing basis. If any of the conditions in that *rule* for the use of the *group ICARA process* are not met, all *MIFIDPRU investment firms* covered by that *group ICARA process* will need to operate individual *ICARA processes* instead.

(3) An *investment firm group* that wishes to operate a *group ICARA process* must therefore ensure that its risk management processes are sufficiently robust to satisfy the requirements in *MIFIDPRU* 7.9.5R and that there is appropriate accountability of the responsible *governing body* in accordance with the requirements of that *rule*.

(4) The *FCA* considers that it is particularly important that there is a proper analysis of how the *overall financial adequacy rule* and wind-down planning arrangements apply to each individual *MIFIDPRU investment firm* within the *investment firm group*. This reflects the fact that the solvency of *firms* must be assessed on an individual basis and legal entities must be wound down separately.

Combined ICARA documents covering multiple group entities

7.9.10 R Where an *investment firm group* contains multiple *MIFIDPRU investment firms*, the *ICARA document* for each *firm* may be combined within a single document, provided that:

(1) to the extent that any risks are managed under a *group ICARA process*, this is clearly documented and explained; and

(2) for any risks that are managed on an individual basis, and for any requirements that *MIFIDPRU* 7.9.5R specifies must always apply on an individual basis under a *group ICARA process*, the

combined *ICARA document* clearly explains the position of each individual *firm* and how it complies with the relevant requirements.

7.9.11 G The effect of *MIFIDPRU* 7.9.10R is that even where an *investment firm group* does not operate a *group ICARA process*, a single *ICARA document* can be used to document the individual *ICARA processes* operated by multiple *MIFIDPRU investment firms* within that *investment firm group*. However, the single *ICARA document* must clearly explain how each *MIFIDPRU investment firm* meets the applicable requirements on an individual basis.

7.10 Supervisory review and evaluation process

Application

7.10.1 G (1) This section contains *guidance* on the *FCA's* approach to the *supervisory review and evaluation process* (*SREP*) of the *ICARA process*.

(2) Although there are no *rules* in this section that impose direct obligations on *MIFIDPRU investment firms* or *UK parent entities*, such entities may find the *guidance* in this section helpful in understanding the *FCA's* general approach to considering whether *MIFIDPRU investment firms* are complying with the *overall financial adequacy rule* and the other requirements of the *ICARA process*.

(3) The *guidance* in this section relates only to the *FCA's* approach to the *SREP*. It does not apply in relation to any other supervisory action that the *FCA* may take outside the context of a *SREP*, except where stated.

Purpose

7.10.2 G The *own funds* and *liquid assets* necessary to comply with the *overall financial adequacy rule* need to be assessed by the *firm* and, where appropriate, the *FCA*. This involves:

(1) the *ICARA process* applied by the *firm*, or, in the circumstances set out in *MIFIDPRU* 7.9, by the *investment firm group*;

(2) the *FCA's* monitoring of the information provided by a *firm* under its ongoing reporting obligations in *MIFIDPRU* 9; and

(3) in appropriate cases, a *SREP*, which is conducted by the *FCA*.

Decision to conduct a SREP

7.10.3 G (1) There is no mandatory frequency with which the *FCA* will conduct a *SREP* on a particular *MIFIDPRU investment firm* or *investment firm group*. Instead, the *FCA* will decide how to prioritise its resources to conduct *SREPs* by taking into account a range of factors, which include, but are not limited to:

(a) the nature, scale and complexity of the business carried on by a *firm* or *investment firm group*;

(b) the *FCA's* analysis of the risks associated with the *firm* or *investment firm group* and its potential to cause harm to *consumers* or to the financial markets;

(c) the information provided by a *firm* or other members of its *group* to the *FCA* under any notification and reporting obligations under *MIFIDPRU* and any other provisions in the *Handbook*;

(d) the history of the *firm's* or *investment firm group's* interactions with the *FCA*;

(e) any broader concerns about the types of products or services offered by the *firm* or the *investment firm group*, or the markets in which it operates; and

(f) any concerns relating to the *firm* or *investment firm group* which may be notified to the *FCA* by other regulators (including non-financial services regulators).

(2) In appropriate cases, the *FCA* may choose to conduct a review of a particular population of *MIFIDPRU investment firms* or *investment firm groups* that share common features (for example, because they are all active in a particular market sector). In such cases, the *FCA* may subsequently choose to issue *guidance* on a sectoral basis or to impose additional *requirements* on all, or only a subset of, the entities included within that review.

(3) The scale of a *SREP* that the *FCA* carries out on an individual *MIFIDPRU investment firm* or *investment firm group* may vary, depending on the nature of the *FCA's* concerns and the potential degree of risk posed by the *firm* or *investment firm group*. In certain cases, the *FCA* may limit its review to only a subset of the information and factors that it would normally consider under the general approach described in *MIFIDPRU* 7.10.4G and 7.10.5G.

[**Note:** article 36 of the *IFD*.]

Information and factors considered by the FCA when conducting a SREP

7.10.4 G When conducting a *SREP*, the *FCA* will take into account such information as it considers relevant, which may include the following:

(1) the *firm's* or *investment firm group's ICARA document*;

(2) any relevant information provided by the *firm* or other members of its *group* as part of its reporting obligations under *MIFIDPRU* 9 or other obligations in the *Handbook*;

(3) any other information or documents requested by the *FCA* for the purposes of the *SREP*;

(4) interviews with members of the *firm's governing body*, or its employees, advisors, service providers, and auditors;

(5) information shared by other authorities; and

(6) any other relevant information that the *FCA* holds.

7.10.5 G The following is a non-exhaustive list of factors that the *FCA* will normally consider when conducting its *SREP*:

(1) the extent to which the *firm's* or *investment firm group's* risk management framework includes a clearly defined risk appetite;

(2) the governance arrangements operated by the *firm* or *investment firm group*, including whether there are clear lines of accountability and evidence of appropriate senior management involvement;

(3) whether the *firm* or *investment firm group* has appropriately identified and assessed the materiality of:

(a) the harms that may arise from the ongoing operation of the *firm's* or *group's* business;

(b) the harms that may result from a disorderly wind-down of the *firm* or other members of its *group*;

(4) whether the *firm* or *investment firm group* has adequate systems and controls in place to monitor and manage the risks arising from its business;

(5) whether the *firm* or *investment firm group* has properly integrated its *ICARA process* into day-to-day decision making within its business;

(6) whether the *firm*, and where applicable, other individual members of its *investment firm group*, have adequate *own funds* and *liquid assets* to comply with the *overall financial adequacy rule*;

(7) whether the capital and liquidity planning and business model analysis (and, where applicable, stress testing and reverse stress testing) conducted by the *firm* or *investment firm group* is based on plausible scenarios that are relevant to the business it undertakes; and

(8) whether the wind-down planning assessment conducted by the *firm*, and where applicable, other individual members of its *investment firm group*, is adequate, contains a clear explanation of the key steps needed to ensure an orderly wind-down and is based on realistic assumptions.

[**Note:** article 36 of the *IFD*.]

Examples of actions that the FCA may take following a SREP

7.10.6 G (1) Once the *FCA* has completed a *SREP*, it will consider whether any corrective action is necessary to ensure that (among other outcomes) a *firm*:

(a) is complying with the *overall financial adequacy rule*;

(b) has an appropriate plan in place to ensure an orderly wind-down; and

(c) is appropriately identifying and managing the material potential harms that may result from the ongoing operation of the *firm's* business.

(2) When considering the action that it may take, the *FCA* will have regard to all of the powers available to it and the potential harms that it has identified during the *SREP*. The following is a non-exhaustive list of actions that the *FCA* may take:

(a) requiring a *firm* to hold additional *own funds* or *liquid assets*;

(b) requiring a *firm* to implement new risk management or governance arrangements;

(c) requiring a *firm* to provide the *FCA*, within a specified period, an improvement plan to ensure that the *firm* complies with the applicable requirements in the *Handbook* or other legislation;

(d) requiring a *firm* to apply a particular policy for provisioning or for the treatment of assets when calculating its *own funds* or *own funds requirement*;

(e) restricting the activities that a *firm* may undertake as part of its business (which may be on a permanent basis, for a specified period of time, or until certain specified conditions are met);

(f) requiring a *firm* to reduce the level of risk involved in the products or services it provides, including in relation to activities that it has outsourced to third parties;

(g) requiring a *firm* to reduce or limit the amount of variable remuneration it pays;

(h) requiring a *firm* to reduce or limit its distributions of profits;

(i) imposing additional or more frequent reporting requirements on a *firm*;

(j) requiring a *firm* to hold an *own funds* or *liquid assets* buffer in excess of the amounts necessary to comply with the *overall financial adequacy rule*;

(k) requiring a *firm* to make additional public disclosures;

(l) requiring a *firm* to strengthen its data security, confidentiality or data protection processes;

(m) requiring a *firm* to provide additional information to *clients* or counterparties;

(n) withdrawing a permission previously granted under *MIFIDPRU* to apply a specific treatment (such as a *K-CMG permission*, or a permission to use an internal model for the purposes of the *K-NPR requirement*);

(o) requiring a *firm* to use a different *wind-down trigger*;

(p) requiring a *firm* to modify its legal structure or the structure of its *group*, where doing so would improve the *FCA's* ability to supervise the *firm*;

(q) giving individual *guidance* to the *firm* on any of the above matters or on any other matter that the *FCA* considers is relevant.

[**Note:** article 39 of the *IFD*.]

7.10.7 G While the *FCA* will have regard to all powers available to it, the *FCA* would generally expect to take the actions described in *MIFIDPRU* 7.10.6G by using one or more of the following approaches:

(1) exercising the powers under section 55J of the *Act* permitting the *FCA* to vary or cancel a *firm's permission* on the *FCA's* own initiative;

(2) inviting a *firm* to make a voluntary application for the imposition of a *requirement* under section 55L(5) of the *Act*;

(3) imposing a *requirement* on a *firm* on the *FCA's* own initiative under section 55L(3) of the *Act*;

(4) withdrawing a *MIFIDPRU* permission in accordance with the *rules* in *MIFIDPRU*;

(5) imposing a *requirement* on a *parent undertaking* in accordance with [section 143K] of the *Act*;

(6) requiring a *firm* or *parent undertaking* to provide additional information to the *FCA* under section 165 of the *Act*;

(7) requiring a report by a *skilled person* in accordance with section 166 of the *Act*; or

(8) giving individual *guidance* to a *firm* under section 139A of the *Act*, as further described in *SUP* 9.3.

General FCA approach to requiring a firm to hold additional own funds or liquid assets

7.10.8 G (1) Following a *SREP*, the *FCA* may conclude that a *firm* should hold an additional amount of *own funds* or *liquid assets* to comply with the *overall financial adequacy rule*.

(2) Where this is the case, the *FCA* will normally specify an amount of *own funds* and/or *liquid assets* that the *firm* should hold by:

(a) issuing individual *guidance*; or

(b) imposing a *requirement* on the *firm*.

(3) The amount in (2) will typically represent the *FCA's* assessment of the *firm's* overall *own funds threshold requirement* or *liquid assets threshold requirement*. However, in some cases, it may be specified on a different basis (such as by reference to a specific component of the *threshold requirement* or to a particular risk or harm).

(4) Where the *FCA* has undertaken a sectoral review, as described in *MIFIDPRU* 7.10.3G(2), it may issue *guidance* to, or impose a *requirement* on some or all *firms* that are active in that sector, without conducting an individual *SREP* in relation to each *firm*. The *guidance* or *requirement* may relate to:

(a) additional amounts of *own funds* or *liquid assets* that such *firms* must hold; or

(b) other actions that such *firms* must undertake.

7.10.9 G (1) The *FCA* will determine whether a *requirement* or *guidance* is more appropriate. Where the *FCA* chooses to issue *guidance*, this will normally explain how the *FCA* will approach supervising the *overall financial adequacy rule* in relation to the *firm*. The *FCA* expects that the *firm* would normally confirm to the *FCA* that the *firm* will treat the amounts specified in that *guidance* as its *threshold requirements* going forward (and will therefore hold the relevant of *own funds* and *liquid assets* to comply with the *overall financial adequacy rule*), unless the *firm* subsequently determines under its *ICARA process* that higher amounts are required.

(2) Where the *FCA* considers that it is appropriate to apply a *requirement* in connection with the *overall financial adequacy rule*, it may invite a *firm* to make a voluntary application under section 55L(5) of the *Act* to impose a *requirement* on the *firm* to hold the level of *own funds* or *liquid assets* that the *FCA* has assessed as being the *firm's threshold requirements*.

(3) If a *firm* declines to make a voluntary application to impose the relevant *requirement*, the *FCA* may use its powers under section 55L(3) of the *Act* to impose the *requirement* on the *firm* on the *FCA's* own initiative.

(4) In appropriate cases, the *FCA* will also consider whether it is appropriate to invite a *parent undertaking* of the *firm* to make a voluntary application under [section 143K(1)] of the *Act*, or to impose a *requirement* on such a *parent undertaking* on the *FCA's* own initiative under [section 143K(3)] of the *Act*. Examples of when the *FCA* may choose to apply this approach include where:

(a) an *investment firm group* is operating an *ICARA process* that covers multiple *firms* in accordance with *MIFIDPRU* 7.9; or

(b) the *FCA* considers that the potential harms arising from a *firm's* membership of its *group* can be addressed more effectively by imposing a *requirement* on the *parent undertaking*.

(5) *Guidance* on a *threshold requirement* issued by the *FCA* (or, where applicable, a *requirement* to hold a minimum level of *own funds* or *liquid assets* imposed on a *firm* by the *FCA*) will apply until the *FCA* issues *guidance* on a revised *threshold requirement* (or varies or removes the *requirement* relating to *own funds* or *liquid assets*) in relation to the *firm*.

(6) If a *firm* subsequently determines, as a result of its *ICARA process*, that it needs to hold a higher level of *own funds* or *liquid assets* to satisfy the *overall financial adequacy rule*, it must hold that higher level. This is because the *FCA's* assessment of a *firm's threshold requirement* (or a *requirement* applied to the *firm* by the *FCA*) reflects an assessment carried out at that point in time and does not relieve the *firm* of its obligation to ensure that it is meeting the *overall financial adequacy rule* at all times.

(7) A *firm's* business model or operating model may undergo a significant change, with the result that the *firm* considers that the *threshold requirement* specified in the *guidance* issued by, or the *requirement* applied by, the *FCA* exceeds the amount of *own funds* or *liquid assets* that the *firm* requires to comply with the *overall financial adequacy rule*. In this case, the *firm*:

(a) should undertake its own assessment of the amounts that the *firm* now requires to comply with the *overall financial adequacy rule* or, where applicable, to address the risks in relation to which the *requirement* was imposed; and

(b) having undertaken the determination in (a), may contact the *FCA* to request a review of the existing *guidance* or *requirement*.

7.10.10 G The following is a non-exhaustive list of situations in which the *FCA* may assess that a *firm* must hold additional *own funds* to comply with the *overall financial adequacy rule*:

(1) the business of the *firm* or *investment firm group* may result in material harm that is not sufficiently covered by the *firm's* assessment of its *own funds threshold requirement* and has not otherwise been adequately mitigated;

(2) the *firm* or *investment firm group* does not comply with the governance requirements in *MIFIDPRU* 7.2 or 7.3;

(3) the *firm's* or *investment firm group's ICARA process* does not comply with the relevant requirements in *MIFIDPRU* 7;

(4) the adjustments in relation to the prudent valuation of the *firm's* or *investment firm group's trading book* are insufficient to enable the *firm* or *investment firm group* to sell out or hedge its positions within a short period without incurring material losses under normal market conditions;

(5) the review of the *firm's* use of internal models or own estimates of delta for the purposes of the *K-NPR requirement* or *K-TCD requirement* indicates that non-compliance with the requirements for applying those models would be likely to lead to inadequate levels of *own funds*;

(6) the manner in which the *firm* or *investment firm group* operates its business suggests that there is a significant risk that it will fail to comply with the *overall financial adequacy rule* in the foreseeable future; or

(7) the *firm's* wind-down plan does not identify realistic and credible actions for ensuring an orderly wind-down or is based on unreasonable or unrealistic assumptions.

[**Note:** article 40(1) of the *IFD*.]

7.10.11 G The *FCA* may provide *guidance* on a *firm's own funds threshold requirement* (or, where applicable, impose a *requirement*) by reference to:

(1) a percentage of the *firm's own funds requirement*;

(2) the requirement that would result from applying a modified co-efficient to one or more *K-factor metrics* for the purposes of the *firm's K-factor requirement*; and/or

(3) a fixed amount.

7.10.12 G A *firm* will be required to meet any *own funds threshold requirement* with *own funds* that satisfy the conditions in *MIFIDPRU* 7.6.5R unless the *FCA* applies an alternative *requirement* to the *firm*.

[**Note:** article 40(4) of the *IFD*.]

7.10.13 G The following is a non-exhaustive list of situations in which the *FCA* may assess that a *firm* needs to hold additional *liquid assets* to comply with the *overall financial adequacy rule*:

(1) the business of the *firm* or *investment firm group* may result in material harm that is not sufficiently covered by the *liquid assets threshold requirement* as assessed by the *firm* and has not otherwise been adequately mitigated;

(2) the *firm* or *investment firm group* does not comply with the governance requirements in *MIFIDPRU* 7.2 or 7.3 in one or more material respects;

(3) the *firm's* or *investment firm group's ICARA process* does not comply with the requirements in *MIFIDPRU* 7;

(4) the *firm* or *investment firm group's* funding profile indicates that there may be a significant liquidity mismatch between amounts payable and receivables;

(5) the manner in which the *firm* or *investment firm group* operates its business suggests that there is a significant risk that it will fail to comply with the *overall financial adequacy rule* in the foreseeable future; or

(6) the *firm's* wind-down plan does not identify realistic and credible actions for ensuring an orderly wind-down or is based on unreasonable or unrealistic assumptions.

7.10.14 G (1) A *firm* can normally meet its *liquid assets threshold requirement* with any type of *liquid assets*. This is subject to the overriding requirement that in all cases, a *firm* must meet its *basic liquid assets requirement* with *core liquid assets*.

(2) However, in appropriate cases, the *FCA* may require a *firm* to meet all or part of its *liquid assets threshold requirement* with a more limited subset of *liquid assets*. For example, in certain cases, the *FCA* may require a *firm* to hold *core liquid assets* to cover particular risks or may disallow the use of certain *non-core liquid assets*.

(3) In appropriate cases, the *FCA* may:

(a) require a *firm* to apply modified haircuts to *non-core liquid assets*; or

(b) impose certain requirements relating to a *firm's* funding profile and the matching of expected liquidity outflows and inflows.

(4) Where the *FCA* wishes to apply the approaches in (2) or (3), it will normally invite the *firm* to apply for the imposition of a *requirement* to that effect under section 55L(5) of the *Act*. In appropriate cases, the *FCA* may impose such a *requirement* on its own initiative in accordance with section 55L(3) of the *Act*.

7 Annex 1 **Guidance on assessing potential harms that is potentially relevant to all firms**

Purpose

1.1 G (1) This annex contains *guidance* on how a *MIFIDPRU investment firm* can assess the potential harms arising from its business as part of the *ICARA process*.

(2) This *guidance* is designed to be of potential relevance to all *firms*, but not every aspect of this *guidance* will be relevant to every *firm*. A *firm* should consider this *guidance* in light of its particular business model.

(3) *Firms* are reminded that their *ICARA process* must be proportionate to the nature, scale and complexity of their activities. This *guidance* should be interpreted by reference to what is proportionate and appropriate for a particular *firm*.

General approach to assessing material potential harms

1.2 G (1) For the purposes of its *ICARA process*, a *firm* should identify potential harms by considering plausible hypothetical scenarios that might occur in relation to the activities that the *firm* carries on. The *firm* should also consider the possibility that certain scenarios might occur at the same time or that there might be a correlation between connected scenarios.

(2) A *firm* should generally estimate the nature and size of potential harms by using its own knowledge and experience.

(3) Where appropriate, a *firm* may use peer analysis to estimate potential harms. When doing so, the *firm* should take into account any material differences between the *firm's* business and the business carried on by its peer, and to the extent that it is aware of them, any material differences in their respective systems and controls.

(4) A *firm* may, but is not required to, use statistical models to identify potential harms, but where it does so, the *firm* should consider the following factors:

(a) the importance of ensuring that the statistical model is properly integrated into the *firm's* wider approach to mitigating risk under the *ICARA process* and appropriately takes into account the *guidance* on assessing harm in *MIFIDPRU* 7;

(b) the *FCA's* expectation that relevant *individuals* within the *firm* who are responsible for the *firm's* risk management function or for the oversight of that function should fully understand how the model operates, including any relevant assumptions or limitations and should be able to explain how this contributes to compliance with the *overall financial adequacy rule*;

(c) the accuracy of the model depends on ensuring that the inputs into the model are appropriate and properly reflect the *firm's* business;

(d) the importance of periodically checking that the outputs of the model remain appropriate. This includes model validation; and

(e) the fact that excessive reliance upon the model may result in the *firm* failing to operate wider risk management systems and controls.

(5) In appropriate cases, it may be reasonable for a *firm* to take into account the impact of insurance when assessing potential harms and considering how the *firm* manages risks. However, *firms* should note that in many cases, insurance may not be an adequate substitute for financial resources that are required to address harm immediately. *Firms* should also consider the terms of any insurance, including any limitations or exclusions, when

assessing the extent to which insurance may be an appropriate and effective risk mitigant.

Examples of situations that may result in material harm to clients

1.3 G In the *FCA's* view, the following are non-exhaustive examples of risks to *clients* or to the market that may arise from a *firm's* business:

(1) breach of an investment mandate, resulting in *clients* being exposed to risks outside of their specified tolerance or to investments which are otherwise unsuitable for their objectives;

(2) trading or dealing errors that result in losses to *clients*;

(3) outages in, or other problems with, the *firm's* systems that cause disruption to the continuity of the *firm's* services (for example, by preventing the *firm's clients* from being able to see the value of their investments or from being able to issue trading instructions), leading to financial losses for *clients*;

(4) corporate finance advice which results in a legal claim against the *firm*;

(5) losses to *clients* caused by the activities of the *firm's tied agents* or *appointed representatives* (including in respect of any business which is not *MiFID business* for which the *firm* may be liable as principal) for which the *firm* is responsible;

(6) provision of unsuitable *investment advice*, for example in relation to pension transfers or investments, resulting in *clients* suffering losses;

(7) failure to comply with any applicable provisions of *CASS*, resulting in potential losses to *clients*; and

(8) the inability to return money received by the *firm* by way of *title transfer collateral arrangement* promptly to a *client* when required.

Examples of situations that may result in harm to the firm

1.4 G (1) Events that result in material harm to a *firm* may affect the viability of the *firm's* business. In turn, that may affect the *firm's* ability to meet its obligations to *clients* or to its other counterparties and may increase the risk of a disorderly wind-down.

(2) In the *FCA's* view, the following are non-exhaustive examples of situations that could result in material harm to a *firm*:

(a) claims on *tied agents* or *appointed representatives* that result in the *firm* being liable as principal;

(b) the failure of significant *clients* or counterparties upon which the *firm* relies to generate a significant proportion of its revenue;

(c) significant operational events, such as the failure of key systems or internal fraud; and

(d) obligations of the *firm* relating to liabilities under a defined benefit pension scheme.

Assessing the harm that may result from insufficient liquidity

1.5 G When assessing potential harms that may occur in connection with its business, a *firm* should consider any potential impact on its *liquid assets*. Where a *firm* has insufficient *liquid assets* to cover the relevant harm, it may find itself unable to pay its debts as they fall due. In turn, this could trigger an unexpected insolvent wind-down, which has the potential to cause harm to *clients*, counterparties and the wider markets.

1.6 G (1) The systems that the *firm* uses to identify and monitor liquidity risk should be tailored to its business lines, the currencies in which it operates, its structure (taking into account, for example, whether it operates *branches* or supports *subsidiaries* or other *group* entities). In addition, those systems should consider liquidity costs, benefits and risks, including intra-day liquidity risks.

(2) The *FCA* expects that the systems that a *firm* uses to identify and monitor liquidity risk will be proportionate to the complexity, size, structure and risk profile of the *firm* and the scope of its operations.

1.7 G When a *firm* is assessing the quality and amount of *liquid assets* that it has available, the *FCA* considers that the following are non-exhaustive factors that may be relevant:

(1) the extent to which assets held by the *firm* can be converted into cash within a reasonable time period;

(2) any legal or operational restrictions that may apply to the *firm* or to particular assets, which may affect the *firm's* ability to realise assets or to access cash in a timely manner;

(3) the extent to which *liquid assets* may be held, or the proceeds of the *firm's* assets may be received, in currencies other than the expected currency of the *firm's* liabilities and the ease with which those currencies can be converted (including in stressed market conditions); and

(4) any legal or practical restrictions on the transferability of funds between the *firm* and other members of its *group*, including in stressed market conditions.

1.8 G When a *firm* is assessing the amount of *liquid assets* it may need to address potential harms, the *FCA* considers that the following are non-exhaustive factors that may be relevant:

(1) any concentration of the *firm's* funding arrangements, including in relation to:

(a) counterparties (or groups of connected counterparties) providing funding;

(b) products or facilities used to provide funding; and

(c) currencies;

(2) the extent to which the *firm* may be exposed to mismatches between the maturity of its assets and its liabilities;

(3) whether stressed market conditions could lead to accelerated cash outflows from the *firm* or longer-term reductions in the availability of *liquid assets*;

(4) whether intra-day obligations could affect the *firm's* ability to meet its payment and settlement obligations in a timely manner (including potential margin calls in relation to the *firm's* own positions, or positions of the *firm's clients* in respect of which the *firm* has an obligation to meet the relevant margin call);

(5) any requirements on the *firm* (whether or not they are legally binding) arising from any off-balance sheet arrangements, including:

(a) commitments under any credit or liquidity facilities (including those which may be cancelled at any time) or guarantees;

(b) obligations under any liquidity facilities supporting securitisation programmes; or

(c) obligations in relation to *client money*;

(6) payments that the *firm* may make to maintain its franchise, reputation or brand or to ensure the continued viability of its business, even though the *firm* may be under no legal obligation to make such payments; and

(7) the possibility of other unexpected payment obligations, such as:

(a) direct or indirect costs arising from litigation;

(b) redress payments; or

(c) fines or penalties.

1.9 G (1) When considering liquidity risks and potential harms, a *firm* should consider whether it has sufficient diversification in funding sources.

(2) A *firm* should consider whether there may be a correlation between different market conditions and the *firm's* ability to access funding from different sources.

(3) When analysing what level of funding diversification is appropriate for its business, a *firm* should consider the following:

(a) the maturity date of any funding arrangements;

(b) the nature of the counterparty providing the funding;

(c) whether the funding arrangement is secured or unsecured;

(d) if the funding arrangement is in the form of a *financial instrument*, the relevant type of instrument;

(e) the currency of the funding arrangement; and

(f) the geographical market of the funding arrangement.

(4) A *firm* should regularly assess whether its ability to raise short, medium and long-term liquidity is sufficient for its ongoing requirements.

1.10 G (1) A *firm* should consider whether it has appropriately addressed potential harms arising from liquidity risks in relation to the following aspects of the *firm's* significant business activities:

(a) product pricing;

(b) performance measurement and incentives; and

(c) the approval process for new products.

(2) The *FCA* expects that a *firm* would take into account the liquidity risks arising from any significant business activities and product lines, whether or not they are accounted for on the *firm's* balance sheet.

(3) The *FCA* also expects that *firms* will have clearly identified the liquidity costs and benefits attributable to particular significant business and product lines and that relevant *individuals* within business line management for those areas will have an appropriate understanding of such costs and benefits.

(4) A *firm* should address all significant business activities, including those that involve the creation of contingent exposures which may not have an immediate balance sheet impact.

(5) Incorporating liquidity pricing into a *firm's* processes may assist in aligning the risk-taking incentives of individual business lines within a *firm* with the liquidity risk and potential harms that may result from the activities of those business lines.

1.11 G (1) *Firms* should consider intra-day liquidity positions when considering liquidity risks and potential harms that may result from their operations.

(2) As part of their *ICARA process*, the *FCA* would expect *firms* to identify:

(a) any significant time-critical payment or settlement obligations and any arrangements that are in place to prioritise such payments;

(b) any significant payment or settlement obligations that the *firm* may have as a result of acting as a custodian or a settlement agent;

(c) any potential net funding shortfalls that the *firm* may have at different points during the *day*;

(d) potential significant disruptions to its intra-day liquidity flows and any arrangements in place to deal with these; and

(e) any arrangements necessary to ensure the proper management of collateral.

1.12 G When identifying liquidity risks and potential material harms that may result in relation to a *firm's* use and management of collateral, the *FCA* expects that the following considerations will be relevant:

(1) the *firm's* ability to distinguish clearly at any time between encumbered assets and assets that are unencumbered and available to meet the *firm's* liquidity needs, particularly in an emergency situation;

(2) the jurisdiction in which the assets are based or registered and any legal or regulatory restrictions that may apply to the availability or use of the assets as a result;

(3) any operational restrictions that may apply in relation to the assets;

(4) the extent to which collateral deposited by the *firm* with a counterparty or third party may have been rehypothecated;

(5) the extent to which the assets available to the *firm* to use as collateral are likely to be acceptable to the *firm's* major counterparties and liquidity providers;

(6) the impact of any existing financing or security arrangements entered into by the *firm* (which may contain financial covenants, warranties, events of default or negative pledge clauses) on the *firm's* ability to provide collateral; and

(7) the potential impact of severe but plausible stressed scenarios on the *firm's* ability to provide collateral where necessary and on any collateral received by the *firm*.

1.13 G A *firm* that has significant positions in foreign currencies should consider the liquidity risk and potential harms that may arise as a result of such positions.

1.14 G As part of its assessment under *MIFIDPRU* 7.9.2R, a *firm* that forms part of a *group* should consider the extent to which membership of that *group* might have an impact on the *firm's* own liquidity position.

In-depth stress testing and reverse stress testing

1.15 G The *guidance* in *MIFIDPRU* 7 Annex 1.16G to *MIFIDPRU* 7 Annex 1.20G is relevant to *firms* with larger or more complex businesses.

1.16 G The *FCA* would normally expect that stress testing carried out by a *firm* would involve the following:

(1) identifying severe but plausible adverse scenarios which are relevant to the *firm* and the market in which it operates;

(2) stating clear assumptions, when compared to the *firm's* business-as-usual projections, which are consistent with the scenarios identified in (1);

(3) considering the impact of the scenarios identified in (1) against the *firm's* own risk appetite, by reference to:

(a) individual business lines or portfolios; and

(b) the overall position of the *firm* as a whole;

(4) assessing the impact of the scenarios in (1) on the *firm's*:

(a) available *own funds* and *liquid assets*; and

(b) *own funds requirement* and *basic liquid assets requirement*;

(5) estimating the effects of scenarios identified in (1) on each of the following as they relate to the *firm*, both before and after taking into account any realistic management actions:

(a) profits and losses;

(b) cash flows;

(c) the liquidity position; and

(d) the overall financial position; and

(6) the *firm's governing body* regularly reviewing the scenarios identified in (1) to ensure that their nature and severity remain appropriate and relevant to the *firm*.

1.17 G When considering the impact of the scenarios in *MIFIDPRU* 7 Annex 1.16G(1) on a *firm's* available *liquid assets*, the *FCA* considers that the following factors may be relevant:

(1) correlations between funding markets;

(2) the effectiveness of diversification across the *firm's* chosen sources of funding;

(3) any potential additional margin calls or collateral requirements;

(4) contingent claims, including potential draws on committed lines extended to third parties or other entities within the *firm's group*;

(5) *liquid assets* absorbed by off-balance sheet vehicles and activities (including conduit financing);

(6) the transferability of *liquid assets*;

(7) access to central bank market operations and liquidity facilities;

(8) estimates of future balance sheet growth;

(9) the continued availability of market liquidity in a number of currently highly liquid markets;

(10) the ability to access secured and unsecured funding;

(11) currency convertibility; and

(12) access to payment or settlement systems on which the *firm* relies.

1.18 G The *FCA* would normally expect that reverse stress testing carried out by a *firm* would involve the following:

(1) identifying a range of adverse circumstances which would cause the *firm's* business model to become unviable;

(2) assessing the likelihood that the adverse circumstances in (1) will occur;

(3) determining whether the risk of the *firm's* business model becoming unviable is unacceptably high when compared with the *firm's* risk appetite or tolerance; and

(4) where the *firm* determines under (3) that the risk is unacceptably high, adopting effective arrangements, processes, systems or other measures to prevent or mitigate that risk. This may include making appropriate changes to the *firm's* business model or operating model.

1.19 G For the purposes of reverse stress testing, the *FCA* considers that the following are non-exhaustive examples of when a *firm's* business model may become unviable:

(1) all or a substantial portion of the *firm's* counterparties being unwilling to continue transacting with the *firm* or seeking to terminate their contracts with it. In some circumstances, the failure of a single major counterparty or *client* may cause a *firm's* business to become unviable, particularly if this could result in wider market disruption;

(2) another member of the *firm's group* becoming unable or unwilling to provide the support which is necessary for the *firm* to continue its business (for example, by withdrawing access to shared services or funding arrangements);

(3) the *firm's* existing shareholders or owners being unwilling to provide new capital when required; or

(4) a sustained and continued reliance on income or revenue generated from a peripheral activity (for example, interest income derived from *client money*).

1.20 G The following table is a simple example of how a *firm* might analyse and record the outcome of stress testing using the *guidance* in *MIFIDPRU* 7 Annex 1.18G.

Example scenario	Likelihood	Mitigants
Failure of a significant counterparty leads to a liquidity shortfall that causes the *firm* to default on its own obligations	Medium – above *firm's* risk appetite	Contingency funding plan
30% drop in revenue over a 6-*month* period leads to sustained losses and management actions have little impact	Low – in line with *firm's* risk appetite	
Management actions after a stress event fail to rebuild capital and the *firm's group* and shareholders are unwilling to inject further capital	Low – in line with *firm's* risk appetite	
Large numbers of staff and outsourced providers are absent due to illness during a pandemic and the *firm* is not able to operate revenue-generating activities for a *month*	High – above *firm's* risk appetite	Identify back up outsourcing providers and enable staff to work from home
Cyber-attack results in the *firm* being unable to access systems and provide services for 3 weeks. This results in loss of revenue, a liquidity shortfall and fines from regulators	Medium – above *firm's* risk appetite	Improvements to cyber resilience

1.21 G A *firm's* business model may become unviable long before the *firm's* financial resources have been exhausted. The *FCA* recognises that not every business failure is the result of a lack of financial resources and individual *firms* may vary in their assessment of when they would be unwilling or unable to continue carrying on their activities. Non-exhaustive examples of where a *firm's* business model may become unviable before its financial resources are exhausted include:

(1) the *firm* has a sustained and continued reliance on income or revenue generated from a peripheral or ancillary activity, such as interest income derived from *client money*; or

(2) where the *firm* is reliant on *title transfer collateral arrangements* to meet its *basic liquid assets requirement* on a sustained basis.

7 Annex 2 Additional guidance on assessing potential harms that is relevant for firms dealing on own account or firms with significant investments on their balance sheet

Purpose

2.1 G (1) This annex contains *guidance* on how a *MIFIDPRU investment firm* can assess the potential harms arising from its business as part of its *ICARA process*. This *guidance* is primarily intended to be relevant to *firms* that *deal on own account* or hold significant investments on their balance sheets. It should be interpreted in light of the *firm's* individual business model.

(2) *Firms* are reminded that their *ICARA process* must be proportionate to the nature, scale and complexity of their activities. This *guidance* should be interpreted by reference to what is proportionate for a particular *firm*.

2.2 G *Firms* that *deal on own account* or hold significant investments on their balance sheets may be at increased risk of events that result in significant losses or other harm to the *firm*. In turn, this may increase the risk of a *firm* defaulting on its obligations to counterparties or becoming insolvent and entering a disorderly wind-down.

Examples of situations that may result in material harm to the firm

2.3 G In the *FCA's* view, the following are non-exhaustive examples of situations that may result in harm to the *firm*:

(1) material adverse changes in the book value of the *firm's* assets;

(2) the failure of the *firm's clients* or counterparties; and

(3) losses incurred or payments due in connection with positions taken by the *firm* in *financial instruments*, foreign currencies and commodities (irrespective of whether those positions form part of the *firm's trading book* or not).

2.4 G When a *firm* is assessing potential harms connected with material changes in the book value of the *firm's* assets, the following are non-exhaustive factors that may be relevant:

(1) changes in the creditworthiness or the default of a *client* or counterparty, where that change or default may result in the *firm* realising assets below their book value or recording impairments, revaluations or write-downs;

(2) changes in market conditions which may affect relevant prices, indices or rates, including changes in equity, debt or foreign exchange markets or interest rates;

(3) operational events or natural disasters that may affect the value of the *firm's* assets;

(4) any concentration of the *firm's* assets in relation to a specific:

(a) *client* or counterparty (or group of connected *clients* or counterparties);

(b) economic sector or sub-sector; or

(c) geographical market.

In the *FCA's* view, this concentration assessment should not be limited to the particular risks covered by the requirements in *MIFIDPRU* 5, but should involve a broader assessment of the risks that may arise in relation to any such concentration;

(5) whether any of the *firm's* assets are, or have a value which is dependent upon, complex products, such as interests in securitisations or structured products which are complex or opaque;

(6) the extent to which the *firm* has used leverage (including contingent leverage); and

(7) whether the *firm* has any exposures under off-balance sheet items, such as commitments or guarantees.

2.5 G When a *firm* is assessing potential harms arising from the failure of its *clients* or counterparties, the *FCA* considers that the following are non-exhaustive factors that may be relevant:

(1) changes in the creditworthiness or the default of a *client* or counterparty, which may result in direct losses for the *firm* or the need to revalue or replace transactions;

(2) changes in market conditions which may result in the *firm* incurring greater costs to replace a transaction that the *client* or counterparty has failed to settle;

(3) the risk that collateral received from the *client* or counterparty may not be as effective as expected at covering the losses arising from that *client* or counterparty's failure or default; and

(4) any concentration of the *firm's* exposures in relation to the *client* or counterparty or the economic sector or geographical market in which that *client* or counterparty is active.

2.6 G Where a *firm* is subject to the *K-TCD requirement* or the *K-CON requirement*, the *FCA* would generally expect the *firm* to consider whether those requirements are sufficient to cover the harms that may result from the failure of its *clients* or counterparties to fulfil their obligations. In some cases, those requirements may not apply in relation to the *client*, counterparty or position in question, or may not adequately address the relevant risks. Where this is the case, the *firm* should consider other measures to address the potential harm.

2.7 G Where a *firm* is assessing potential harms arising from the *firm's* positions in *financial instruments*, foreign currencies and commodities, the *FCA* considers that the following are non-exhaustive factors that may be relevant:

(1) the extent to which the relevant position may involve risks that are not adequately captured by the *firm's K-NPR requirement*, *K-CMG requirement* or *K-CON requirement*, such as:

(a) basis risk between certain products;

(b) risks arising from approximate valuations applied to non-linear products;

(c) the risk that large movements in pegged currencies may be underestimated; or

(d) risks arising from inadequate proxy market data;

(2) whether a position is illiquid or distressed, or whether it may become so under severe but plausible market conditions, and how this may affect the expected holding period for that position;

(3) the extent to which it is possible to hedge a position under both normal, and severe but plausible, market conditions;

(4) whether a position is difficult to value because of a lack of recent observable market data;

(5) whether the intra-day exposure associated with a position differs significantly from the end-of-day exposure;

(6) any known weaknesses in any model used by the *firm* to assess the risks arising from the position; and

(7) the concentration of the portfolio in which the position is held, including by reference to:

(a) issuers or counterparties;

(b) economic sectors or sub-sectors; and

(c) geographical markets.

7 Annex 3 Notification under MIFIDPRU 7.6.11R in relation to level of own funds

R [*Editor's note*: The form can be found at this address: https://www.fca.org.uk/publication/forms/[xxx]]

7 Annex 4 Notification under MIFIDPRU 7.7.14R in relation to level of liquid assets

R [*Editor's note*: The form can be found at this address: https://www.fca.org.uk/publication/forms/[xxx]]

7 Annex 5 Notification under MIFIDPRU 7.8.5R of submission date of data item MIF007

R [*Editor's note*: The form can be found at this address: https://www.fca.org.uk/publication/forms/[xxx]]

7 Annex 6 Notification under MIFIDPRU 7.1.9R in relation to non-SNI thresholds for applying committee requirements and extended remuneration requirements

R [*Editor's note*: The form can be found at this address: https://www.fca.org.uk/publication/forms/[xxx]]

7 Annex 7 Map of rules and guidance relating to the ICARA process

7.1 G (1) The table in this annex identifies the *rules* in *MIFIDPRU* 7 that impose obligations relating to the *ICARA process* and the *guidance* provisions corresponding to those *rules*.

(2) *MIFIDPRU investment firms* may find this annex helpful when designing and reviewing their *ICARA processes* to ensure that all mandatory requirements have been met.

(3) *Firms* should not use this table as a substitute for reading and applying the detailed *rules* and *guidance* in *MIFIDPRU* 7.

MIFIDPRU rule	**Basic obligation**	**Associated guidance**	**Content of guidance**
***MIFIDPRU* 7.4: baseline ICARA obligations**			
MIFIDPRU 7.4.7R	The *overall financial adequacy rule*	*MIFIDPRU* 7.4.8G	Explanation of the link between the *overall financial adequacy rule* and the *ICARA process*
MIFIDPRU 7.4.9R	The requirement to operate an *ICARA process* to identify, monitor and, if proportionate, reduce all material potential harms relevant to the *firm*	*MIFIDPRU* 7.4.16G	*Guidance* on how *firms* should seek to mitigate the risk of potential harms
MIFIDPRU 7.4.10R	The requirement for the *ICARA process* to be proportionate to the nature, scale and complexity of the *firm's* business		
MIFIDPRU 7.4.11R	The requirement for the *ICARA process* to be internally consistent	*MIFIDPRU* 7.4.12G	Explanation of the *FCA's* expectations in relation to consistency and coherency of the *ICARA process*
MIFIDPRU 7.4.13R	The requirement to identify all material harms	*MIFIDPRU* 7.4.14G	Explanation of the basic factors that will be relevant when

	that may result from the *firm's* business		identifying potential harms
		MIFIDPRU 7.4.15G	Cross-reference to additional *guidance* in *MIFIDPRU* 7 Annex 1R and *MIFIDPRU* 7 Annex 2R
		MIFIDPRU 7 Annex 1G	General *guidance* on identifying potential harms that may be relevant to all *firms*
		MIFIDPRU 7 Annex 2G	Additional *guidance* on identifying potential harms that may be relevant for a *firm* that is *dealing on own account* or that has significant balance sheet positions
***MIFIDPRU* 7.5: Capital and liquidity planning, stress testing, wind-down planning and recovery planning**			
MIFIDPRU 7.5.2R	Business model assessment and capital and liquidity planning requirements, including stress testing	*MIFIPRU* 7.5.3G	*Guidance* referring to Finalised Guidance FG20/1
		MIFIDPRU 7.5.4G	*Guidance* on stress testing obligations and reverse stress testing for larger or more complex *firms*
		MIFIDPRU 7 Annex 1.15G to 7 Annex 1.20G	Additional *guidance* on more in-depth stress testing and reverse stress testing
MIFIDPRU 7.5.5R	Recovery planning requirements	*MIFIDPRU* 7.5.6G	*Guidance* on issues that may be relevant when assessing potential recovery actions

MIFIDPRU 7.5.7R	Wind-down planning requirements	*MIFIDPRU* 7.5.8G	*Guidance* referring to the Wind-Down Planning Guide and Finalised Guidance FG20/1
MIFIDPRU 7.5.9R	Requirement to use wind-down analysis to assess levels of *own funds* and *liquid assets* required under *overall financial adequacy rule*	*MIFIDPRU* 7.5.10G	Explanation of the interaction between the *overall financial adequacy rule* and the *wind-down triggers*
MIFIDPRU* 7.6: Assessing and monitoring the adequacy of *own funds			
MIFIDPRU 7.6.2R	Requirement to produce a reasonable estimate of impact of potential harms on *own funds*	*MIFIDPRU* 7.6.4G	*Guidance* on how the assessment of potential harms interacts with the *own funds threshold requirement* and the *overall financial adequacy rule* and how the *firm* should conduct its assessment
MIFIDPRU 7.6.3R	Requirement to use assessment under *MIFIDPRU* 7.6.2R to assess if additional *own funds* required to meet *overall financial adequacy rule*		
		MIFIDPRU 7.6.6G	*Guidance* explaining the circumstances in which the *guidance* in *MIFIDPRU* 7.6.7G to *MIFIDPRU* 7.6.10G is relevant
		MIFIDPRU 7.6.7G	*Guidance* on how a *non-SNI MIFIDPRU investment firm* should assess whether harms may be covered by its *own funds requirement*
		MIFIDPRU 7.6.8G	*Guidance* on circumstances in which harms may not be covered by a *non-SNI MIFIDPRU*

			investment firm's own funds requirement
		MIFIDPRU 7.6.9G	*Guidance* on how an *SNI MIFIDPRU investment* should assess whether harms may be covered by its *own funds requirement*
		MIFIDPRU 7.6.10G	*Guidance* on how a *firm's* assessment of potential harms contributes to determining its *own funds threshold requirement*
MIFIDPRU 7.6.5R	Requirement to meet *own funds threshold requirement* with specified types of *own funds*		
MIFIDPRU 7.6.11R	Notification requirements when a *firm's own funds* reach certain levels	*MIFIDPRU* 7.6.12G	*Guidance* on the *FCA's* ability to set an alternative *early warning indicator*
		MIFIDPRU 7.6.13G	*Guidance* explaining how notifications under *MIFIDPRU* 7.6.11R interact with general notification obligations under *Principle* 11 or *SUP* 15.3
		MIFIDPRU 7.6.14G and *MIFIDPRU* 7.6.15G	Explanation of *FCA's* approach to intervention when *firm's own funds* reach certain levels
MIFIDPRU* 7.7: Assessing and monitoring the adequacy of *liquid assets			
MIFIDPRU 7.7.2R	Requirement to produce reasonable	*MIFIDPRU* 7.7.3G	*Guidance* on the interaction between the *overall financial*

	estimate of *liquid assets* required by the *firm*		*adequacy rule* and the *liquid assets* that a *firm* must hold
		MIFIDPRU 7.7.4G	*Guidance* on how a *firm* should assess the *liquid assets* required for the ongoing operation of its business
		MIFIDPRU 7.7.5G	*Guidance* on the *basic liquid assets requirement* and how to determine the *firm's liquid assets threshold requirement*
MIFIDPRU 7.7.6R	Requirement to meet *liquid assets threshold requirement* with *core liquid assets* and *non-core liquid assets*	*MIFIDPRU* 7.7.7G	General principles applicable to *non-core liquid assets*
MIFIDPRU 7.7.8R	Basic definition of *non-core liquid assets*	*MIFIDPRU* 7.7.9G	*Guidance* on exclusions for *non-core liquid assets*
MIFIDPRU 7.7.10R	Requirement to apply appropriate haircut to *non-core liquid assets*	*MIFIDPRU* 7.7.11G and 7.7.12G	*Guidance* on minimum haircuts for *non-core liquid assets*
		MIFIDPRU 7.7.13G	*Guidance* on approach to applying haircuts to shares or units in collective investment undertakings
MIFIDPRU 7.7.14R	Notification requirements when a *firm's liquid assets* reach certain levels	*MFIIDPRU* 7.7.15G	*Guidance* explaining how notifications under *MIFIDPRU* 7.6.14R interact with general notification obligations under *Principle* 11 or *SUP* 15.3

		MIFIDPRU 7.7.16G and 7.7.17G	Explanation of *FCA's* approach to intervention when *firm's liquid assets* reach certain levels
MIFIDPRU* 7.8: Reviewing and documenting the *ICARA process			
MIFIDPRU 7.8.2R	Requirement to review the *ICARA process* at least annually	*MIFIDPRU* 7.8.3G	*Guidance* about when a large or complex *firm* should review its *ICARA process* more frequently
		MIFIDPRU 7.8.4G	*Guidance* on reviewing the *ICARA process* following a material change in the *firm's* business
MIFIDPRU 7.8.5R	Requirement for *firm* to notify the *FCA* of the submission date of the *firm's* MIF007 (ICARA assessment questionnaire) return	*MIFIDPRU* 7.8.6G	*Guidance* on interaction between the *firm's ICARA review* and its submission date for its MIF007 return
MIFIDPRU 7.8.7R	Requirement to submit MIF007 return following review of *ICARA process* due to a material change in the *firm's* business		
MIFIDPRU 7.8.8R	Requirement to document review of the *ICARA process* and minimum contents of review document		
MIFIDPRU 7.8.9R	Requirement for *firm's governing body* to review	*MIFIDPRU* 7.8.10G	*Guidance* on the interaction between the obligations in

	and approve the *ICARA document*		*COCON* and the *ICARA process*
MIFIDPRU 7.8.11R	Record keeping requirements in relation to the *ICARA process*		
MIFIDPRU* 7.9: Firms forming part of a *group			
MIFIDPRU 7.9.2R	Requirement for any *firm* that forms part of a *group* to assess risks arising from that *group* or its other members	*MIFIDPRU* 7.9.3G	*Guidance* on the entities included within a *firm's* assessment of *group* risk
MIFIDPRU 7.9.5R	Ability of *investment firm group* to operate the *ICARA process* on a *group*-level basis	*MIFIDPRU* 7.9.4G	*Guidance* that an *investment firm group* is not required to operate an *ICARA process* on a *consolidated basis*
MIFIDPRU 7.9.6R	Disapplication of individual *ICARA process* requirement in relation to *MIFIDPRU investment firm* included in a *group ICARA process*		
MIFIDPRU 7.9.7R	Circumstances in which a *group ICARA process* cannot be used	*MIFIDPRU* 7.9.9G	*Guidance* on when the *FCA* might prohibit the use of a *group*-level *ICARA process* in relation to one or more *firms*
MIFIDPRU 7.9.8R	Application of requirements in *MIFIDPRU* 7.4 to *MIFIDPRU* 7.8 to an *investment firm*		

	group operating a *group ICARA process*		
MIFIDPRU 7.9.10R	Ability to include multiple *firms* within one *ICARA document*	*MIFIDPRU* 7.9.11G	*Guidance* on when a single *ICARA document* can be used

In the following text, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

9 Reporting

…

9.2 Periodic reporting requirements

… …

9.2.2 R The following table belongs to *MIFIDPRU* 9.2.1R:

(A) ***Data item***	**(B)** ***Data item* description**	**(C)** **Reporting frequency**	**(D)** **Reporting reference dates**	**(E)** **Submission deadline**
…	…	…	…	…
MIF005	K-CON concentration risk reporting	Quarterly	Last *business day* in: (1) March; (2) June; (3) September; (4) December	20 *business days* after the reporting reference date
<u>MIF007</u> <u>(note 1)</u>	<u>ICARA assessment questionnaire</u>	<u>Annually</u> <u>(note 2)</u>	<u>The reference date according to which the *firm* reviews the adequacy of its *ICARA process* under</u>	<u>The date notified to the *FCA* by the *firm* under *MIFIDPRU* 7.8.5R (or such other date as</u>

			MIFIDPRU 7.8.2R	directed by the *FCA*)
Note 1	Where a *firm* is included in a *group ICARA process* in accordance with *MIFIDPRU* 7.9.5R, the *firm* must still submit *data item* MIF007 on an individual basis, containing information about the *firm* that has been derived from that *group ICARA process*. *Data item* MIF007 does not apply on a *consolidated basis*.			
Note 2	Under *MIFIDPRU* 7.8.2R, in certain circumstances, a *firm* may carry out a review of its *ICARA* process more frequently than the minimum required annual frequency. If so, the *firm* must submit *data item* MIF007 separately after each review.			

…

9.2.4 R The following table belongs to *MIFIDPRU* 9.2.3R:

(A) ***Data item***	**(B)** ***Data item* description**	**(C)** **Reporting frequency**	**(D)** **Reporting reference dates**	**(E)** **Submission deadline**
…	…	…	…	…
MIF003	Metrics monitoring	Quarterly	Last *business day* in: (1) March; (2) June; (3) September; (4) December	20 *business days* after the reporting reference date
MIF007 (note 2)	ICARA assessment questionnaire	Annually (note 3)	The reference date according to which the *firm* reviews the adequacy of its *ICARA process* under *MIFIDPRU* 7.8.2R	The date notified to the *FCA* by the *firm* under *MIFIDPRU* 7.8.5R (or such other date as directed by the *FCA*)

Note 1	If, exceptionally, the *FCA* has exempted an *SNI MIFIDPRU investment firm* from the liquidity requirements in *MIFIDPRU* 6, the *firm* is not required to submit MIF002.
Note 2	Where a *firm* is included in a *group ICARA process* in accordance with *MIFIDPRU* 7.9.5R, the *firm* must still submit *data item* MIF007 on an individual basis, containing information about the *firm* that has been derived from that *group ICARA process*. *Data item* MIF007 does not apply on a *consolidated basis*.
Note 3	Under *MIFIDPRU* 7.8.2R, in certain circumstances, a *firm* may carry out a review of its *ICARA* process more frequently than the minimum required annual frequency. If so, the *firm* must submit *data item* MIF007 separately after each review.

…

Insert the following new chapter, MIFIDPRU 10, after MIFIDPRU 9 (Reporting). The text is not underlined.

10 Firms acting as clearing members and indirect clearing firms

10.1 Application

10.1.1 R This chapter applies to a *MIFIDPRU investment firm* that is:

(1) a *clearing member*; or

(2) an *indirect clearing firm*.

10.1.2 R This chapter also applies to the *UK parent entity* of an *investment firm group* that contains a *clearing member* or an *indirect clearing firm*.

10.2 Categorisation of clearing firms as non-SNI MIFIDPRU investment firms

10.2.1 R (1) A *MIFIDPRU investment firm* that is a *clearing member* or an *indirect clearing firm* is a *non-SNI MIFIDPRU investment firm*.

(2) The classification in (1) applies irrespective of whether the *firm* satisfies the conditions in *MIFIDPRU* 1.2 (SNI MIFIDPRU investment firms) or not.

10.2.2 R (1) This *rule* applies where:

(a) an *investment firm group* contains a *clearing member* or an *indirect clearing firm*; and

(b) the *UK parent entity* of the *investment firm group* in (a) is subject to prudential consolidation in accordance with *MIFIDPRU* 2.5 (Prudential consolidation).

(2) Where this *rule* applies, the *UK parent entity* in (1) must comply with the relevant obligations in *MIFIDPRU* on a *consolidated basis* as if it were a *non-SNI MIFIDPRU investment firm*.

(3) The requirement in (2) applies irrespective of whether the *UK parent entity* satisfies the conditions in *MIFIDPRU* 2.5.21R or not.

10.2.3 G (1) The effect of *MIFIDPRU* 10.2.1R is that a *firm* that acts as a *clearing member* or *indirect clearing firm* will always be a *non-SNI MIFIDPRU investment firm*. This is the case even where the *firm* might otherwise satisfy all the other criteria in *MIFIDPRU* 1.2 to be classified as an *SNI MIFIDPRU investment firm*.

(2) The effect of *MIFIDPRU* 10.2.2R is that where the *consolidated situation* of a *UK parent entity* includes a *clearing member* or *indirect clearing firm*, that *UK parent entity* will always be a *non-SNI MIFIDPRU investment firm* on a *consolidated basis*.

(3) *MIFIDPRU* 10.2.1R applies equally to a *firm* that is a self-clearing *firm*.

10.3 Application of K-DTF requirement to clearing activities

10.3.1 R (1) This *rule* applies to transactions in *financial instruments* in relation to which a *MIFIDPRU investment firm* provides clearing services in its capacity as a *clearing member* or an *indirect clearing firm*.

(2) Except where *MIFIDPRU* 10.3.2R applies, a *firm* must include the transactions in (1) in its calculation of *DTF* for the purposes of the *K-DTF requirement* in accordance with the remainder of this *rule*.

(3) The transactions in (1) must be included in a *firm's DTF* on the following basis:

(a) where the order that gave rise to the clearing transaction was a *cash trade*, the clearing transaction must also be treated as if it were a *cash trade* (irrespective of whether it would otherwise meet that definition); and

(b) where the order that gave rise to the clearing transaction was a *derivatives trade*, the clearing transaction must also be treated as if it were a *derivatives trade* (irrespective of whether it would otherwise meet that definition).

10.3.2 R (1) This *rule* applies where a *firm*:

(a) executes an order:

(i) in its own name (whether for its own account or on behalf of a *client*); or

(ii) in the name of a *client*; and

(b) also provides clearing services in its capacity as a *clearing member* or *indirect clearing firm* in relation to a transaction that results from the order in (a).

(2) Where this *rule* applies, the value of the relevant order in (1)(a) is not included in the *firm's* measurement of *DTF* attributable to clearing services under *MIFIDPRU* 10.3.1R, provided that the value of the order has already been included in one of the following in relation to the *firm's* execution services:

(a) the calculation of the *firm's COH* under *MIFIDPRU* 4.10 (K-COH requirement); or

(b) the calculation of the *firm's DTF* under *MIFIDPRU* 4.15 (K-DTF requirement).

10.3.3 G (1) *MIFIDPRU* 10.3.1R requires a *MIFIDPRU investment firm* to calculate an additional *K-DTF requirement* in relation to any clearing transactions it undertakes in relation to *financial instruments*.

(2) *MIFIDPRU* 10.3.2R applies to a *MIFIDPRU investment firm* that both executes an order and subsequently provides clearing services in relation to the resulting transaction (including where the *firm* is acting as a self-clearing *firm*). In this scenario, the *firm* is not required to include the clearing transaction in its calculation of *DTF*, provided that the value of the original executed order has already been included in either the *firm's* measurement of its *DTF* or *COH*.

(3) The intention of *MIFIDPRU* 10.3.2R is that a *firm* is not required to "double-count" the value of the original order and the resulting clearing transaction where the *firm* is involved in both executing and clearing the same trade.

10.3.4 R Where prudential consolidation applies to a *UK parent entity* under *MIFIDPRU* 2.5.7R, the *UK parent entity* must include within the calculation of its consolidated *K-DTF requirement* any transactions that are cleared by *clearing members* or *indirect clearing firms* that are included within its *consolidated situation*.

10.4 Own funds requirement for CCP default fund exposures

10.4.1 R This section applies to:

(1) a *MIFIDPRU investment firm* that is a *clearing member*; and

(2) a *UK parent entity* to which consolidation under *MIFIDPRU* 2.5.7R applies, where the relevant *investment firm group* includes one or more *clearing members*.

10.4.2 R (1) A *MIFIDPRU investment firm* must include its pre-funded contributions to the default fund of a *CCP* in the calculation of its *K-TCD requirement* in accordance with the remainder of this *rule*.

(2) The *firm* must apply the *rules* and *guidance* in *MIFIDPRU* 4.14 (K-TCD requirement) in relation to the relevant default contribution with the following modifications:

(a) the transactions specified in *MIFIDPRU* 4.14.3R shall be deemed to include pre-funded contributions made by the *firm* to the default fund of a *CCP*;

(b) for the purposes of *MIFIDPRU* 4.14.9R, the replacement cost (RC) of the default fund contribution shall be the book value of that asset in accordance with the applicable accounting framework;

(c) for the purposes of *MIFIDPRU* 4.14.29R, the applicable risk factor shall be 8%; and

(d) for the purposes of *MIFIDPRU* 4.14.30R, the credit valuation adjustment (CVA) shall be 1.

10.4.3 G (1) For the avoidance of doubt, where a *MIFIDPRU investment firm* that is a *clearing member* or an *indirect clearing firm* has trade exposures to a *CCP*, it should consider whether such exposures arise from a transaction listed in *MIFIDPRU* 4.14.3R as being within scope of the *K-TCD requirement*. *MIFIDPRU* 4.14.3R(1)(a) and *MIFIDPRU* 4.14.4R exclude from the scope of the *K-TCD requirement* derivatives contracts that are directly or indirectly cleared through an *authorised central counterparty*.

(2) However, the exclusion in (1) does not apply to a pre-funded contribution of a *clearing member* to the default fund of a *CCP*, as such an exposure is not a contract cleared through the *authorised central counterparty*. *MIFIDPRU* 10.4.2R explains how a *firm* should calculate the *K-TCD requirement* in relation to such a contribution.

10.4.4 R Where this section applies to a *UK parent entity* in accordance with *MIFIDPRU* 10.4.1R(2), the requirement in *MIFIDPRU* 10.4.2R and the modifications it makes to the *rules* and *guidance* in *MIFIDPRU* 4.14 apply to that *UK parent entity* in relation to any pre-funded contributions to the default fund of a *CCP* made by any entities included within the *consolidated situation*.

In the following text, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

TP 1 Own funds transitional provisions

Application

1.1 R *MIFIDPRU* TP 1 applies to:

(1) a *MIFIDPRU investment firm*; ~~and~~

(2) a *UK parent entity* that is required by *MIFIDPRU* 2.5.7R to comply with *MIFIDPRU* 3 on the basis of its *consolidated situation*~~.~~; and

(3) a *parent undertaking* to which the *group capital test* applies.

…

Continuing validity of IFPRU own funds notifications

1.12 R (1) This *rule* applies to any notification listed in column (A) of the table in *MIFIDPRU* TP 1.13R, where that notification was validly submitted by a *firm* or *parent undertaking* to the *FCA* for the purposes of the relevant *rule* in the *IFPRU* sourcebook before [*Editor's note*: insert date that MIFIDPRU sourcebook begins to apply].

(2) Where this *rule* applies, a notification in column (A) of the table in *MIFIDPRU* TP 1.13R shall be deemed to have been a valid notification for the purposes of the corresponding provision in column (B) in the same row of that table.

1.13 R The table belongs to *MIFIDPRU* TP 1.12R.

(A) **IFPRU notification submitted before** [*Editor's note*: insert date that MIFIDPRU sourcebook begins to apply]	**(B)** **Deemed notification for the purposes of MIFIDPRU on or after** [*Editor's note*: insert date that MIFIDPRU sourcebook begins to apply]
IFPRU 3.2.10R: notification of issuance of own funds instruments	*MIFIDPRU* 3.6.5R(1) (for a *MIFIDPRU investment firm*) *MIFIDPRU* 3.6.8R(1)(b) (for a *UK parent entity* to which consolidation under *MIFIDPRU* 2.5.7R applies)

	MIFIDPRU 3.7.4R(1)(b) (for a *parent undertaking* to which the *group capital test* applies)
IFPRU 3.2.13R: notification of issuance of ordinary *shares* or debt instruments under a debt securities programme	*MIFIDPRU* 3.6.5R(1) (for a *MIFIDPRU investment firm*) *MIFIDPRU* 3.6.8R(1)(b) (for a *UK parent entity* to which consolidation under *MIFIDPRU* 2.5.7R applies) *MIFIDPRU* 3.7.4R(1)(b) (for a *parent undertaking* to which the *group capital test* applies)

1.14 G The effect of *MIFIDPRU* TP 1.12R and 1.13R is that a notification that was validly submitted for the purposes of the *rules* relating to the issuance of own funds in *IFPRU* continues to be valid for the purposes of the notification requirements relating to the issuance of *own funds* in *MIFIDPRU* 3.6 or 3.7 (as applicable). This means that:

(1) a *MIFIDPRU investment firm* or *parent undertaking* to which *IFPRU* applied is not required to submit another notification to the *FCA* in relation to pre-existing instruments in order to treat those instruments as *additional tier 1 instruments* or *tier 2 instruments* under *MIFIDPRU*; and

(2) where the *MIFIDPRU investment firm* or *parent undertaking* issues the same class of instruments on or after [*Editor's note*: insert date that MIFIDPRU begins to apply], it can rely on the exemption from the notification requirement in *MIFIDPRU* 3.6.5R(2), provided that such instruments are identical in all material respects to the previous issuance notified to the *FCA* under *IFPRU*.

1.15 G For the avoidance of doubt, *MIFIDPRU* TP 1.12R and 1.13R do not affect the underlying criteria in *MIFIDPRU* 3 for classifying an instrument as *own funds*. Instead, those provisions merely deem existing notifications to be notifications for equivalent purposes under *MIFIDPRU*. This means that if the instruments that are the subject of the notifications do not meet the criteria in *MIFIDPRU* 3 to be classified as *own funds*, a *firm* or *parent undertaking* must not treat those instruments as such. It is the responsibility of the *firm* or *parent undertaking* relying on the transitional provisions in this annex to assess whether the relevant criteria are met in relation to any particular instrument.

TP 2 Own funds requirements: transitional

…

Transitional for fixed overheads requirement and K-factor requirement for former IFPRU investment firms and BIPRU firms

2.7 R …

(2) A *firm* may substitute the alternative requirement in (3) for each of:

(a) its *fixed overheads requirement* under *MIFIDPRU* 4.5; and

(b) to the extent applicable, its *K-factor requirement* under *MIFIDPRU* 4.6.

…

…

Transitional for fixed overheads requirement and K-factor requirement for former exempt CAD firms

2.10 R …

(2) A *firm* may substitute the alternative requirement in (3) in place of each of:

(a) its *fixed overheads requirement* under *MIFIDPRU* 4.5; and

(b) to the extent applicable, its *K-factor requirement* under *MIFIDPRU* 4.6.

…

Transitional for K-factor requirement for firms not in existence before [*Editor's note*: insert the date on which MIFIDPRU begins to apply]

2.11 R …

(3) The alternative requirement is an amount equal to twice the *fixed overheads requirement* of the *firm*, as calculated in accordance with *MIFIDPRU* 4.5 from time to time.

…

…

Transitional for fixed overheads and K-factor requirements: exempt commodities firms

2.21 R …

(2) A *firm* may substitute the alternative requirement in (3) in place of each of:

(a) its *fixed overheads requirement* under *MIFIDPRU* 4.5; and

(b) to the extent applicable, its *K-factor requirement* under *MIFIDPRU* 4.6.

…

…

Continuing validity of UK CRR market risk permissions

2.24 R (1) This *rule* applies to any permission listed in column (A) of the table in *MIFIDPRU* TP 2.25R, where that permission was granted to a *firm* by the *FCA* for the purposes of the *UK CRR* before [*Editor's note*: insert date that MIFIDPRU sourcebook begins to apply].

(2) Where this *rule* applies, a permission in column (A) of the table in *MIFIDPRU* TP 2.25R shall be deemed to have the effect described in column (B) in the same row of that table.

2.25 R This table belongs to *MIFIDPRU* TP 2.24R.

(A) **UK CRR permission granted before** [*Editor's note*: insert date that MIFIDPRU sourcebook begins to apply]	**(B)** **Effect of permission under MIFIDPRU on or after** [*Editor's note*: insert date that MIFIDPRU sourcebook begins to apply]
Articles 329, 352(1) or 358 *UK CRR*: permission to use own estimates for delta for the purposes of the standardised approach for the market risk of options	The permission in column (A) shall be deemed to be a valid notification under *MIFIDPRU* 4.12.10R for equivalent purposes.
Article 331 *UK CRR*: permission to use sensitivity models to calculate interest rate risk	The permission in column (A) shall be deemed to have been granted on equivalent terms for its remaining duration under *MIFIDPRU* 4.12.66R.[5]

2.26 G (1) *MIFIDPRU* 4.12.10R requires a *MIFIDPRU investment firm* that wishes to use its own estimates of delta for the purposes

[5] *Editor's note*: The FCA will explain its approach to sensitivity model permissions in the policy statement responding to CP20/24 and the near-final rules that will be published alongside that policy statement.

of the standardised approach for the market risk of options to notify the *FCA* that it meets certain minimum standards before doing so. Previously, *firms* that were subject to the *UK CRR* were required to seek the *FCA's* permission before using their own estimates of delta for these purposes. The effect of *MIFIDPRU* TP 2.24R and 2.25R is that any permission granted for these purposes to a former *CRR firm* that has subsequently become a *MIFIDPRU investment firm* will be treated as a valid notification for the purposes of *MIFIDPRU* 4.12.10R. This means that the *firm* does not need to submit a new notification under *MIFIDPRU* 4.12.10R in order to use its own estimates of delta under that *rule* for which the *firm* previously had permission.

(2) The effect of *MIFIDPRU* TP 2.24R and 2.25R is that a former *CRR firm* that was granted a permission to use interest rate sensitivity models under article 331 *UK CRR* and that has subsequently become a *MIFIDPRU investment firm* can treat that permission as having been granted on equivalent terms for the purposes of the corresponding requirement under *MIFIDPRU*. The duration of the original permission is not affected. For example, if a *firm* was granted permission to use an interest rate sensitivity model on 1 June 2021 for a one-year duration, that permission will be treated from [*Editor's note*: insert date that MIFIDPRU sourcebook begins to apply] as if it had been granted under *MIFIDPRU*, but will still expire on 1 June 2022.

…

TP 4 K-factor metric calculations: transitional

…

Purpose

4.3 G (1) The standard *rules* in *MIFIDPRU* 4 require a *MIFIDPRU investment firm* to collect data on the *K-factor metrics* that are relevant to the *investment services and/or activities* that the *firm* carries on. Certain ~~*K-factor metric*~~ *K-factor average metric* calculations are based on average values and require a minimum level of historical data.

(2) *MIFIDPRU* TP 4 contains transitional rules for the calculation of a *firm's K-factor requirement* where a *firm* was carrying on *investment services and/or activities* immediately before *MIFIDPRU* began to apply, but does not have the historical data necessary to calculate the relevant ~~*K-factor metric*~~ *K-factor average metric*.

…

(4) *MIFIDPRU* TP 4 does not apply to the extent that a *firm* modifies its *permissions* on or after [*Editor's note*: insert the date on which MIFIDPRU begins to apply] to carry on new *investment services and/or activities*. In that case, to the extent relevant to the new activity, the *rules* in *MIFIDPRU* 4 specify that the *firm* should use the information in the business projections submitted with its application for a variation of *permission* to calculate the relevant ~~*K-factor metric*~~ *K-factor average metric* until historical data becomes available.

Duration

4.4 G The duration of the transitional arrangements in *MIFIDPRU* TP 4 depends on the relevant ~~*K-factor metric*~~ *K-factor average metric*. Under *MIFIDPRU* TP 4.5.R(3), the transitional arrangements cease to apply once a *firm* has (or should have) collected sufficient historical information to perform the necessary calculations in accordance with the standard calculation *rules* for the relevant ~~*K-factor metric*~~ *K-factor average metric* in *MIFIDPRU* 4.

Missing historical data for K-factor calculations: transitional for individual MIFIDPRU firms

4.5 R (1) This *rule* applies to the extent that a *MIFIDPRU investment firm* does not have the necessary historical data to calculate the ~~*K-factor metric*~~ *K-factor average metric* required for any of the following in accordance with the relevant *rules* in *MIFIDPRU* 4:

(a) its *K-AUM requirement*;

(b) its *K-CMH requirement*;

(c) its *K-ASA requirement*;

(d) its *K-COH requirement*;

(e) its *K-DTF requirement*; or

(d) its *K-CMG requirement*.

(2) Subject to *MIFIDPRU* TP 4.13R(2)(a), where this *rule* applies, a *firm* may either:

(a) use reasonable estimates to fill any missing historical data points in the calculation of the relevant ~~*K-factor metric*~~ *K-factor average metric*; or

(b) by way of derogation from the standard calculation *rules* in *MIFIDPRU* 4, use the modified calculation in

MIFIDPRU TP 4.11R to calculate the relevant ~~*K-factor metric*~~ *K-factor average metric*.

(3) This *rule* ceases to apply in relation to a *K-factor metric* on the earlier of the following:

(a) the date on which the *firm* has collected sufficient historical information to calculate the ~~*K-factor metric*~~ *K-factor average metric* in accordance with the standard calculation *rules* in *MIFIDPRU* 4; or

(b) the date that falls *n months* after the date on which *MIFIDPRU* first began to apply, where *n* is the number of *months'* worth of data points required to calculate that ~~*K-factor metric*~~ *K-factor average metric* in accordance with the standard calculation *rules* in *MIFIDPRU* 4.

4.6 G (1) *MIFIDPRU* TP 4.5R(3) specifies the date on which the transitional arrangements for calculating a ~~*K-factor metric*~~ *K-factor average metric* will cease to apply and the *firm* will therefore need to use the standard calculation *rules* in *MIFIDPRU* 4 in relation to that ~~*K-factor metric*~~ *K-factor average metric*. This date may vary depending on the position of the individual *firm*.

(2) Under *MIFIDPRU* TP 4.5R(3)(a), once a *firm* has sufficient historical information to perform the calculation in the standard way, it is no longer permitted to use either reasonable estimates for missing data points or to use the modified calculation in *MIFIDPRU* 4.11R. For example, on the date on which *MIFIDPRU* begins to apply, Firm A already has historical data on its *AUM* covering the previous 10 *months*. The standard calculation of ~~*AUM*~~ *average AUM* in *MIFIDPRU* 4 requires 15 *months* of historical data. Since the *firm* must begin collecting *AUM* data no later than the date that *MIFIDPRU* begins to apply, the *firm* will have sufficient data to perform the standard calculation 5 *months* later. At that point, the transitional arrangements under *MIFIDPRU* TP 4 will no longer apply to the *firm's* calculation of ~~*AUM*~~ *average AUM*.

(3) *MIFIDPRU* TP 4.5R(3)(b) acts as a "long-stop" date for the transitional arrangements under *MIFIDPRU* TP 4. Since a *firm* must begin collecting data on its *K-factor metrics* no later than the date that *MIFIDPRU* begins to apply, all *MIFIDPRU investment firms* should have sufficient historical data to perform the standard calculation of a *K-factor metric* once sufficient *months* have elapsed to cover at least the standard calculation period for that *K-factor metric*. For example, the standard calculation for ~~*CMH*~~ *average CMH* requires 9 *months* of historical data. For the purposes of *MIFIDPRU* TP 4.5.R(3)(b), the value of *n* is therefore 9, and the transitional arrangements

under *MIFIDPRU* TP 4 will cease to apply in relation to the calculation of ~~*CMH*~~ *average CMH* 9 *months* after *MIFIDPRU* first begins to apply.

4.7 R (1) A *firm* must apply its chosen approach under *MIFIDPRU* TP 4.5R(2) consistently in relation to a specific ~~*K-factor metric*~~ *K-factor average metric*.

(2) A *firm* may apply different approaches under *MIFIDPRU* TP 4.5R(2) in relation to different ~~*K-factor metrics*~~ *K-factor average metric*.

4.8 G *MIFIDPRU* TP 4.7R prevents a *firm* from changing its approach to missing historical data points in relation to a particular ~~*K-factor*~~ *K-factor average metric*. For example, if a *firm* is missing the necessary historical data points and chooses to apply the modified calculation in *MIFIDPRU* TP 4.11R to determine ~~*AUM*~~ *average AUM*, it cannot subsequently decide to estimate the missing values for ~~*AUM*~~ *average AUM* instead. However, a *firm* may choose, for example, to use reasonable estimates for missing values for ~~*AUM*~~ *average AUM*, but to apply the modified calculation in *MIFIDPRU* TP 4.11R for the purposes of missing values for ~~*COH*~~ *average COH*. In the example, this could reflect the fact that the *firm* has a reasonable basis on which to estimate *AUM*, but is unable to produce reasonable estimates for *COH*.

…

4.10 G If a *firm* does not have a reasonable basis on which to estimate missing historical data points in relation to a ~~*K-factor metric*~~ *K-factor average metric*, it should apply the modified calculation in *MIFIDPRU* TP 4.11R.

4.11 R (1) A *firm* that is using the modified calculation for determining a ~~*K-factor metric*~~ *K-factor average metric*, other than in relation to the *K-CMG requirement*, must apply the following requirements:

…

(d) *x* is a fixed value, being:

(i) 12 in the case of ~~*AUM*~~ *average AUM*;

(ii) 6 in the case of ~~*CMH*, *ASA* or *DTF*~~ *average CMH*, *average ASA* or *average DTF*; and

(iii) 3 in the case of ~~*COH*~~ *average COH*.

…

4.12 G (1) The following are worked examples of the modified calculation in *MIFIDPRU* TP 4.11R.

(2) Firm A has chosen to apply the modified calculation in relation to ~~*AUM*~~ *average AUM*. *MIFIDPRU* has been in force for 6 *months*. Firm A would calculate its ~~*AUM*~~ *average AUM* as follows:

~~(i)~~(a) The value of *n* is 6, being the length of time that *MIFIDPRU* has been in force.

~~(ii)~~ (b) The value of *y* is zero, as zero is greater than *n* minus *x* (i.e. 6 minus 12). This means that Firm A must not exclude any of the most recent *months* of daily figures.

~~(iii)~~ (c) When calculating ~~*AUM*~~ *average AUM* for present purposes, Firm A must therefore calculate the arithmetic mean of the previous 6 *months* of daily values for *AUM*.

(3) Firm B applies the modified calculation in relation to ~~*COH*~~ *average COH*, as it is unable to generate reasonable estimates for missing data points for *COH*. *MIFIDPRU* has been in force for 4 *months*. Firm B would calculate its ~~*COH*~~ *average COH* as follows:

~~(i)~~(a) The value of *n* is 4, being the length of time that *MIFIDPRU* has been in force.

~~(ii)~~ (b) The value of *y* is 1, as *n* minus *x* (i.e. 4 minus 3) is greater than zero.

~~(iii)~~ (c) When calculating ~~*COH*~~ *average COH* for present purposes, Firm B must therefore calculate the arithmetic mean of the previous 4 *months* of daily values for *COH*, excluding the values for the most recent *month*.

(4) *MIFIDPRU* has been in force for 10 *months*. Although Firm C would like to apply the modified calculation in relation to ~~*CMH*~~ *average CMH*, under *MIFIDPRU* TP 4.5R(3)(b), this is not permitted. This is because the standard calculation of ~~*CMH*~~ *average CMH* under *MIFIDPRU* 4 requires only 9 *months* of daily values. Firm C should therefore have collected sufficient data by that time to be able to apply the standard calculation.

Missing historical data for K-factor calculations: transitional for investment firm groups to which consolidation applies

4.13 R (1) If the conditions in (2) are met, a *UK parent entity* may apply the transitional arrangements in *MIFIDPRU* TP 4.5R to 4.11R, as modified by *MIFIDPRU* TP 4.14R, when calculating ~~*K-factor metrics*~~ *K-factor average metrics* on a *consolidated basis*.

(2) The conditions are as follows:

(a) to the extent that it is relying on the transitional arrangements in *MIFIDPRU* TP 4, each *MIFIDPRU investment firm* in the *investment firm group* must apply the same approach under *MIFIDPRU* TP 4.5R(2) in relation to calculating a specific ~~*K-factor metric*~~ *K-factor average metric* on an individual basis; and

(b) the *UK parent entity* must apply the same approach under *MIFIDPRU* TP 4.5R(2) in relation to calculating a specific ~~*K-factor metric*~~ *K-factor average metric* on a *consolidated basis* as the *firms* in (a) have applied on an individual basis.

4.14 R Where a *UK parent entity* is applying *MIFIDPRU* TP 4.5R to 4.11R in accordance with *MIFIDPRU* TP 4.13R, the following modifications apply:

(1) references to a "*K-factor metric*" or a "*K-factor average metric*" shall be read as references to that *K-factor metric* or *K-factor average metric* as it applies on a *consolidated basis*;

…

…

The following text is new and is not underlined.

TP 6 Application of criteria to be classified as an SNI MIFIDPRU investment firm: transitional

Application

6.1 R *MIFIDPRU* TP 6 applies to the following:

(1) a *MIFIDPRU investment firm*; and

(2) a *UK parent entity*, in accordance with *MIFIDPRU* TP 6.9R.

Purpose

6.2 G (1) *MIFIDPRU* TP 6 explains how a *MIFIDPRU investment firm*, or a *UK parent entity* which is applying *MIFIDPRU* 1.2 on a *consolidated basis*, should determine whether it meets the conditions to be classified as an *SNI MIFIDPRU investment firm* on the date on which *MIFIDPRU* begins to apply.

(2) Under *MIFIDPRU* TP 6.4R, a *MIFIDPRU investment firm* or a *UK parent entity* may use either the reasonable estimates approach or the alternative calculation in *MIFIDPRU* TP 4.5R(2) to determine missing historical data points for the

purposes of applying the *average AUM* or *average COH* conditions under *MIFIDPRU* 1.2.1R(1) and (2).

(3) Under *MIFIDPRU* TP 6.7R, a *MIFIDPRU investment firm* or a *UK parent entity* must use its best efforts to estimate any missing historical data points for the purposes of applying the condition relating to total annual gross revenue from *investment services and/or activities* in *MIFIDPRU* 1.2.1R(7).

(4) For the avoidance of doubt, the transitional arrangements in *MIFIDPRU* TP 6 apply only to the extent that the firm has missing historical data points. If a *firm* has observed historical data covering any part of the relevant period, the *firm* should use those data points when applying the relevant calculations.

Duration

6.3 G The duration of the transitional arrangements in *MIFIDPRU* TP 6 depends upon the relevant condition for classification as an *SNI MIFIDPRU investment firm* under *MIFIDPRU* 1.2. Under *MIFIDPRU* TP 6.4R(5) and *MIFIDPRU* TP 6.7R(3), the transitional arrangements cease to apply once a *firm* or *UK parent entity* has (or should have) collected sufficient historical information to apply the relevant condition in accordance with the applicable methodology in *MIFIDPRU* 1.2.

Missing historical data for application of SNI classification criteria: transitional for individual MIFIDPRU investment firms

6.4 R (1) This *rule* applies to the extent that a *MIFIDPRU investment firm* does not have the necessary historical data to determine if the following conditions are met:

(a) the *average AUM* condition in *MIFIDPRU* 1.2.1R(1); or

(b) the *average COH* condition in *MIFIDPRU* 1.2.1R(2).

(2) If a *firm* has chosen to apply the alternative approach in *MIFIDPRU* 1.2.4R for the purposes of assessing whether a condition in (1) is met, this *rule* applies to the extent that the *firm* does not have the necessary historical data to apply that alternative approach to the relevant condition.

(3) Where this *rule* applies, a *firm* may (subject to (4) and to *MIFIDPRU* TP 6.5R) use either of the approaches set out in *MIFIDPRU* TP 4.5R(2) to assess whether the relevant condition in (1) is met.

(4) A *firm's* choice of approach under (3) must be consistent with any choice that the *firm* has made under *MIFIDPRU* TP 4.5R(2) in relation to the same *K-factor average metric* for the

purposes of applying the transitional arrangements in *MIFIDPRU* TP 4.

(5) This *rule* ceases to apply in relation to a condition in (1) on the earlier of the following:

(a) the date on which the *firm* has collected sufficient historical information necessary to apply the condition in accordance with the applicable methodology under *MIFIDPRU* 1.2; or

(b) the date that falls *n months* after the date on which *MIFIDPRU* first began to apply, where *n* is the number of *months'* worth of data points required to apply that condition in accordance with the applicable methodology under *MIFIDPRU* 1.2.

6.5 R (1) This *rule* applies where, for the purpose of determining whether the *average AUM* condition in *MIFIDPRU* 1.2.1R(1) or the *average COH* conditions in *MIFIDPRU* 1.2.1R(2) is met, a *firm* has chosen to apply both:

(a) the alternative approach in *MIFIDPRU* 1.2.4R; and

(b) the modified calculation under *MIFIDPRU* TP 4.5R(2)(b).

(2) Where this *rule* applies, the modified calculation applies as if:

(a) in *MIFIDPRU* TP 4.11R(1)(a), the words "excluding the most recent *y months*" were deleted; and

(b) *MIFIDPRU* TP 4.11R(1)(c) and (d) were omitted.

6.6 R (1) A *firm* must apply its chosen approach under *MIFIDPRU* TP 6.4R(2) consistently in relation to a specific condition in *MIFIDPRU* TP 6.4R(1).

(2) A *firm* may apply different approaches under *MIFIDPRU* TP 6.4R(2) in relation to different conditions in *MIFIDPRU* TP 6.4R(1).

6.7 R (1) This *rule* applies to the extent that a *MIFIDPRU investment firm* does not have the necessary historical data to determine if the condition relating to the total annual gross revenue from *investment services and/or activities* in *MIFIDPRU* 1.2.1R(7) is met.

(2) Where this *rule* applies, a *firm* must use its best efforts to estimate any missing historical data points for the calculation of the condition in (1).

(3) This *rule* ceases to apply in relation to a condition in (1) on the earlier of the following:

(a) the date on which the *firm* has collected sufficient historical information necessary to apply the condition in accordance with the standard methodology under *MIFIDPRU* 1.2; or

(b) the date on which two complete financial years for the *firm* have elapsed after the date that *MIFIDPRU* first began to apply.

6.8 R A *firm* must, upon request, provide a reasonable explanation to the *FCA* of how the *firm* has determined any estimate under *MIFIDPRU* TP 6.4R(3) or *MIFIDPRU* TP 6.7R(2).

6.9 G (1) In the *FCA's* view, it is unnecessary to provide transitional arrangements for the following conditions:

(a) the *average ASA* condition in *MIFIDPRU* 1.2.1R(3);

(b) the *average CMH* condition in *MIFIDPRU* 1.2.1R(4);

(c) whether the *firm* has *permission* to *deal on own account* in *MIFIDPRU* 1.2.1R(5); and

(d) the condition relating to the balance sheet total of the *firm* in *MIFIDPRU* 1.2.1R(6).

(2) The *average ASA* and *average CMH* conditions require that the *firm* has not held any *MiFID client money*, or any *client* assets in the course of *MiFID business*, during the preceding 9 *months*, excluding the most recent 3 months. The *FCA* considers that a *firm* should already have information on whether it has held *client money* or *client* assets in the past. If the *firm* is unable to determine if any amounts of *client money* or *client* assets were held in connection with *MiFID business*, it should apply *MIFIDPRU* 4.8.6R or *MIFIDPRU* 4.9.6R and treat such amounts as if they were held in connection with *MiFID business* for these purposes.

(3) The conditions in (1)(c) and (1)(d) do not rely on historical information and therefore can be assessed by the *firm* at the point at which *MIFIDPRU* first begins to apply without any need for transitional arrangements.

6.10 G (1) *MIFIDPRU* TP 6.4R(5) and *MIFIDPRU* TP 6.6R(2) specify the date on which the transitional arrangements for applying certain conditions under *MIFIDPRU* 1.2.1R will cease to apply. From that date onwards, the *firm* will need to apply the standard methodology for determining whether it meets the relevant condition. This date may vary depending on the position of the individual *firm* and the relevant condition.

(2) Under *MIFIDPRU* TP 6.4R(5)(a), once a *firm* has sufficient historical information to apply a condition in *MIFIDPRU* TP 6.4R(1), it is no longer permitted to rely on the transitional arrangements. The following are examples of how this requirement applies:

(a) Example 1: On the date on which *MIFIDPRU* begins to apply, Firm A already has historical data on its *AUM* covering the previous 10 *months*. Assuming that the *firm* is applying the standard criteria under *MIFIDPRU* 1.2.1R (and not the alternative approach in *MIFIDPRU* 1.2.4R), the *average AUM* condition under *MIFIDPRU* 1.2.1R(1) requires 15 *months* of historical data. Since the *firm* must be collecting *AUM* data once *MIFIDPRU* begins to apply, Firm A will have sufficient data to apply the standard calculation for the *average AUM* condition 5 *months* later. At that point, the *firm* will no longer be able to rely on the transitional arrangements under *MIFIDPRU* TP 6, but will instead need to use the observed historical data to determine if the condition in *MIFIDPRU* 1.2.1R(1) is met.

(b) Example 2: Firm B has notified the *FCA* under *MIFIDPRU* 1.2.4R that it is using the alternative approach to applying the *average AUM* condition in *MIFIDPRU* 1.2.1R. Firm B has 13 *months* of historical data on its *AUM*. Under *MIFIDPRU* 6.4R(5)(a), Firm B is prohibited from relying on the transitional arrangements in *MIFIDPRU* TP 6. Although the standard calculation for the *AUM* condition in *MIFIDPRU* 1.2.1R(1) would require 15 *months* of historical data, the alternative approach under *MIFIDPRU* 1.2.4R(2) requires only 12 *months* of data. As Firm B has sufficient observed historical data to apply its chosen methodology, the transitional arrangements do not apply.

6.11 G (1) *MIFIDPRU* 6.4R(4) and 6.6R are designed to ensure consistency in a *firm's* approach to applying the transitional arrangements in *MIFIDPRU* TP 4 and *MIFIDPRU* TP 6.

(2) *MIFIDPRU* TP 6.4R(4) requires a *firm* to be consistent in its choice of approaches for the purposes of *MIFIDPRU* TP 4 and *MIFIDPRU* TP 6. For example, Firm A does not have sufficient information to calculate its *average AUM* for the purposes of the condition in *MIFIDPRU* 1.2.1R(1) and the *K-AUM requirement* under *MIFIDPRU* 4.7. If Firm A chooses

to use the reasonable estimates approach under *MIFIDPRU* TP 4.5R(2) to calculate its *K-AUM requirement*, the *firm* must also use the reasonable estimates approach under *MIFIDPRU* TP 6.4R(3) to apply the *average AUM* condition in *MIFIDPRU* 1.2.1R(1). The estimates that Firm A uses for both purposes should be consistent.

(3) *MIFIDPRU* TP 6.6R prevents a *firm* from alternating between approaches for the purposes of *MIFIDPRU* TP 6. For example, Firm B chooses under *MIFIDPRU* TP 6.4R(3) to apply the alternative calculation in *MIFIDPRU* TP 4.11R for the purposes of the determining whether the *average COH* condition in *MIFIDPRU* TP 6.4R(1) is met. Firm B cannot later decide to switch to applying the reasonable estimates approach to determine whether that condition is met.

6.12 G *MIFIDPRU investment firms* are reminded that under *MIFIDPRU* TP 5, they are required to collect at least 1 *month* of *K-factor metrics* that are relevant to any *investment services and/or activities* they carry on before *MIFIDPRU* begins to apply in full. When determining any estimate for the purposes of *MIFIDPRU* TP 6.4R(3) or *MIFIDPRU* 6.7R(2), a *firm* should have regard to any observed historical data that is available. Where the observed historical data covers a short period, a *firm* should take into account possible seasonal variations in figures or other factors which might be relevant to the accuracy of the estimate.

Missing historical data for application of SNI classification criteria: transitional for investment firm groups to which consolidation applies

6.13 R (1) A *UK parent entity* to which consolidation under *MIFIDPRU* 2.5 applies may apply the transitional arrangements in *MIFIDPRU* TP 6.4R to 6.12G to its *consolidated situation* in accordance with this *rule*.

(2) Where a *UK parent entity* is applying *MIFIDPRU* TP 6.4R to 6.12G in accordance with (1), the following modifications apply:

(a) references to a condition in *MIFIDPRU* 1.2.1R shall be read as references to that condition as it applies on a *consolidated basis*; and

(b) references to a "*MIFIDPRU investment firm*" or a "*firm*" shall be read as references to the *UK parent entity*.

(3) Any estimate produced by the *UK parent entity* of an *investment firm group* under *MIFIDPRU* TP 6.4R(3) or *MIFIDPRU* TP 6.7R(2) for the purposes of its *consolidated situation* must be consistent with any estimates produced on

an individual basis by any *MIFIDPRU investment firms* forming part of that *investment firm group*.

TP 7 Former non-CRR firms and parent undertakings: transitional for own funds instruments

Application

7.1 R *MIFIDPRU* TP 7 applies to a *MIFIDPRU investment firm* that, immediately before [*Editor's note*: insert date that *MIFIDPRU* begins to apply]:

(1) was an *authorised person*; and

(2) was not classified as a *CRR firm* in accordance with the *rules* then in force.

7.2 R (1) *MIFIDPRU* TP 7 also applies to the following if the conditions in (2) are met:

(a) a *UK parent entity* to which *MIFIDPRU* 3 applies on a *consolidated basis* in accordance with *MIFIDPRU* 2.5.7R; and

(b) a *parent undertaking* to which the *group capital test* applies.

(2) The conditions are that immediately before [*Editor's note*: insert date that *MIFIDPRU* begins to apply] the *UK parent entity* or *parent undertaking*:

(a) formed part of the same *investment firm group* as a *firm*, which, on [*Editor's note*: insert date that *MIFIDPRU* begins to apply] became a *MIFIDPRU investment firm*; and

(b) was not required to hold *own funds* on either an individual or a consolidated basis in accordance with the *UK CRR*.

Purpose

7.3 G (1) Before *MIFIDPRU* began to apply, certain *firms* that subsequently became *MIFIDPRU investment firms* determined their available capital resources according to various provisions in *GENPRU* or *IPRU-INV*. In addition, certain other *firms* may not have been subject to a dedicated prudential sourcebook in the *FCA Handbook* that contained a detailed regime for recognising the eligibility of capital resources.

(2) The *rules* on *own funds* in *MIFIDPRU* 3 broadly replicate the approach to recognising capital resources under the *UK CRR*. The purpose of *MIFIDPRU* TP 7 is to permit *firms* that were not *CRR firms* immediately before *MIFIDPRU* began to apply to recognise instruments as *own funds* under *MIFIDPRU* without requiring separate permission from, or notification to, the *FCA* if those instruments:

(a) were issued before *MIFIDPRU* began to apply; and

(b) meet the conditions to be classified as *own funds* under *MIFIDPRU* 3 (other than the conditions relating to the requirements to seek prior *FCA* consent or to notify the *FCA*).

(3) *MIFIDPRU investment firms* that were classified as *CRR firms* immediately before *MIFIDPRU* began to apply are reminded that under *MIFIDPRU* TP 1, a previous permission recognising the issuance of capital instruments as *common equity tier 1 capital* under the *UK CRR* will be deemed to be an equivalent permission under *MIFIDPRU*. The notifications previously made by such *firms* in relation to the issuance of *additional tier 1 instruments* and *tier 2 instruments* will continue to be valid.

(4) *MIFIDPRU* TP 7 also applies to *UK parent entities* to which *MIFIDPRU* 3 applies on a *consolidated basis* and *parent undertakings* to which the *group capital test* applies, where those entities were not required to hold *own funds* on an individual or consolidated basis under the *UK CRR* immediately before *MIFIDPRU* came into force. This means that provided that the existing instruments issued by such entities meet the relevant conditions in *MIFIDPRU* 3, they can be treated as *own funds* for the purposes of the application of *MIFIDPRU* 3 on a *consolidated basis* or the *group capital test* as long as the entity complies with *MIFIDPRU* TP 7.

Eligibility of pre-MIFIDPRU capital resources meeting requirements in MIFIDPRU 3 to qualify as own funds under MIFIDPRU without a separate permission or notification

7.4 R (1) This *rule* applies to any capital instrument that:

(a) was issued by a *firm*, *UK parent entity* or *parent undertaking* before [*Editor's note*: insert date on which *MIFIDPRU* begins to apply]; and

(b) was still in issue on [*Editor's note*: insert date on which *MIFIDPRU* begins to apply].

(2) The *firm*, *UK parent entity* or *parent undertaking* in (1)(a) shall be deemed to have been granted the permission, or to have complied with the notification obligation, in column (A) of the table in *MIFIDPRU* 7.5R in relation to a capital instrument where the following conditions are met:

(a) the conditions in column (B) of the same row of the table in *MIFIDPRU* 7.5R are satisfied in relation to that instrument; and

(b) the *firm* has submitted the notification in *MIFIDPRU* TP 7 Annex 1R via the *online notification and application system* by no later than [*Editor's note*: insert date on which *MIFIDPRU* begins to apply].

(3) A deemed permission or notification under (2) shall cease to apply in relation to a capital instrument if the terms of that instrument are varied on or after [*Editor's note*: insert date on which *MIFIDPRU* begins to apply] and the instrument ceases to meet:

(a) in relation to an instrument being treated as *common equity tier 1 capital*, the conditions in *MIFIDPRU* 3.3 (other than the condition for prior *FCA* permission to classify the instrument as *common equity tier 1 capital*);

(b) in relation to an instrument being treated as *additional tier 1 capital*, the conditions in *MIFIDPRU* 3.4; and

(c) in relation to an instrument being treated as *tier 2 capital*, the conditions in *MIFIDPRU* 3.5.

7.5 R This table belongs to *MIFIDPRU* TP 7.4R.

(A) **Requirement for permission or notification with which the *firm*, *UK parent entity* or *parent undertaking* is deemed to have complied**	**(B)** **Conditions for deemed compliance to apply**
Individual *MIFIDPRU investment firms*	
Article 26(3) *UK CRR* (as applied and modified by *MIFIDPRU* 3.3.1R) and *MIFIDPRU* 3.3.3R: Requirement for prior *FCA* permission to classify an issuance of	Immediately before *MIFIDPRU* began to apply, the capital instruments met the conditions to be classified as *common equity tier 1 capital* in *MIFIDPRU* 3.3, except for the requirement for prior *FCA* permission

capital instruments by a *firm* as *common equity tier 1 capital*	under article 26(3) of the *UK CRR* and *MIFIDPRU* 3.3.3R
MIFIDPRU 3.6.5R(1)(a): Requirement to notify the *FCA* of the intention to issue *additional tier 1 instruments*	Immediately before *MIFIDPRU* began to apply, the capital instruments met the conditions to be classified as *additional tier 1 capital in MIFIDPRU* 3.4
MIFIDPRU 3.6.5R(1)(b): Requirement to notify the *FCA* of the intention to issue *tier 2 instruments*	Immediately before *MIFIDPRU* began to apply, the capital instruments met the conditions to be classified as *tier 2 capital* in *MIFIDPRU* 3.5
UK parent entities to which consolidation under *MIFIDPRU* 2.5.7R applies	
Article 26(3) *UK CRR* (as applied and modified by *MIFIDPRU* 3.3.1R) and *MIFIDPRU* 3.3.3R, as they apply on a *consolidated basis* under *MIFIDPRU* 2.5.7R(1): Requirement for prior *FCA* permission to classify an issuance of capital instruments by a *UK parent entity* as *common equity tier 1 capital*	Immediately before *MIFIDPRU* began to apply, the capital instruments met the conditions to be classified as *common equity tier 1 capital* in *MIFIDPRU* 3.3 (as it applies on a *consolidated basis*), except for the requirement for prior *FCA* permission under article 26(3) of the *UK CRR* and *MIFIDPRU* 3.3.3R
MIFIDPRU 3.6.5R(1)(a), as modified by *MIFIDPRU* 3.6.7R: Requirement to notify the *FCA* of the intention to issue *additional tier 1 instruments*	Immediately before *MIFIDPRU* began to apply, the capital instruments met the conditions to be classified as *additional tier 1 capital* in *MIFIDPRU* 3.4 (as it applies on a *consolidated basis*)
MIFIDPRU 3.6.5R(1)(b), as modified by *MIFIDPRU* 3.6.7R: Requirement to notify the *FCA* of the intention to issue *tier 2 instruments*	Immediately before *MIFIDPRU* began to apply, the capital instruments met the conditions to be classified as *tier 2 capital* in *MIFIDPRU* 3.5 (as it applies on a *consolidated basis*)
Parent undertakings to which the *group capital test* applies	
Article 26(3) *UK CRR* (as applied and modified by *MIFIDPRU* 3.3.1R) and *MIFIDPRU* 3.3.3R, as they apply to a *parent undertaking* under *MIFIDPRU* 3.7.4R(1)(a): Requirement for prior *FCA* permission to classify an issuance of capital instruments by a *parent*	Immediately before *MIFIDPRU* began to apply, the capital instruments met the conditions to be classified as *common equity tier 1 capital* in *MIFIDPRU* 3.3, except for the requirement for prior *FCA* permission under article 26(3) of the *UK CRR* and *MIFIDPRU* 3.3.3R

undertaking as *common equity tier 1 capital*	
MIFIDPRU 3.6.5R(1)(a), as modified by *MIFIDPRU* 3.7.4R(1)(b): Requirement to notify the *FCA* of the intention to issue *additional tier 1 instruments*	Immediately before *MIFIDPRU* began to apply, the capital instruments met the conditions to be classified as *additional tier 1 capital* in *MIFIDPRU* 3.4
MIFIDPRU 3.6.5R(1)(b), as modified by *MIFIDPRU* 3.7.4R(1)(b): Requirement to notify the *FCA* of the intention to issue *tier 2 instruments*	Immediately before *MIFIDPRU* began to apply, the capital instruments met the conditions to be classified as *tier 2 capital* in *MIFIDPRU* 3.5

7.6 G Where a *firm*, *UK parent entity* or *parent undertaking* is deemed under *MIFIDPRU* TP 7.3R and 7.4R to have notified the *FCA* of its intention to issue *additional tier 1 instruments* or *tier 2 instruments*, *MIFIDPRU* 3.6.5R(2)(a) will apply to a subsequent issuance of the same class of instruments. In practice, this means that provided that the subsequent issuance of the same class is on terms that are identical in all material respects to the existing class of those instruments, no further notification to the *FCA* under *MIFIDPRU* 3.6.5R(1) will be required.

TP 7 Annex 1 Notification under MIFIDPRU TP 7.4R(2)(b) on treating pre-MIFIDPRU capital instruments as own funds under MIFIDPRU 3

R [*Editor's note*: The form can be found at this address: https://www.fca.org.uk/publication/forms/[xxx]]

TP 8 Commodity and emission allowance dealers

8.1 R

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.	*MIFIDPRU* 6	R	The *rules* and *guidance* in *MIFIDPRU* 6	Until [*Editor's note*: insert	[*Editor's note*: insert the date on

			do not apply to a *commodity and emission allowance dealer*.	date five years after the date on which MIFIDPRU begins to apply].	which MIFIDPRU begins to apply]

[**Note:** article 57(1) of the *IFR*.]

TP 9 IFPRU waivers: transitional

Application

9.1 R *MIFIDPRU* TP 9 applies to a *non-SNI MIFIDPRU investment firm*.

9.2 R *MIFIDPRU* TP 9 applies where, immediately before 1 January 2022, a *waiver* given in relation to a *rule* listed in column A of the table in *MIFIDPRU* TP 9.5R has effect.

Duration of transition

9.3 R This section applies to each *waiver* in *MIFIDPRU* TP 9.2R, until the direction given in respect of that *waiver* ceases to have effect on its terms, or is revoked, whichever is the earlier.

Transitional

9.4 R Each *waiver* given in relation to a *rule* listed in column A of the table in *MIFIDPRU* TP 9.5R is treated as a *waiver* given to the *firm* in relation to the *rule* listed in the same row in column B of the table.

Table

9.5 R Table of FCA rules

Column A	Column B
SYSC 4.3A.8R	*MIFIDPRU* 7.3.5R
SYSC 7.1.18R	*MIFIDPRU* 7.3.3R
SYSC 19A.5.12R	*MIFIDPRU* 7.3.1R

Sch 1 Record keeping requirements

Sch 1.1 G (1) The aim of the *guidance* in the following table is to give the reader an overview of the relevant record keeping requirements in *MIFIDPRU*.

(2) It is not a complete statement of those requirements and should not be relied on as if it were.

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
MIFIDPRU 4.7.5R	Currency conversion rate	The market rate chosen to convert *AUM* amounts in foreign currencies into the *firm's* functional currency	At the time of the relevant measurement	Not specified
MIFIDPRU 4.10.23R(4)	Basis on which *firm* has applied the alternative approach in *MIFIDPRU* 4.10.23R to determine the value of an order when measuring *COH*	The basis in *MIFIDPRU* 4.10.23R(3) on which the *firm* is applying the alternative approach in *MIFIDPRU* 4.10.23R to determine the value of an order when measuring *COH*	At the time that the *firm* decides to apply the alternative approach	Not specified
MIFIDPRU 7.1.4R(3)	Currency conversion rate	The market rate chosen to convert the value of amounts in foreign currencies into pounds sterling for the purposes of determining the application of certain governance requirements under *MIFIDPRU* 7	At the time of the relevant measurement	Not specified

MIFIDPRU 7.8.11R	*ICARA document* approval	The *firm's ICARA document* and records of the *governing body* review and approval under *MIFIDPRU* 7.8.9R	At the time that the *governing body* approves the *ICARA document* under *MIFIDPRU* 7.8.9R	3 years from the date on which the *governing body* gave its approval under *MIFIDPRU* 7.8.9R

Sch 1.2 G *MIFIDPRU investment firms* are also reminded of the general record keeping obligations that apply under *SYSC* 9 (Record keeping).

Sch 2 Notification requirements

Sch 2.1 G (1) The aim of the *guidance* in the following table is to give the reader an overview of the relevant notification requirements in *MIFIDPRU*.

(2) It is not a complete statement of those requirements and should not be relied on as if it were.

Handbook reference[6]	Subject of notification	Trigger events	Time allowed
MIFIDPRU 1.2.4R(3)	Applying alternative calculation for *AUM* or *COH* for *SNI MIFIDPRU investment firm* criteria	Decision to apply alternative approach	Not applicable
MIFIDPRU 1.2.4R(4)	Ceasing to apply alternative calculation for *AUM* or *COH* for *SNI MIFIDPRU investment firm* criteria	Decision to cease applying alternative approach	Not applicable
MIFIDPRU 1.2.7R(2)	Use of end-of-day value for calculating *average CMH* for	Record-keeping or reconciliation error as described in	Immediate notification

[6] *Editor's note*: This notifications table includes notification requirements that were published in CP20/24. In some cases, these requirements will be updated in the forthcoming policy statement containing the near-final rules resulting from that consultation. Where relevant, the rule references in this table should therefore be read alongside the near-final rules in that policy statement.

	SNI MIFIDPRU investment firm criteria	*MIFIDPRU* 1.2.7R(1)	
MIFIDPRU 1.2.13R(3)(b)	*Non-SNI investment firm* meeting criteria to be classified as an *SNI MIFIDPRU investment firm*	Meeting *SNI MIFIDPRU investment firm* criteria for at least 6 *months*	Not applicable
MIFIDPRU 1.2.16R	*Firm* ceasing to meet one of the criteria to be classified as an *SNI MIFIDPRU investment firm*	Ceasing to meet one or more of the *SNI MIFIDPRU investment firm* criteria	Prompt notification
MIFIDPRU 2.5.17R(2)(f)	Application of proportional consolidation to a *participation* meeting the conditions in *MIFIDPRU* 2.5.17R	Decision to apply proportional consolidation	Not applicable
MIFIDPRU 3.3.3R(2)	Notification of subsequent issuance of capital instruments qualifying as *common equity tier 1 capital*	Proposed issuance of capital instruments of an existing class of *common equity tier 1 capital*	No fewer than 20 *business days* before the issuance
MIFIDPRU 3.6.3R	Notification of proposed reduction, repurchase, call or redemption of *own funds instruments* where conditions in *MIFIDPRU* 3.6.4R are met	Proposed redemption of *own funds instruments* where conditions in *MIFIDPRU* 3.6.4R are met	No later than the 20th *business day* before the *day* on which the reduction, repurchase, call or redemption will occur
MIFIDPRU 3.6.5R	Notification of proposed issuance of *additional tier 1 instruments* or *tier 2 instruments*	Proposed issuance of *additional tier 1 instruments* or *tier 2 instruments*	At least 20 *business days* before the

			intended issuance date
MIFIDPRU 4.12.7R	Notification of non-material change or non-material extension in use of an internal model for the *K-NPR requirement*	Proposal to implement a non-material change to a model or to extend the use of a model in a non-material manner	Not applicable
MIFIDPRU 4.12.10R	Use of own estimates for delta for standardised approach to market risk of options	Decision to apply own estimates for delta where conditions in *MIFIDPRU* 4.12.10R are met	Not applicable
MIFIDPRU 4.13.10R	Notification that conditions for use of *K-CMG permission* are no longer met	*Portfolio* ceasing to meet conditions in *MIFIDPRU* 4.13.9R for use of a *K-CMG permission*	Immediate notification
MIFIDPRU 4.13.20R	Notification that *firm* will calculate the *K-NPR requirement* for a *portfolio* for which it previously had a *K-CMG permission*	Decision to calculate the *K-NPR requirement* for a *portfolio* where conditions in *MIFIDPRU* 4.13.19R are met	Not applicable
MIFIDPRU 5.6.3R	Notification that *concentration risk soft limit* has been exceeded	Exceeding *concentration risk soft limit* for a *client* or *group of connected clients* as specified in *MIFIDPRU* 5.6.2R	Notification without delay

MIFIDPRU 5.9.3R	Notification that "hard" exposure limits in *MIFIDPRU* 5.9.1R have been exceeded	Exceeding limit in *MIFIDPRU* 5.9.1R	Notification without delay
MIFIDPRU 5.11.2R	Exemption from *MIFIDPRU* 5.2 to *MIFIDPRU* 5.10 for *commodity and emission allowance dealers*	Decision to apply exemption where conditions in *MIFIDPRU* 5.11.1R are met	Not applicable
MIFIDPRU 7.1.9R	Notification that *firm* has met necessary conditions to fall within either *MIFIDPRU* 7.1.4R(1)(a) or (b) for a continuous period of at least 6 *months*	Meeting conditions in either *MIFIDPRU* 7.1.4R(1)(a) or (b) for a continuous period of at least 6 *months*	Not applicable
MIFIDPRU 7.1.12R	Notification that *firm* no longer meets the conditions necessary to fall within *MIFIDPRU* 7.1.4R(1)(a) or (b)	No longer meeting conditions in *MIFIDPRU* 7.1.4R(1)(a) or (b) when the *firm* previously did so	Prompt notification
MIFIDPRU 7.6.11R	Notification where *own funds* fall below certain specified levels	*Own funds* falling below levels specified in *MIFIDPRU* 7.6.11R	Immediate notification
MIFIDPRU 7.7.14R	Notification where *liquid assets* fall below certain specified levels	*Liquid assets* falling below levels specified in *MIFIDPRU* 7.7.14R	Immediate notification
MIFIDPRU 7.8.5R	*Firm's* choice of submission date(s) or change of submission date(s) for *data item* MIF007 (ICARA assessment questionnaire)	Initial choice of submission date or change of submission date for *data item* MIF007	Not applicable

MIFIDPRU TP 1.8R	Notification of *firm's* intentions in relation to *additional tier 1 instruments* issued before [*Editor's note*: insert date that MIFIDPRU sourcebook begins to apply]	*Firm* has outstanding *additional tier 1 instruments* on [*Editor's note*: insert date that MIFIDPRU sourcebook begins to apply]	By no later than [*Editor's note*: insert date one month after MIFIDPRU sourcebook begins to apply]
MIFIDPRU TP 7.4R	Notification to treat capital instruments issued before [*Editor's note*: insert date that MIFIDPRU sourcebook begins to apply] as *own funds* under *MIFIDPRU* 3	*Firm* has issued capital instruments before [*Editor's note*: insert date that MIFIDPRU sourcebook begins to apply] that it wishes to treat as *own funds* under *MIFIDPRU* 3	By no later than [*Editor's note*: insert date that MIFIDPRU sourcebook begins to apply]

Sch 3 Fees and other payment requirements

Sch 3.1 G There are no requirements for fees or other payments in *MIFIDPRU*.[7]

Sch 4 Rights of action for damages

Sch 4.1 G (1) The table below sets out the *rules* in *MIFIDPRU*, contravention of which by an *authorised person* may be actionable under section 138D of the *Act* (Actions for damages) by a *person* who suffers loss a result of the contravention.

(2) If "Yes" appears in the column headed "For private person", the *rule* may be actionable by a *private person* under section 138D (or, in certain circumstances, that *person's* fiduciary or representative: see regulation 6(2) and 6(3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001/2256)). If "Yes" appears in the column headed "Removed", this indicates that the *FCA* has removed the right of action under section 138D(3) of the *Act*.

[7] *Editor's note*: The FCA will consult on proposed fees for certain applications for permissions under MIFIDPRU in a future consultation paper. Schedule 3 to MIFIDPRU may be updated at that time to reflect such proposals.

If so, a reference to the *rule* in which the right of action is removed is also given.

(3) The column headed "For other person" indicates whether the *rule* may be actionable by a *person* other than a *private person* (or that *person's* fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of *person* by whom the *rule* may be actionable is given.

Chapter/Appendix	**Rights of action under section 138D of the *Act***		
	For private person	**Removed**	**For other person**
All *rules* in *MIFIDPRU*	No	Yes – *MIFIDPRU* 1.3.1R	No

Sch 5 Rules that can be waived or modified

Sch 5.1 G The *rules* in *MIFIDPRU* may be waived or modified by the *FCA* under section 138A of the *Act* (Modification or waiver of rules) where the relevant conditions in that section are met.

Annex D

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

16 Reporting requirements

… …

16.12 Integrated Regulatory Reporting

…

Regulated Activity Group 3

… …

16.12.11 R The applicable *data items* referred to in *SUP* 16.12.4R are set out according to *firm* type in the table below:

Description of *data item*	***Firms'* prudential category and applicable *data items* (note 1)**				
	MIFIDPRU investment firms	**Firms other than *MIFIDPRU investment firms***			
		***IPRU(INV)* Chapter 3**	***IPRU(INV)* Chapter 5**	***IPRU(INV)* Chapter 9**	***IPRU(INV)* Chapter 13**
…	…	…	…	…	…
Capital adequacy	MIF001 (notes 2 and 3)	FSA033 (note 5)	FSA034 or FSA035 or FIN071 (note 7)	FSA031	Section D1 RMAR
<u>Supplementary capital data for *collective portfolio management investment firms*</u>	<u>FIN067</u> <u>(note 13)</u>				

ICARA assessment questionnaire	MIF007 (note 3)				
Threshold conditions					Section F RMAR
…	…	…	…	…	…
Note 2	A *UK parent entity* of an *investment firm group* to which consolidation applies under *MIFIDPRU* 2.5 must also submit this report on the basis of the *consolidated situation*.				
Note 3	Data items MIF001 – ~~MIF006~~ MIF007 must be reported in accordance with the *rules* in *MIFIDPRU* 9.				
…	…				
Note 12	Only applicable to a *parent undertaking* to which the *group capital test* applies.				
Note 13	Only applicable to *firms* that are *collective portfolio management investment firms*.				

16.12.12	R	The applicable reporting frequencies for *data items* referred to in *SUP* 16.12.4R are set out in the table below according to *firm* type. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

Data item	***Non-SNI MIFIDPRU investment firm***	***SNI MIFIDPRU investment firm***	***Investment firm group***	***Firm* other than a *MIFIDPRU investment firm***
…	…	…	…	…
FSA040	Quarterly	Quarterly		Quarterly
FIN067	Quarterly	Quarterly		

	(note 3)	(note 3)		
FIN071				Quarterly
…	…	…	…	…
MIF006	Quarterly (note 3)	Quarterly (note 3)		
MIF007	Annually (note 4)	Annually (note 4)		
Section A RMAR				Half yearly (note 1) Quarterly (note 2)
…	….	…	…	…
Note 3	Reporting frequencies and reporting periods for this *data item* are calculated on a calendar year basis and not by reference to the *firm's accounting reference date*. The relevant quarters end on the last *business day* of March, June, September and December.			
Note 4	The reporting period for MIF007 is determined by the date on which the *firm* reviews its *ICARA process* under *MIFIDPRU* 7.8.2R and the submission date that applies under *MIFIDPRU* 7.8.5R.			

16.12.13 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.12R, unless indicated otherwise.

Data item	**Quarterly**	**Half yearly**	**Annual**
…	…		
FSA040	15 *business days*		
FIN067	20 *business days*		

FIN071	20 *business days*		
…	…		
MIF006	20 *business days*		
<u>MIF007</u>	<u>The submission date that applies under *MIFIDPRU* 7.8.5R</u>		
Section A RMAR	30 *business days*	30 *business days*	
…	…		

…

Regulated Activity Group 4

…

16.12.15 R The applicable *data items* referred to in *SUP* 16.12.4R are set out according to *firm* type in the table below:

Description of *data item*	***Firms'* prudential category and applicable *data items* (note 1)**						
	MIFIDPRU investment firms	***Firms* other than *MIFIDPRU investment firms***					
		IPRU(INV) **Chapter 3**	***IPRU(INV)*** **Chapter 5**	***IPRU(INV)*** **Chapter 9**	***IPRU(INV)*** **Chapter 11** **(*collective portfolio management firms* only)**	***IPRU(INV)*** **Chapter 12**	***IPRU(INV)*** **Chapter 13**
…							

Capital adequacy	MIF001 (note 3 and 4)	FSA033	FSA034 or FSA035 or FIN071 (note 5)	FSA031	FIN066	FIN069	Section D1 RMAR
ICARA assessment questionnaire	MIF007 (note 4)						
Supplementary capital data for *collective portfolio management investment firms*	FIN067 (note 9)						
Threshold conditions							Section F RMAR
…	…						
Note 4	Data items MIF001 – ~~MIF006~~ MIF007 must be reported in accordance with the *rules* in *MIFIDPRU* 9.						
…	…						
Note 8	Only applicable to a *parent undertaking* to which the *group capital test* applies.						
Note 9	Only applicable to *firms* that are *collective portfolio management investment firms*.						

16.12.16 R The applicable reporting frequencies for *data items* referred to in *SUP* 16.12.15R are set out in the table below according to *firm* type. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

Data item	***Non-SNI MIFIDPRU investment firm***	***SNI MIFIDPRU investment firm***	***Investment firm group***	***Firm* other than a *MIFIDPRU***

				investment firm
…	…			
FSA039	Half yearly	Half yearly		Half yearly
FIN067	Quarterly (note 3)	Quarterly (note 3)		
FIN071				Quarterly
…	…			
MIF006	Quarterly (note 3)	Quarterly (note 3)		
MIF007	Annually (note 4)	Annually (note 4)		
Section A RMAR				Half yearly (note 1) Quarterly (note 2)
…	…			
Note 3	Reporting frequencies and reporting periods for this *data item* are calculated on a calendar year basis and not by reference to the *firm's accounting reference date*. The relevant quarters end on the last *business day* of March, June, September and December.			
Note 4	The reporting period for MIF007 is determined by the date on which the *firm* reviews its *ICARA process* under *MIFIDPRU* 7.8.2R and the submission date that applies under *MIFIDPRU* 7.8.5R.			

16.12.17 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.16R, unless indicated otherwise.

Data item	**Quarterly**	**Half yearly**	**Annual**
…	…		
FSA039		30 *business days*	
FIN067	20 *business days*		
FIN071	20 *business days*		
…	…		
MIF006	20 *business days*		
MIF007	The submission date that applies under *MIFIDPRU* 7.8.5R		
Section A RMAR	30 *business days*	30 *business days*	
…	…		

…

Regulated Activity Group 7

…

16.12.22A R The applicable *data items* referred to in *SUP* 16.12.4R are set out according to type of *firm* in the table below:

Description of *data item*	***Firms'* prudential category and applicable *data item* (note 1)**		
	MIFIDPRU investment firms	***Firms* subject to *IPRU(INV)* Chapter 13**	***Firms* that are also in one or more of *RAGs* 2 to 6 and not subject to *IPRU(INV)* Chapter 13**
…	…		
Group capital test	MIF006		

	(notes 6 and 8)		
ICARA assessment questionnaire	MIF007 (note 6)		
Supplementary capital data for *collective portfolio management investment firms*	FIN067 (note 10)		
…	…		
Note 4	Does not apply to an *SNI MIFIDPRU investment firm* which has been granted an exemption from the liquidity requirements in *MIFIDPRU* 6.		
Note 5	Only applicable to a *non-SNI MIFIDPRU investment firm*.		
Note 6	Data items MIF001 – ~~MIF006~~ MIF007 must be reported in accordance with the *rules* in *MIFIDPRU* 9.		
…	…		
Note 9	Where a *firm* submits *data items* for both *RAG* 7 and *RAG* 9, the *firm* must complete Section D1.		
Note 10	Only applicable to *firms* that are *collective portfolio management investment firms.*		

…

16.12.23A R The applicable reporting frequencies for *data items* referred to in *SUP* 16.12.22AR are set out in the table below. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

Data item	**Frequency**				
	Non-SNI MIFIDPRU investment firm	***SNI MIFIDPRU investment firm***	***Investment firm group***	**Annual regulated business revenue up to and**	**Annual regulated business revenue over £5 million**

				including £5 million	
…	…				
FSA030	Quarterly	Quarterly	Quarterly		
FIN067	Quarterly	Quarterly			
MIF001	Quarterly (note 1)	Quarterly (note 1)	Quarterly (note 1)		
…	…				
MIF006	Quarterly (note 1)	Quarterly (note 1)			
MIF007	Annually (note 2)	Annually (note 2)			
Section A RMAR				Half yearly	Quarterly
…	…				
Note 1	Reporting frequencies and reporting periods for this *data item* are calculated on a calendar year basis and not by reference to the *firm's accounting reference date*. The relevant quarters end on the last *business day* of March, June, September and December.				
Note 2	The reporting period for MIF007 is determined by the date on which the *firm* reviews its *ICARA process* under *MIFIDPRU* 7.8.2R and the submission date that applies under *MIFIDPRU* 7.8.5R.				

16.12.24A R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.23AR, unless indicated otherwise.

Data item	**Quarterly**	**Half yearly**	**Annual**

…	…		
FSA030	20 *business days* (note 1) 30 *business days* (note 2)		
FIN067	20 *business days*		
MIF001	20 *business days* (note 1) 30 *business days* (note 2)		
…	…		
MIF006	20 *business days*		
MIF007	The submission date that applies under *MIFIDPRU* 7.8.5R		
Section A RMAR	30 *business days*	30 *business days*	
…	…		

Regulated Activity Group 8

…

16.12.25A R The applicable *data items* referred to in *SUP* 16.12.4R are set out according to type of *firm* in the table below:

Description of *data item*	***Firms'* prudential category and applicable *data items* (note 1)**				
	MIFIDPRU investment firms	**Firms other than *MIFIDPRU investment firms***			
		***IPRU(INV)* Chapter 3**	***IPRU(INV)* Chapter 5**	***IPRU(INV)* Chapter 9**	***IPRU(INV)* Chapter 13**
…	…				

Group capital test	MIF006 (notes 5 and 6)				
ICARA assessment questionnaire	MIF007 (note 5)				
Threshold conditions					Section F RMAR (note ~~1~~7)
…	…				
Note 5	Data items MIF001 – ~~MIF006~~ MIF007 must be reported in accordance with the *rules* in *MIFIDPRU* 9.				
…	…				

…

16.12.26 R The applicable reporting frequencies for *data items* referred to in *SUP* 16.12.25AR are set out according to the type of *firm* in the table below. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

Data item	***Non-SNI MIFIDPRU investment firm***	***SNI MIFIDPRU investment firm***	***Investment firm group***	***Firm* other than a *MIFIDPRU investment firm***
…	…			
MIF006	Quarterly	Quarterly		
MIF007	Annually (note 4)	Annually (note 4)		
Section A RMAR				Half yearly (note 1) Quarterly (note 2)

…	…			
Note 3	Reporting frequencies and reporting periods for this *data item* are calculated on a calendar year basis and not by reference to the *firm's accounting reference date*. The relevant quarters end on the last *business day* of March, June, September and December.			
Note 4	The reporting period for MIF007 is determined by the date on which the *firm* reviews its *ICARA process* under *MIFIDPRU* 7.8.2R and the submission date that applies under *MIFIDPRU* 7.8.5R.			

16.12.27 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.26R, unless indicated otherwise.

Data item	Quarterly	Half yearly	Annual
…	…		
MIF006	20 *business days*		
MIF007	The submission date that applies under *MIFIDPRU* 7.8.5R		
…	…		

…

SUP 16.17 (Remuneration reporting) is deleted in its entirety. The deleted text is not shown but the section is marked [deleted] as shown below.

16.17 Remuneration reporting [deleted]

Insert the following new section after SUP 16.26 (Reporting of information about Directory persons). The text is not underlined.

16.27 MIFIDPRU Remuneration Report

Application

16.27.1 R This section applies to a *MIFIDPRU investment firm*.

Purpose

16.27.2 G The purpose of this section is to ensure that the *FCA* receives regular information in a standard format to assist it in assessing the effectiveness of *MIFIDPRU investment firms' remuneration* and incentive arrangements.

Reporting requirement

16.27.3 R A *firm* to which this section applies must submit the MIFIDPRU Remuneration Report:

(1) in the format set out in *SUP* 16 Annex [XX]R;

(2) in accordance with the instructions in *SUP* 16 Annex [XX]G; and

(3) online through the appropriate systems accessible from the *FCA's* website.

16.27.4 R The information in the MIFIDPRU Remuneration Report must be denominated in pound sterling.

16.27.5 R Where a *MIFIDPRU investment firm* does not form part of an *investment firm group* to which consolidation applies under *MIFIDPRU* 2.5, it must complete the report on a solo basis in respect of *remuneration* awarded in the last completed financial year to all relevant staff of the *firm* who mainly undertook their professional activities within the *UK*.

16.27.6 R Where a *MIFIDPRU investment firm* forms part of an *investment firm group* to which consolidation applies under *MIFIDPRU* 2.5, it must not complete the report on a solo basis. The *MIFIDPRU investment firm* must complete the report on a consolidated basis in respect of *remuneration* awarded in the last completed financial year to all relevant staff of the *firm* who mainly undertook their professional activities within the *UK*.

16.27.7 G *Firms'* attention is drawn to *SUP* 16.3.25G which permits a single report to be submitted to satisfy the reporting requirements of all *firms* in a *group*.

Frequency and timing of report

16.27.8 R (1) A *firm* to which this section applies must submit a MIFIDPRU Remuneration Report to the *FCA* annually.

(2) The *firm* must submit that report to the *FCA* within 4 months of the end of the *firm's accounting reference date*.

Appendix 2
General Guidance on the application of ex-post risk adjustment to variable remuneration

FINANCIAL CONDUCT AUTHORITY

Finalised Guidance

~~FG21/[X]:~~ General guidance on the application of ex-post risk adjustment to variable remuneration

~~1 July 2015~~[date] [month] [year]

1 Introduction

1.1 This statement is general guidance under section 139A(1) of the Financial Services and Markets Act 2000 (FSMA). It was initially issued on 1 July 2015 and applied to all firms in scope of the FCA's Dual-regulated firms Remuneration Code in SYSC 19D. In 2021, we revoked the guidance and reissued it with an extended scope. It now also applies to FCA investment firms in scope of the MIFIDPRU Remuneration Code in SYSC 19G ~~This guidance statement~~ It has effect from [1 January 2022]~~July 2015~~.

1.2 ~~This guidance is aimed at all firms to whom the Financial Conduct Authority's Dual-regulated firms Remuneration Code in SYSC 19D[1] applies. Its~~The main purpose of this guidance is to set out the FCA's expectations of the way in which firms comply with the requirements on ex-post risk adjustment (also referred to as performance adjustment). Where firms consider an alternative approach to be justified in meeting the requirements on ex-post risk adjustment in the Dual-regulated firms Remuneration Code or the MIFIDPRU Remuneration Code, this should be consistent with the general requirement to promote sound and effective risk management set out in SYSC 19D.2.1R and SYSC 19G.2.8R.

1.3 The Prudential Regulation Authority (PRA) ~~has also~~ issued a Supervisory Statement (SS2/13) entitled 'PRA expectations regarding the application of malus to variable remuneration'. This has been superseded by a Supervisory Statement on Remuneration (SS2/17), which was revised in December 2020 ~~published in October 2013~~[2].

~~[1] The creation of SYSC 19D has been consulted on in CP14/14.~~

[2] PRA Supervisory Statement on Remuneration (December 2020) ~~expectations regarding the application of malus to variable remuneration (October 2013)~~ is available at: https://www.bankofengland.co.uk/prudential-

1.4 The primary purpose of the Dual-regulated firms Remuneration Code and the MIFIDPRU Remuneration Code is to ensure greater alignment between risk and individual reward, to discourage excessive risk taking and short-termism, and encourage more effective risk management, and in turn to support positive behaviours and a strong and appropriate conduct culture within firms. This advances our objectives of securing an appropriate degree of protection for consumers and protecting and enhancing the integrity of the UK financial system.

1.5 The effective, meaningful and timely use of ex-post risk adjustment including malus, is essential to these aims.

1.6 Ex-post risk adjustment refers to the adjustment of variable remuneration to take account of a specific crystallised risk or adverse performance outcome including those relating to misconduct (a 'relevant event'). Ex-post risk adjustments include reducing current year awards, the application of malus (reducing or cancelling deferred incentive awards that have not yet vested), and clawback (recouping already vested awards).

1.7 The FCA expects firms to consider the application of ex-post risk adjustment for relevant events where there has been a materially adverse impact on any of the relevant criteria set out in 3.8. Ex-post risk adjustment should be applied as a minimum in the event of circumstances that fall within the meaning of SYSC 19D.3.62R - SYSC 19D.3.64R or SYSC 19G.6.28R – SYSC 19G.6.32G including for material cases of misconduct.

~~1.8 The importance of ex-post risk adjustment has been underscored both in Directive 2013/36/EU (the Capital Requirements Directive or CRD), which requires up to 100% of the total variable remuneration to be subject to malus or clawback arrangements, and the Parliamentary Commission on Banking Standards' final report.~~

~~1.9~~1.8 Firms should comply with the Dual-regulated firms Remuneration Code's and MIFIDPRU Remuneration Code's provisions on risk and performance adjustment in their spirit as well as to the letter.

~~1.10~~1.9 Where a firm has a Remuneration Committee, the FCA expects the Chair to ensure that the decisions taken by this committee on ex-post risk adjustment support the purpose and objectives of the Dual-regulated firms Remuneration Code and MIFIDPRU Remuneration Code to promote positive behaviours and culture within the firm.

regulation/publication/2017/remuneration-ss
~~http://www.bankofengland.co.uk/pra/Documents/publications/policy/2013/appofmalusss2-13.pdf.~~

2 Scope

2.1 All unvested variable remuneration should, in principle, be capable of forfeiture or recovery through ex-post risk adjustment. Deferred remuneration for the purposes of adjustment includes Long-Term Incentive Plans (LTIPs).

2.2 The use of ex-post risk adjustment should not be limited to employees who engaged directly in misconduct. In all cases, the FCA expects firms to consider applying ex-post risk adjustment to those employees whose roles and responsibilities include areas where failures or poor performance contributed to, or failed to prevent, the crystallisation of risk including cases of misconduct. Ex-post risk adjustment should be applied, including for individuals who:

a. could have been reasonably expected to be aware of the failure, misconduct or weakness in approach that contributed to, or failed to prevent, the crystallisation of risk at the time but failed to take adequate steps to promptly identify, assess, report, escalate or address it; or

b. by virtue of their role or seniority are indirectly responsible or accountable for the relevant event, including senior staff who drive the firm's culture and set its strategy.

2.3 Section 2.2 above includes individuals within control functions (e.g. compliance, risk, internal audit etc.) for the weaknesses and failings identified within these functions. The FCA expects firms to place primary responsibility on the business for meeting standards expected of them and expects the amount and nature of adjustments made to control functions to reflect that allocation of responsibility.

2.4 The FCA expects all firms subject to ex-post risk adjustment to have a firm-wide policy on the application of ex-post risk adjustment (and group-wide policy, where appropriate) for staff subject to the relevant provisions of the Dual-regulated firms Remuneration Code and MIFIDPRU Remuneration Code~~for whom the latter can be partially dis-applied due to their level of earnings under the proportionality rule~~.

3 Expectations in relation to the application of ex-post risk adjustment

3.1 Firms' remuneration policies and employment contracts should make it clear that variable remuneration awards are conditional, discretionary and contingent upon a sustainable and risk-adjusted performance. They are therefore capable of forfeiture or reduction at the employer's discretion.

3.2 Ex-post risk adjustment can be applied collectively at bonus pool level, to groups of employees and to individuals. Firms should apply an appropriate balance of ex-post risk adjustments across these levels.

3.3 The primary focus in applying ex-post risk adjustments should be on individuals. Collective ex-post risk adjustments are likely to be appropriate where there are widespread failings or to meet all or a significant part of the cost of regulatory action and fines, redress and other associated costs from bonus pools. Where a relevant event has a material impact on any of the relevant criteria in paragraph 3.8, the FCA expects to see a similarly material adjustment as a proportion of a firm's bonus pool.

3.4 Where the misconduct, failings or poor performance which led to a relevant event occurred primarily in particular business units or divisions, collective adjustments should be weighted towards those areas.

3.5 Firms should ensure that individuals do not profit from a relevant event. Firms should consider the extent to which past bonuses were earned as a result of identified failings and also give appropriate consideration to the cost of consequent redress and other financial impacts. Firms should apply further ex-post risk adjustment to reflect this and should do so robustly and fairly.

3.6 In considering how much further ex-post risk adjustment to apply to individuals, the FCA expects firms to consider the degree of culpability, involvement or responsibility of an individual and the relevant criteria listed in paragraph 3.8.

3.7 For cases with a high degree of personal responsibility and a high impact in relation to any of the relevant criteria in paragraph 3.8, up to 100% ex-post risk adjustment should be the starting point. For lower degrees of responsibility and impact, proportionately less ex-post risk adjustment may be applied. In all cases, firms should ensure that the size of ex-post reductions reflect the severity of the relevant event, are material in size and are sufficient to drive positive individual behaviours and culture within the firm.

3.8 When deciding the amounts to be adjusted, the FCA expects firms to take into account all relevant criteria, including:

a. The impact on the firm's customers, counterparties and the wider market;
b. The impact of the failure on the firm's relationships with its other stakeholders including shareholders, employees, creditors, the taxpayer and regulators;
c. The cost of fines and other regulatory actions (e.g. Section 166 of FSMA reviews);
d. Direct and indirect financial losses attributable to the relevant failure; and

e. Reputational damage.

4 Timing in the consideration of ex-post risk adjustment

4.1 Firms should start to consider ex-post risk adjustment once relevant events have been identified and impose reductions as soon as reasonably possible.

4.2 Where ex-post risk adjustments are made to current or prior year awards before the full impact of the relevant event is known, subsequent consideration and, where appropriate, subsequent adjustments should be made to ensure the final value of the adjustment fully reflects the impact of the incident.

4.3 Firms should update the FCA on any relevant pending investigations and ahead of any payment of outstanding awards to individuals under investigation for misconduct.

4.4 Risk management failures and misconduct can take years to come to light. This should not prevent firms from applying ex-post risk adjustment to the extent that the relevant individuals have variable remuneration capable of reduction, even where this does not relate to performance in the year in which the relevant event occurred or came to light.

4.5 Firms should freeze the vesting of all variable remuneration potentially due to individuals undergoing internal or external investigation that could result in material ex-post risk adjustment until such an investigation has concluded and the firm has made a decision and communicated it to the relevant employee(s). This does not preclude the vesting of some or all variable remuneration in relation to particular individuals once the firm has established with certainty that ex-post risk adjustment of these amounts is not required.

5 Procedure for considering ex-post risk adjustment

5.1 The FCA expects firms to develop and maintain an adequate procedure for deciding cases that could result in the use of ex-post risk adjustment as part of or alongside regular internal performance management and disciplinary proceedings. This procedure should:

a. Identify which roles, departments, functions and committees are responsible for identifying, escalating and deciding cases that may trigger the use of ex-post risk adjustment.

b. Ensure that control functions including Internal Audit, Compliance, Finance, Human Resources, Legal, Reward and Risk provide relevant information and contribute to discussions as required.

c. Set out clear criteria on the kind of cases that may trigger the use of ex-post risk adjustment. These criteria should be indicative and non-exhaustive. Remuneration Committees should retain full discretion to introduce additional criteria where appropriate.

d. Set out a clear process for determining the degree of culpability, responsibility or accountability, including allowing individuals under investigation to make representations.

e. Promote consistency, fairness and robustness in the application of ex-post risk adjustment.

f. Firms should ensure that the initial process for determining bonus pools is sufficiently transparent to enable them to quantify and articulate clearly the impact of any ex-post risk adjustments they might make prior to them being approved.

g. Clearly record the value of awards and the rationale for why they are that size prior to and following ex-post risk adjustments being applied.

h. Clearly record the value of the adjustments made at individual, business unit and firm levels so that it is possible to determine the value of each adjustment per incident and at the individual employee level. Firms should make consistent judgments and be able to explain how adjustments have been made and why any differences exist between incidents or the individuals concerned.

i. Ex-post risk adjustments should be applied separately after all other factors relevant to setting awards ~~(including those set out in Principle 8 – Profit-based measurement and risk adjustment- and Principle 12b –Remuneration structures – assessment of performance)~~ have been considered to ensure that subsequent adjustments are not made that would reduce or undermine the effect of ex-post risk adjustment at bonus pool or individual level.

j. Firms should ensure that the value of ex-post risk adjustments made to an individual's variable remuneration and the reasons for the adjustments are clearly communicated to the affected individuals in writing and that the value and reasons for collective adjustments are clearly communicated to staff as a group.

5.2 The operation of an effective procedure for considering ex-post risk adjustment is not a substitute for taking account of known increases in risk as they arise, including those relating to conduct. The FCA would expect firms to take these risks into account including for example, where weaknesses in systems and controls have been identified or where there is an increased level of customer complaints, when determining the appropriate size and value of new awards.

6 Co-operation with the FCA

6.1 Firms are expected to provide the FCA with information on their application of ex-post risk adjustment as requested. This information should be sufficient for the FCA to assess the firm's ex-post risk adjustment decisions.

6.2 Where a firm's policies and practices on variable remuneration are under review by the FCA, these firms should comply with any~~the~~ timetable set by the regulators, providing sufficient time for the FCA to form a view before the date by which they intend to communicate and distribute their awards. Firms in scope of the Dual-regulated firms Remuneration Code should ~~Please~~ refer to the FCA and PRA websites for the most up-to-date data collection templates~~ and review timetable~~.

6.3 Where a firm does not meet a~~the~~ timetable set by the regulators, there is likely to be a commensurate impact in the provision of the FCA's view to the firm which may delay the firm's own timetable for communicating and distributing awards.

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