Richard Monks: Good afternoon and welcome to this webinar on the new prudential regime for investment firms. My name is Richard Monks and I'm the Director of Strategy at the FCA. I'd like to welcome you all. The panellists alongside me are Paul Rich described as the architect of the investment firms' prudential review, and Alison Wade, the FCA's leading expert on remuneration in investment firms.

My engagement with this new prudential regime began over five years ago. FCA policy teams were heavily engaged in the joint EBA/ESMA 2015 report. Back then, the creation of a bespoke regime for investment firms rather than one designed for banks was a clear goal, but it seemed a long way off. I'm delighted that five years on, we have made some progress within the European framework and now we have a great opportunity to build on this work and create a bespoke UK regime.

Now, we are recording this event and will be posting it on our website. To ensure sound and visual quality we are filming the event at a central London venue rather than from our own homes. Now, as a regulator I don't crave popularity or fame. It's just not that sort of job. It's very hard to put capital requirements to music and post them on TikTok, but even I must admit to being slightly concerned as I look out at this venue and see so many empty seats.

We have a great team who have worked had to put together the event this afternoon and they have assured me that the empty seats are entirely COVID-related, that we couldn't an in-person audience, but that instead we over 500 people dialled in. I think I believe them, but I would like some reassurance that you are all out there listening to this session so I'd ask as many of you as possible to start sending in questions for the Q&A session.

To do this, there is a box literally just under your screen down there. You simply click ask a question and fire away. We will respond to as many questions as we can today, and we'll group the other questions and respond to these in future publications. In terms of today, I will make just a couple of introductory remarks. I will then ask Paul Rich to provide an overview of the new regime and then I will moderate a Q&A session with Paul and Alison.

So, just a couple of minutes from me up front. Why are we here today? Well, investment firms are critical players in the UK and the global economy. There are currently around 3000 investment firms operating here representing by far the largest market in Europe. These firms have a diverse range of business models. They help ensure capital is allocated efficiently and appropriately and help individuals make the most of their savings and their investments.

These firms operate against a prudential regime that was not designed for them. It was designed for banks which is why the FCA supported the goals of the new EU prudential regime for investment firms which is now being introduced as the IFD and the IFR. The government intends to legislate for a UK regime referred to as the IFPR – the Investment Firm Prudential Regime. We propose to introduce this regime that will achieve similar intended outcomes as the European IFD and IFR whilst at the same time taking into consideration the specifics of the UK market.

The Treasury will endeavour to introduce the IFPR by summer 2021 which is a broadly consistent timetable with the applicability date of IFD and IFR. We would note however, that the precise timing is dependent on progress of the Financial Services Bill through Parliament. Our recent discussion paper DP20/2 is intended to be the initial engagement firms on the UK IFPR and this event is the first of a series of events where we will be engaging directly with firms.

This webinar is intended to take you on a very quick journey so that you hopefully be available to identify which parts of the discussion paper may be particularly interesting to you and give us feedback on that. Now, there is a lot of detail within the proposal and we really want you to engage on this detail. Before I turn to Paul to cover off the proposals, I'd like to pause for a moment to remember the strategic aims of regime.

Firstly, to ensure a better alignment to business models. The regime for the first time aims to deliver a prudential regime that has been designed with just investment firms in mind. There will be a better alignment or regulatory prudential requirements with your business models with business model risk and management strategy.

Secondly, our regulatory approach. The IFPR will focus on the potential harm an investment firm can pose to its clients and the markets in which it operates which is aligned to our wider approach as set out in the FCA Mission. This will also improve our engagement with you so our supervisors can have sensible conversations about your business model and about potential harm to consumers and markets.

Thirdly, lower regulatory costs. The UK regime has the potential for more proportionate regulatory reporting and proportionate disclosure requirements for investment firms. Finally, and perhaps most importantly, on better prudential outcomes. Overall, the prudential standards for investment firms should improve.

For example, a minimum proportional liquidity requirement will now apply to all investment firms. This will lead to improved financial resilience for investment firms. It would mean that where mistakes are made, an investment firm has the prudential resources to put things right and as well as instilling confidence in the market, this could reduce the risk of firms failing unsafely and consequently reduce FSCS costs for other firms.

I'm now going to introduce Paul Rich. Paul will speak for about 20 minutes and then we'll go off to Q&A. Paul will take us through the key concepts within the regime. Paul has 30 years' experience as a Financial Services regulator including the original Capital Adequacy Directive in 1993, CRD II and CRD III amendments and the CRR. Paul has played a lead role in the EBA's expert opinion to the commission and in subsequent European Council negotiations.

In fact, it was Paul's to the commission to put in a review clause in CRR for this new EU prudential regime for investment firms. So, regardless of whether you are quietly thinking that the regime is going in the right direction, or you are scratching your heads and questioning why we are here at all, the person to thank or blame is Paul. Over to you.

Paul Rich: Thank you Richard. Okay, as Richard has said, we are going on a journey. This journey started over a quarter of a century ago with the original Capital Adequacy Directive in 1993 which linked the prudential requirements for investment firms to those to banks right through to the current CRR and then the EU publishing it's Investment Firm Directive and Regulation at the end of last year.

The UK of course has left the European Union and therefore we will be implementing our own domestic UK investment firm prudential regime or what we call the IFPR for short. Now, our discussion paper represents our first step in our dialogue with stakeholders on this regime. It is a whole prudential regime covering many different topics and we cannot hope to give justice all of them today.

Each one in its own right would probably occupy its own webinar so we will try and take you on a very quick tour through the key essential points and areas that you may wish to look at. I would stress there is no substitute for reading the relevant sections of the discussion paper yourself and then responding to us, so we have your comments. The discussion paper is written by focusing on the EU's Investment Firm Directive and Regulation first because they are published and then going on to talk about the thoughts, we have for a UK regime.

Scope – first of all, we should make clear that the new regime will apply to all MiFID investment firms. All investment firms authorised in the UK to do MiFID business. This will see all the existing prudential categorisations which have different treatments attached to them swept away so it is relevant to limited licence, limited activity, full scope firms, exempt CAD firms, local firms, specialised quality derivatives dealers. Anybody who is authorised under MiFID will be within the regime.

We also have a separate chapter in the regime for collected portfolio management investment firms, those that are authorised under [FMD] or UCITS, but take advantage of the ability under those directives or authorisations to do MiFID investment services and activities. To repeat, the new regime is relevant to all investment firms that are authorised under MiFID.

Okay, other than a handful of the larger systemic investment firms that deal on [own account] that could be designated stilled by the PRA – Prudential Regulatory Authority – and would remain under subject to the Capital Requirements Regulation and supervised under the CRD, we believe that all other investment firms will be supervised and potentially regulated by the FCA under the new regime, the IFPR.

There are essentially only two broad categorisations of investment firms under the IFPR. This is those which who are deemed to be small and non-interconnected or SNI and those which are not or non-SNI for short. In order to determine if a firm an SNI, there are series of thresholds which are shown on the screen now. If one or more threshold is exceeded, then the firm cannot be an SNI and therefore categorised as a non-SNI. For SNI firms, there is additional proportionality and derogations from parts of the regime.

The starting place is for each firm to determine whether or not it is a SNI because that will determine the relevance of other parts of the regime whether they apply in full or in part or not at all. These thresholds are largely based on investment services and activities that the firm undertakes or measures of those activities, but also there are some thresholds which relate to balance sheet size and gross income from regulated investment activity.

One feature of the regime we must stress is the definition of capital. The regime will look to the CRR definition, the same as applies to credit institutions. This is a change for firms which are not currently under our IFPRU sourcebook and therefore not currently subject to the CRR definitions of own funds or capital. Firms who are not current IFPRU need to look closely at the changes.

The CRR definitions represent a tightening from what has occurred before, but there also separate changes specifically for investment firms particularly in relation to the deductions. These are all set out in chapter four of the discussion paper and we urge you to look at those to assess the impact upon your firm.

There are no longer capital ratios as exist for banks. The requirements are merely expressed as how much capital you have relative to the total of your capital requirements. However, there are limits on the quality of capital similar to the CRR. For example, Common Equity Tier 1 capital – capital of the purest quality – must represent at least 56% of your total capital requirement represented by the letter D in the equations.

Why 56%? Well, this is simply mathematically to replicate the existing CRR where the total minimum capital ratio is 8%, the Common Equity Tier 1 ratio is 4.5%, so 4.5 divided by 8 should if maths is correct equate to 56%. Okay?

There are a new own funds requirement against which the capital own funds have to be held. There are three component parts. The first is the permanent minimum requirement or PMR. This takes the amount required of initial capital required for authorisation and applies it on an ongoing basis. There is then the fixed overheads requirement based on 0.25 of the previous year's annual fixed overheads, but this now applies to all investment firms.

Thirdly, there will be a new K-factor requirement. The K-factor requirement is a new way of dealing with the potential harm that an investment firm may cause to others – to its clients, to its markets or indeed to itself and then in turn to markets or its clients. These K-factors are based on the nature of activities and the scale of activities that are undertaken.

For a smaller non-interconnected or SNI firm, the own funds requirement will be the higher of the permanent minimum requirement and the fixed overheads requirement. For a non-SNI firm, it will be the higher of the permanent minimum requirement, the fixed overheads requirement and the K-factor requirement.

The K-factor requirements are a new set of requirements. There are four which could apply to any investment firm according to the nature of investment services and activities that it undertakes. These are the assets under management, client money held, assets safeguarded and administered, and client orders handled which relate to either the execution of orders and/or the reception and transmission of client orders.

There are also five additional K-factors which apply only to those investment firms that have permission to deal on their own name or underwrite and that includes where the dealing is in the name of the firm, but only on behalf of clients.

These are the daily trading flow, the net position risk, clearing margin given, trading counterparty default and concentration risk. You'll see replicated on the screen a series of questions which we set out in our DP. We particularly welcome your thoughts on the detail of the application of the K-factors, the additional detail beyond what is set out in the DP necessary to make the regime work in practice.

For example, when measuring assets under management how does one treat negative items such as derivatives within the portfolio? Should we net them, or should we treat them gross or in some other way? We welcome your comments on those questions in response to the DP.

The new regime contains prudential consolidation. Shown on the screen on the right-hand side is a diagram that shows the types of entities which are included with an investment firm group. If there is a credit institution in the group, consolidation takes place under the CRR and it is the responsibility of that bank or credit institution.

We have the new concept of an investment firm group that does not include a credit institution.

The responsibilities for consolidation fall upon the parent entity. This may include an unregulated parent entity and therefore we will expect to be given new powers under the Financial Services Bill in order to make rules to apply to those unregulated parent entities to conduct consolidated supervision.

There is an alternative to prudential consolidation. This is known as the group capital test. Now the purpose of the group capital test is essentially to ensure that there is a stable group structure. Consolidation applies to a number of parts of the whole regime so under the prudential consolidation, one would consolidate not just own funds requirements, but also concentration risk, liquidity, reporting, disclosure.

The group capital test is merely about ensuring adequate, stable group capital structure. It applies to each parent undertaking within the group so in the example shown, there would be three levels of group capital test applying to entity E, entity C and entity A. All of which are parent undertakings in that group structure.

This is to ensure that there is not only a solid foundation, but solid brickwork up to the roof making sure that the capital of an investment firm is backed by capital of the group and there can be no highly leveraged, unstable structures trying to take advantage of regulated entities and the potential for harm that that may cause to clients or to markets.

The regime also has requirements for concentration risk. Now, there are two parts to this, and I should stress one part I've already mentioned – the K-con – the new K-factor requirement for concentration risk. That only applies to firms that deal on own account for themselves or in the name of their clients. That has an additional capital charge which applies where the exposure to any third counterparty based upon its trading counterparty requirements or its net position risk requirements exceeds certain thresholds in the training book.

However, concentration risk goes wider than that and all investment firms including SNIs have a requirement to monitor and control their concentration risk. Further, all non-SNI investment firms will have a duty to report their concentration risk. Remember, it is only those non-SNIs which deal on own account that will be required to calculate any K-CON if it is applicable.

Now, concentration risk will cover new factors such as the place in which a firm places its client money – which bank or which instruments is the client money placed in? Where is our client assets placed? Where does a firm hold its own cash deposits? How concentrated are its earnings? These are issues we all need to give more detail on for firms in our subsequent consultations.

Liquidity – for the first time there is a common minimum liquidity requirement for all investment firms. This is a very simple basic minimum equivalent to one month's worth of the fixed overheads of the firm. This is to ensure that all firms hold liquidity in a liquid for highly liquid form in order to be able to pay their bills as they fall due and to give them time to liquidate other forms of assets.

Those liquid assets are based on those used for banks in the CRR in its delegative regulation, but are extended to recognise investment firms may hold deposits at banks and they may also within limits be able to use trade debtors and fees and commission owing. The DP gives greater details of the types of assets, the haircuts which may apply – in other words, the discounts – because obviously there needs to allow for variation in market prices if one is trying to liquidate those assets and the usage of those assets.

The regime also covers governance and risk management requirements. For SNI investment firms, there are no additional governance requirements beyond those set out in the MiFID would already apply and are contained currently in our Systems and Controls Handbook.

For non-SNI investment firms, there are additional requirements as shown on the screen in relation to organisational structure, internal control mechanisms, policies and practices and for non-SNI firms above a certain balance sheet size, there will be the requirements to hold a risk committee which will constitute independent members that are not conducting an executive function within the firm.

There is also a new process in relation to additional requirements. Some of you may be used to the terms already – ICAP – the internal capital adequacy assessment process. Under the new regime, there will be an ICARA process – the internal capital adequacy and risk assessment process. It is wider than just capital, concerns all forms of risk particularly liquidity and the SREP is the supervisory review and evaluation process.

All firms will be required to assess the treatment of their risks including the potential harm they may cause to their clients or pose the markets in which they operate. Also, what they may require to wind down in an orderly fashion. Then, the supervisory review process will assess the assessments of the firms and lead to regulatory dialogue in relation to those risks may be monitored and managed and dealt with.

This may or may not lead to additional requirements beyond the minimums of the capital requirements which I've very briefly outlined. However, I would stress that the new regime is not simply about chasing every form of risk and quantifying it, it is working out which risks are material to a firm. For example, the new regime does not cover credit risk as Pillar 1 as a minimum. We would expect firms to understand any credit risk that they run and deal with this where appropriate.

In the DP, in figure 11.2 we set out some examples of the types of harm that might arise. I would particularly like to point out two very briefly. The first is title transfer collateral agreements – TTCAs. Now, these do not constitute holding client money under our CAS sourcebook, but they do lead to the potential for harm to clients and therefore we would very much require and expect firms to understand if they use TTCAs, how they manage those risks and tell us that under that ICARA assessment process.

Similarly, we noticed a transition away from LIBOR to new benchmark rates. We'd expect firms – it's not just the responsibility of the sales side, it is also the buy side responsibility to ensure an orderly transition and this is a risk we would expect firms to consider under [unclear] process and we will look closely for under the supervisory review process to make sure that firms are managing those risks.

Okay, a slightly new approach. Under the DP we set out that we believe that any additional requirements if they are applied to capital and indeed liquidity, will be applied by way of requirements and not by individual guidance. A firm – here a non-SNI firm will be looking at both its fixed overheads requirements and any additional for its ability to wind down in an orderly manner.

It would also look at its K-factor requirements and any additional requirements on an ongoing basis which could lead to harm to clients and to markets. In the example shown, it just so happens that the additional assessment results in the total amount of capital under K-factor requirements being higher than what is required to wind down in orderly basis on the FOR. This could vary according to the specifics of an individual investment firm.

In addition, on the right hand side we show how additional guidance may be applied on top in relation to stress testing or the effects of an economic cycle upon individual investment firms where that is deemed to be a material risk. The new regime will have regulatory reporting of course.

This will be a new regime. It will not – it is not intended to be COREP mark II for those who are used to the current reporting regime under the CRR. We believe it should be more appropriate and proportionate. It will of course capture requirements relating to capital, concentration risk, liquidity and how the thresholds of being an SNI are met. As I mentioned before there are concentration risk reporting requirements for all non-SNI investment firms, not just those that deal on own account.

The new regime requirement will cover remuneration requirements. Here we set out the scope. The scope will apply to all non-SNI investment firms. SNI investment firms, smaller non-interconnected ones are out of scope of the additional remuneration requirements that are contained in the new regime. There are however some exceptions or derogations for non-SNI investment firms, largely size related, related to the size of the firm or the size of the bonus - the [variable] remuneration which is applied to material risk takers.

There are other key themes contained within the remuneration requirements. These cover the ratio of fixed available remuneration and it is worth noting that there is no bonus cap in the new regime. How pay-out – the nature of instruments of which pay-out for variable remuneration may be made for non-SNI firms. The deferral of variable remuneration so it is not just paid immediately before you have received the cash.

Ex-post adjustment of malus and clawback, [a need] above a certain size to have remuneration committee and gender neutrality. Alison will, I'm sure, be happy to answer questions on these shortly on any particular aspect. The regime also contains public disclosure. Firms are required to disclosure annually certain key aspects or pieces of information.

Shown in figure 15.1 of the DP is a summary of the requirements which apply mainly to non-SNI investment firms, but there are some requirements which also apply to smaller non-interconnected or SNI investment firms where they have issued additional Tier 1 capital. There are some derogations from the disclosure requirements shown in figure 15.2. As I say, there is no substitute for reading the discussion paper in detail for the areas you believe may apply to you.

There are also transitional provisions. These transition provisions relate to the new capital requirements and seek to limit the size of any increase for those investment firms who may face an increase in their minimum own funds or capital requirements. We have set them out in figure 19.1 in the DP based upon the existing prudential categorisations and also what applies to a new newly authorised MiFID investment firm to help people work out how to navigate. It may be that more than one transitional could apply and firms need to look at which might be the most beneficial for them.

We are also looking at where those transitional provisions may not cover everything and if we spot gaps, we will consider whether additional transitional positions may be justified.

Okay, in order to help navigate the discussion paper, as I say, there's an awful lot of content. It's a whole prudential regime. I would urge you to look at Annexe 3 as a starting point. Annexe 3 sets out the types of requirements and firms to which they apply. So, in this screen, we see all the paragraphs or chapters of the DP which we believe apply to all MiFID investment firms; all MiFID investment firms should read these sections. These sections are not mutually exclusive, by the way. It may be that more than one section applies according to the nature of your business model or activities. There are sections which apply on this chart to all SNI investment firms, all non-SNI investment firms, non-SNI investment firms that do portfolio management, and so on.

As we said, there are particular chapters relating - or sections relating to commodity and emissions allowance dealers, paragraphs which relate to partnerships, LLPs and non-joint-stock companies, and finally a chapter for collected portfolio management investment firms, which I mentioned earlier.

That concludes a very, very quick tour of some of the highlights of the new regime and I would urge you to get in your responses to us. The deadline for discussion paper for responses is 25 September but please, the sooner you can get responses to us, the more time we have to process and the more we can look at how our consultation papers can really take account of the detail to make this regime work as practically and as pragmatically as possible. Thank you for listening.

Richard Monks: Thank you, Paul. Paul is now going to join me for the Q&A session, alongside another colleague of mine, Alison Wade. Alison is the FCA expert on remuneration in investment firms. She's developing the new remuneration regime which forms part of the IFPR, and also represents the FCA on the FSB's working group on remuneration.

So, we've had a number of questions in advance of the session today. We're going to start with a couple of those questions, and then in terms of questions that are coming in live, we will try and address as many of those as possible as well. We're going to start with remuneration which certainly is a subject that we've had a lot of questions in so far.

So, Alison, why is it necessary to have such restrictive remuneration rules that look as if they've been designed for banks?

Alison Wade: Thank you, Richard. Well, the purpose of our four remuneration codes that we currently have, has always been to ensure greater alignment between risk and individual reward and also to support positive behaviours and a strong conduct culture within firms. Now, these will remain our overarching aims when we're creating a new remuneration regime for investment firms. We will base the new regime on the remuneration provisions in the IFD, but also taking into account what is possible and appropriate in a UK-specific context.

So, our aim is to have remuneration rules which are proportionate to the risks posed to and by investment firms, instead of the current rules, which Paul has already set out for us, largely the same as those which apply to credit institutions such as banks. Though at the same time, we also recognise the diversity of investment firms. So, it’s unlikely to be proportionate to apply all remuneration rules to all MiFID investment firms in a blanket manner.

So, looking at the IFD itself, it itself takes into account proportionality by setting a threshold below which small and non-interconnected, so SNIs, so do not have to apply remuneration rules. It also foresees as well as this, that the smaller of the non-SNIs, so the larger investment firms, the smaller of those should also be exempted from having to apply some of the trickier rules shall we say, on variable remuneration. So, I'm thinking for example of those on deferral and on pay-out.

Now, we've said in our discussion paper that we think it may indeed be appropriate to increase this latter threshold up to the maximum permitted under the IFD, which is €300million, where a firm, of course, satisfies the other conditions too. But equally, we've also set out in the paper that there may be firms for whom it would be appropriate to reduce the starting threshold of the IFD which is €100million. So, again, setting out this idea of proportionality. For some, it may be higher, for some it may be lower.

So, a key question I think for us is whether these thresholds in the IFD are the right way to appropriately recognise the differences between the various types of investment firms in the UK.

Now, there's a certain tension I think between on the one hand, the desire that I think a lot of us have for regulation to be kept as simple as we can. But on the other hand, trying to meet the differing interests of the diverse types of investment firms in scope. So, I have no doubt in moving forward, some trade-offs will be necessary along the way, but to be clear, our overall aim will remain to ensure that all investment firms have remuneration policies and practices that are and remain consistent with and promote effective risk alignment.

Richard Monks: Thanks, Alison. Turning to a slightly more detailed question now. Is it intended that the remuneration proposals will apply to CPMI firms and, if so, how will that be split between MiFID and AIFMD activities?

Alison Wade: Clearly, there are two aspects to this question. So, firstly, whether the new remuneration regime will apply to CPMIs. I think it's worth pointing out here that we're talking about AIFMs or UCITS firms with so-called top-up permissions which enable them to carry out certain additional MiFID activities. So, it seems that the starting point here really ought to be that CPMIs are carrying out some MiFID activities. Now, this raises the question for me really of whether there is any reason not to apply the same remuneration rules to these firms as those which apply to other types of firms doing the same business, namely the same MiFID activities.

So, the purpose of RDP really is to seek views from stakeholders on quite complex matters such as these. So, I would speak now to everyone who is watching and listening to this. Do tell us what you think about this, particularly if you are one the CPMIs potentially affected.

The second aspect of the question regarding the possibility of splitting between MiFID and AIFMD activities. So, this I think gives rise to an interesting underlying issue and that is how the remuneration rules could apply to CPMIs given that part of their business is MiFID activity and another part is not.

I don't claim to have the answer to this just yet. It's certainly something that we're actively considering, and again, I would encourage stakeholder to respond to the DP with their thoughts and ideas on how such a split might work, or indeed whether they consider it might be more pragmatic to avoid the complexities around splitting by perhaps applying one set of remuneration requirements to both types of activities.

Richard Monks: Thanks Alison. We've had questions on alternative corporate structures such as limited liability partnerships. Perhaps, can you touch on those for remuneration and then I'll ask Paul to talk about this as well.

Alison Wade: Certainly, yes. So, we are aware, as we've set out in the discussion paper that there are particular challenges for LLPs and other types of partnerships in implementing certain types of remuneration requirements. I'm thinking especially those requirements for later to deferral and to the obligation on some firms to establish remuneration committees.

Now, we've said in the discussion paper that we're keen to gain a fuller understanding of these difficulties from stakeholders so that we can consider potential options which will enable us to still meet the overarching objectives of our remuneration rules that I set out just a moment ago. So again, I would ask all partnerships or indeed any firm whose corporate structures may be idiosyncratic in some way, to include in their responses as much information as they can about what particular difficulties with the remuneration rules arise given the particular corporate structure of your firm, and importantly, we’re also very open to your ideas; your ideas of how difficulties could potentially be mitigated but without creating a lot of very complex exemptions that perhaps aren't foreseen in the IFD.

Richard Monks Thanks, Alison. Turning to you now, Paul, but still thinking about alternative corporate structures such as LLPs, what's the position with consolidation?

Paul Rich: Okay Richard, well, thank you, first of all, there are two parts here. Unlike the current regime, the IFPR recognises that investment firms can be in non-joint-stock companies. So, first of all, I would urge people to look at chapter four on the definition of capital which asks questions about the nature of capital instruments that firms that don't issue shares may need to hold. That is also related to remuneration as well. If you're looking at remuneration in capital instruments, variable remuneration, one needs to look at the types of capital instruments that are acceptable to be held by partnerships, LLPs and even sole traders can exist as MiFID investment firms.

In terms of potential consolidation that exist currently under the existing regime, but unlike the existing regime the new regime is not solely based on a balance sheet approach and therefore because consolidation can work for firms at the moment, we don't envisage any difficulties with working in the new regime.

Richard Monks: Thanks, Paul. A final question, or a final pre-submitted question I should say, for you Alison. I think given the operational difficulties of introducing a new regime halfway through a performance year, will any new remuneration rules only apply from the start of the next year?

Interviewee: Yep. We are very aware that it can be particularly challenging for firms to apply new remuneration rules for part of a performance year. So, not just from an operational perspective, but potentially also from a legal perspective. It is however just worth pointing out that not all firms have performance years running from January to December. So, we have got firms on different performance years. Also, I would also just point out that the IFD itself requires the remuneration provisions to be applied by firms from 26 June 2021. So, for many firms, that would be in the middle of the year. There is no transitional period in the IFD or wording to the effect of from the next performance year. But we do of course acknowledge that this timing issue is a particularly tricky one. It is something that we will consult on in due course, and in the meantime, as always, we're very open to views from stakeholders on this timing issue as part of their responses to the discussion paper.

Richard Monks: Alison, thank you. I'm sure we may have some further questions on the day on remuneration, so don't go anywhere.

Paul, on categorisation, will the FCA be telling firms which category they fall in or is this something they must determine for themselves?

Paul Rich: Initially, we expect that the investment firms will need to look at the thresholds themselves according to their business model and determine with or not they can be an SNI, and then effectively to notify us would be our current expectation and then we can determine effective reporting that goes with that.

However, this is a matter of course we will look at according to how the thresholds are defined in practice and the information received from our regulator returns.

Richard Monks: Thanks, Paul. We've now had both a pre-submitted question and a new question has come in, in terms of net position risk. So, Paul the opening question here of does net position risk, or KNPR, does that ever apply to firms that do not have a trading book?

Paul Rich: Okay, the first answer is no. The net position risk only applies to firms that deal on own account, in their own name, including for clients, in respect of a trading book. Having said that, once it applies, the net position risk is effectively covering them capturing the market risk and that includes FX and commodities risks and therefore includes FX and commodities that exist within the non-trading book of the firm. So, the first determining factor is do you have a trading book? Is the firm dealing in its own name? Yes, then NPR applies to the extent it has only net positions, but equally, it then extends FX and commodities risk to positions that exist outside of trading book.

Richard Monks: A couple of - sticking with the K factors, Paul, in terms of clearing margin given, or KCMG, what about the use of third country clearing members and qualifying CCPs in respect of clearing margin given?

Paul Rich: Well, we have to be pragmatic and realise of course that a trading investment firm will be trading potentially on a global basis. It won't just be doing business on UK exchanges with UK clearing members, or indeed with the same clearing member. A firm may use multiple clearing members and indeed multiple entities across a group may be trading. So, we have to look in order to make a regime work effectively at how we can use the clearing margin given to reflect the nature of firms' trading operations.

Richard Monks: Thank you, Paul. Another question on clearing margin given. In obvious cases of double-counting such as when the firm changes from a KCMG to KMPR, where the capital required would appear for three months in both K factor, would the FCA allow firms to adjust the capital requirement?

Paul Rich: Okay, thank you. This is quite a detailed question and thank you for this. This is something we will need to consider how to respond to in our consultation because it's quite right that as the K factors are often based on historic figures and a run of data, we need to make sure there is not double counting. The principle should be, in general, unless where a regime says otherwise, that double-counting should be avoided and therefore we need to look at how this will be addressed.

In practice, we would not expect firms to change periodically between the net position risk and the alternative of the clearing margin given method. There should be an element of consistency and not switching all the time. But where it does happen, we do actually need to consider how that will operate in practice.

Richard Monks: Thanks, Paul. Going from a very, very specific question to something much broader, do you think it likely that the Pillar 2 add-on will be significantly higher than it was before?

Paul Rich: Okay, this is a question that will depend very much on an individual firm basis, but as a general high-level, I would say there is no point in a new minimum regime, or Pillar 1 as it's called at the moment, if all you do is then take your existing requirements and add them on top as a new Pillar 2. The new regime is not just primarily about capital, or indeed about raising capital. It should be about making the minimum do more of the job, to the extent the minimum requirements of Pillar 1 do more of the job, then Pillar 2 can be much more about an understanding of the management of risk in the business model and deal with the more exceptional cases where things are more material deviations from the norm and where there are particular features of a firm which are either not well controlled or lead to additional sources of risk to clients and to markets.

Richard Monks: A slightly more practical question on this issue, how will firms transition from ICAAP or ICARA?

Paul Rich: Well, we do have a section in the discussion paper about that and about how we might also transition any existing capital guidance to requirements under the new regime, but this is very much a practical question and we very much welcome practical suggestions from industry because firms are better having - operating the ICAAP process, you are better understanding the practical issues that you face when undertaking those reviews and therefore we look forward to receiving people's thoughts on how to ease that transition. But then we recognise that there needs to be a transition off.

Richard Monks: Thank you, Paul. We've had a number of questions on reporting, perhaps not surprisingly. The EBA consultation however on regulator reporting contains many templates, including partial submission of COREP. Is the FCA intending to be more proportionate than this?

Paul Rich: Okay, reporting is an area we are currently looking at. Obviously, it has to go hand in hand with knowing what the detailed requirements will be and therefore need to be reported. So, there's a lot of work in progress in this area. However, what I would say, and I would go back to the beginning of the process when this work started through the European Banking Authority, it was very, very clear that the new regime was not intended to have a reporting regime which became a COREP Mark II, a common reporting regime as per the CRR, which has a very complex taxonomy as it has high expenditure build and lots and lots of detailed information.

So, our initial view on this is that the reporting regime needs to be pragmatic, proportionate and the information needs to be understandable by firms producing the information and usable by supervisors to supervise the firm according to that information.

We're also conscious of the timelines and that time is particularly short, so our initial thoughts here, without prejudice to subsequent consultation, is that we believe we need to be pragmatic in order to get implementation in for day one, and then look at usage of that information, and if there are to be any larger system builds or more detailed regulatory reporting, that needs to be done in the fullness of time and we need to look at what systems FCA may then produce to enable - to help firms produce that information.

Richard Monks: Thanks, Paul. We've had a question on reporting and particularly liquidity reporting. So, building on your first answer, some firms must currently submit two different liquidity reporting forms. So, do you think that the format and scope of this reporting is going to change?

Paul Rich: The new regime has a basic minimum liquidity requirement. Anybody who is currently a BIPRU 12 reporting firm, subject to liquidity requirements there, that regime will get swept away by the new minimum, Pillar 1, which we said was quite simple and basic, and liquidity will take a greater focus within a firm's own individual assessment according to its business model under the ICARA process and the supervisory review process.

So, we will not expect in terms of the new regime to have additional reporting, liquidity reporting, as we do at the moment. Having said that, what our supervisory colleagues may be doing at the moment for some investment firms, bearing in mind the effects of Covid and the need to look quite sensibly at liquidity of investment firms, that as existing temporary measures will depend upon the timing as we go forward.

Richard Monks: Thanks, Paul. We touched on CPMIs earlier in terms of remuneration. How do you think the assets under management will split between the MiFID and AIFM business for calculating the K factors?

Paul Rich: This is actually an easier question than the one given to Alison, slightly earlier, because for assets under management, there will be a very clear segregation between are they discretionary portfolio management business under MiFID, or is it purely in relation to the collective portfolio management? We believe the AUM will only apply to the MiFID discretionary business or indeed the ongoing advice - the advice of an ongoing nature and not apply to the collective investment business for which there are separate prudential requirements based on the AUM under the FMD or UCITS.

Richard Monks: Thanks, Paul. Can you - a question we've just had in. Can you give us some more details on the group consolidation test?

Paul Rich: Okay, I'm not sure whether they're talking about here prudential consolidation - I'll answer it in both forms. If it's prudential consolidation, which is captured in chapter seven of our discussion paper, then the capital requirements there are effectively treating the investment firm group as if it was a single investment firm, so that it will be - in the same way as an individual firm has to look at the higher of its permanent minimum requirement, its fixed overheads requirement and its non-SNI, its K factor requirement, then the same would apply at consolidation. There will be a consolidated PMR, a consolidated FOR and a consolidated KFR, and we will set out more details in subsequent consultation about how those are calculated.

If it’s in relation to the group capital test, this is not something with the amount of time we have available today to answer now, but I would urge people to look at the chapter eight of the discussion paper where we have a worked example and a number of paragraphs explaining this and then to write in subsequently, if you believe that does not answer your questions, and we will provide more information when we consult.

Richard Monks: Thanks, Paul. We've had a number of questions on implementation. The first question we've had pre-submitted. Has the FCA identified where there may be a need for a more pragmatic transition to new regime?

Interviewee: Well, I think transition will depend upon which aspects of the regime we see, and depending on feedback, may or may not cause issues for firms. I've already mentioned there are capital requirements transitions in terms of the level of requirements where there are material increases. We will look at those and see whether they cover the different scenarios. We talked about reporting. It may be, for example, that reporting we need to do something pragmatic to allow people to produce the information from day one, because we recognise that if a number of the K factors are based on historical runs of data, it may not be sensible to expect people to start collecting that data even from the date which pre-dates today in some cases. So, we will look at that.

As Alison has already dealt with, there are questions of transition in remuneration and the dates of transition in relation to how one moves from individual capital guidance under Pillar 2 to a new requirement under the new regime, how one moves from risk under ICAAP to the new ICARA process. So, we will look at this generally in terms of are there particular issues in relation to the feedback where we believe that some time is needed in order to get to the steady state position.

Richard Monks: In terms of the time needed, will the UK be in place roughly around the same timetable as the EU regime?

Paul Rich: Well, this is something that's hard to predict at the moment. As the Treasury noted in its June update to the Financial Services Bill, they were expecting to legislate to have a new regime by the summer of 2021, next year. So, to some extent, we are dependent upon the passage of the Bill through parliament once it is put to parliament, and that is necessary in order to give us the powers to make our final rules. We also need to look at what is possible and back to your point about transition, we are very conscious of the timeframe. It is hard to actually predict what is necessary at this point and the precise point in time at which we can introduce what is a whole new prudential regime.

Richard Monks: A related question to that. A question has come in, in advance, in terms of when will firms get more information on the new regime so they can start to prepare for it? Will there be additional guidance available on the key changes as there was with the implementation of MiFID 2, to allow firms to do a gap analysis and really accurately address any shortfalls in requirements?

Paul Rich: Okay, first of all, in relation to gap analysis, there is a series of material in the discussion paper itself which does places compared to the existing regime. But no, we will not do a detailed gap analysis, because unlike MiFID, it's not an extension or amendment of an existing regime, MiFID to MIFID2. This is a new prudential regime and therefore, in a number of places, it's just simply not comparable other than, for example, a firm's capital position maybe X today and Y tomorrow, but if the component parts are very different then comparison does not particularly make sense to do that, to spend time on the detailed gap analysis.

However, in relation to more information, as I said, the discussion paper is the start of the process, work continues on that in relation to our consultation material. Indeed, for me personally, that work will continue the moment this webinar finishes. Indeed, I even dream the requirements in my sleep these days, bearing in mind the amount of time that is available, and we are looking currently at when we might consult, how we might consult what is a sensible or doable nature of packaging of material to get it out the door, because we are very conscious there are some parts that are even more important for firms to have early sight of than others. So, those are exactly the issues we're grappling with at the moment.

Richard Monks: Thanks, Paul. We'll touch on the timetable just a we're wrapping up in a couple of minutes. Question for you Alison, the EBA RTS implies that all NEDs on UK boards of investment firms will be material risk takers. Is this the FCA intention?

Alison Wade: Yep. So, I think this question relates to a recent consultation paper published by the EBA around draft RTS. So, the question is asking whether our intention is the same as the EBA's in relation to all non-executive directors on UK boards of investment firms, whether our intention is also that these are all material risk takers.

I think the best way to approach this is to actually talk about our approach more broadly to EBA materials that are starting to come out and be published in terms of consultation. In relation to the IFD and IFR, what we are looking to do, including on this specific matter raised in the stakeholder question, is to take such RTS and draft RTS as a starting point, to see what elements of that would make sense from a UK perspective, what elements may potentially needs some tweaking to make it more appropriate for the UK context.

So, I think it's worth asking all stakeholders who are watching and listening to this to feel very much free to also let us know how they are responding to such EBA consultations. That could be by telling us what you think of the drafts that are already in the public domain as part of your responses to our discussion paper, or it could also be simply by forwarding onto us any responses that you might be formulating to the EBA consultations, so that that will help inform our decision-making around the aspects of the RTS that we believe are appropriate for the UK context and those which maybe would benefit from some tweaking.

Richard Monks: Thanks, Alison. I should add that the same point I think applies in responding to other EBA documents…

Alison Wade: Absolutely.

Richard Monks: …in terms of trying to inform the FCA of how you're responding as well. That will be very, very helpful.

We're now almost at 3:30, so we're almost at the end of time for this whistle-stop tour through the investment firm prudential review. So, just to wrap up, I've just for two specific asks to the 500-plus audience out there, plus to everybody else in the industry. Firstly, we're really asking for comment on this discussion paper by 20 September this year, so in about a month's time. As Paul has suggested, as well as doing this in the day time, he's beginning to dream about the investment firm prudential review as well. So, bearing that in mind, please get your comments in. Of course, you don’t need to wait until 25 September. The teams are here. We're up and running, we're responding to comments and the questions you submitted today and in advance of today. I think we will be taking forward and thinking through as well.

So, please don't wait to get the questions and the comments in. Absolute deadline in terms of responding to the discussion paper is 25 September. Details are on the slides in terms of how to respond.

The second thing I will leave you with is whether you could try and give some feedback, and again, there should be a link underneath the presentation in terms of how this event has been. It's the first of this event, the first of this type of event that the FCA has done on this subject. We are thinking about in this Covid world, in this virtual world, how best to engage with industry on these issues. A lot of the traditional ways of engagement we won't be able to do perhaps for a few months or so.

We'd love to hear feedback on this session, what do you want more of, what could we do differently? Critically, I think this regime is in the regulator's interest, it's in the investment firms' interest, and it's also in the interests of your customers and those consumers that we are here to help.

So, I think it's in everybody's interest if we can try and work together on these proposals and I'd really encourage you to engage as much and as early as possible but to also give us feedback on this event so we can engage with you in the most effective way.

Finally, although there isn't a big audience here for a traditional clap of hands and to show appreciation, I just want to say huge thank you to Paul Rich and Alison Wade for their time today and for responding to these questions. I know the two of you will be heavily engaged with industry over the coming months and year as well.

Alison Wade: Thank you.

Richard Monks: Thanks, Paul.

END OF TRANSCRIPT