

FCA identifies further IFPR failings

AT A GLANCE

November 2023 (updated from February 2023)

November 2023 update

- The FCA published final [observations](#) from its thematic review into investment firms' implementation of the Investment Firm Prudential Regime (IFPR) rules on 27 November 2023. This followed initial [observations](#) from its thematic review on 27 February 2023.

February 2023

- The FCA focused on capital adequacy, liquidity adequacy and wind-down planning under the ICARA process, and wider regulatory reporting, finding several areas where firms are falling short of its expectations.
- Firms involved in the thematic review will have received individual feedback, but all investment firms must urgently consider the key findings and proactively address them. The FCA's thematic review is continuing.

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What were the FCA's main findings?

- The FCA identified four areas where firms need to improve:
- **Investment firm groups:** many investment firm groups chose to complete a 'group ICARA process'. But when considering the thresholds of individual firms, the assessment didn't always comprehensively consider the risk and harms at each firm, and group level consolidated numbers were not adjusted for the effect of intragroup offsets.
- The FCA found that group-level financial resource requirements were allocated to individual firms without clear rationale.
- Groups undertaking a 'consolidated ICARA' must either have been invited to do so by the FCA or apply for a voluntary requirement (VREQ). Not all firms did this. Regardless, all individual firms must still complete a solo ICARA process, which again the FCA found was not always the case.
- **ICARA assessments:** the FCA found an absence of unified and integrated assessments, with a mismatch between risks assessed and associated risk management processes. Firms didn't use the risks they face when assessing risk appetite, warning indicators, early-warning triggers or stress testing scenarios. Firms also didn't consistently use reverse stress testing to quantify the cost of wind-down plans.
- Some firms significantly reduced their capital requirements for operational, credit and market risks under the IFPR, including ignoring risks not explicitly included in a K-Factor calculation despite acknowledging their presence, and often did not provide an explanation for these changes.
- Firms did not define own funds and liquidity triggers by reference to their own businesses, and failed to include orderly wind-down resources in calculations. There was also insufficient use of reverse stress scenarios to test credibility of intervention points.
- Where firm's OFTR/LATR were driven by wind-down resources, the FCA found firms often did not have adequate resources to minimise harm in failure.

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- If a firm's threshold requirement only equals its wind-down resource, its proposed actions would need to reflect its inability to absorb any further stress, and any breach of the threshold must be reported to FCA under Principle 11.
- FCA found some firms had failed to act on previous feedback. Board engagement was varied, with the best firms providing in-depth training to senior staff.
- **Wind-down plans:** Overall, wind-down own funds and liquid asset assessments were less robust, with unrealistic assumptions and poor modelling.
- Firms should have started wind-down planning estimates with a stress scenario or trigger event, rather than in a benign environment.
- Investment firm groups didn't consider critical wind-down dependencies over other group entities, such as the financial resilience of group service companies.
- Overall the FCA found wind-down planning was not often comprehensive, with elements (often bespoke processes or products) not assessed.
- **Data quality:** Some firms provided inaccurate or incomplete data, which the FCA specifically references back to SYSC and SM&CR responsibilities. The FCA cites a number of previous publications to underline the importance it places on regulatory reporting.

cashflows and liquidity stresses, which led to inadequate assessments of liquid asset requirements. The FCA states these firms could run out of cash in stressed conditions, resulting in firm failure.

- The FCA found most firms did not have early warning indicators and triggers for intervention to take timely action to mitigate harm. The FCA reminds firms that internal points of intervention and action based on stress testing, and the maintenance of a resource buffer are prudent practices in managing financial resources.
- The FCA states some firms did not adequately consider the impact of membership in a group when completing wind-down assessments. Individual firms within groups may not have adequately planned for potential failure. The FCA also states firms in a group should consider preparing a group wind-down plan to: enable consistency in assumptions; identify critical dependencies across firms in the group; assess the availability of shared resources; and to clarify senior management roles.
- The FCA found many firms assessed operational risk capital using approaches that did not lead to adequate assessments of own funds. Incomplete assessments of risks means that firms will have insufficient resources to manage their own risks. The FCA reminds firms that their management bodies are required to ensure that adequate resources are allocated to the management of all material risks and to the use of internal models for those risks.

November 2023

- The FCA published further observations from its review on 27 November 2023. The FCA found firms had made good progress in understanding the requirements of the new regime. Firms made a shift towards considering and seeking to mitigate potential harms. However, the FCA found further key areas of improvement, discussed below.
- The FCA found some firms gave improper consideration to

- In addition to its key findings, the FCA published examples of the good and poor practices it observed. Poor practices are discussed below. For example, on group ICARA processes, the FCA found that some firms did not adequately consider the impact on individual firms, such as specific wind-down actions for individual firms. On individual firm ICARA processes, the FCA found



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wind-down planning resource was not considered in the assessment of threshold requirements.

- On early warning indicators, the FCA found that while some firms' stress tests were back tested against recent market stress events, other firms did not effectively use stress tests to identify how much more resources should exceed threshold requirements in unstressed conditions, nor did they test the appropriateness of the resource levels in their risks appetite frameworks.
 - On liquid asset requirements, among other things, the FCA found insufficient consideration given to the actual liquidity stresses the firm faced, leading to the same stress tests used for both capital stress testing and liquidity stress testing.
 - In relation to operational risk capital assessments, the FCA found some firm assessments included complicated methodologies on the attribution of risks and harm which resulted in poor firm assessments of adequate resources. The FCA also found some firms apply assumptions without explaining them (for example, scenario correlations).
 - The FCA found untested and out of date wind-down plans, with unaligned cost assumptions.
 - Some ICARA documents contained no clear summary of the drivers of threshold requirements and the stresses relied upon for the analysis.
 - On data integrity, the FCA found inconsistencies with the MIF007 and the ICARA document / other reports and management information. Further, it was clear that some firms did not use FCA guides on how to complete reports due to missing data points.
- ### What do firms need to do?
- It is clear that there are many areas where firms need to review and revisit their IFPR implementation and ICARA reporting to ensure alignment of risk processes and the ICARA. The FCA makes clear it expects firms to consider its findings to assess how they can strengthen their process.
 - Firstly, if not already done so, all firms should review their existing ICARAs against the FCA's observations, and put plans in place to address any gaps through their 2024 processes and documents.
 - Given the strength of the findings related to wind down planning, firms should revisit their approaches, taking into account the FCA's [wind down planning guidance](#) and the findings of this review.
 - All firms should review the governance over their regulatory reporting processes and should take steps to validate (and correct where necessary) the accuracy and quality of previous regulatory submissions.
 - Investment firm groups must immediately reconsider their ICARA process, at both firm and group levels. This should include reviewing risks and harms, mitigants and thresholds.
 - All firms should review the alignment of their risk management processes with their ICARAs, with a particular focus on the specific risks of harm being considered, the setting and use of risk appetites and own funds and liquid asset triggers and limits
 - Boards, and SMF holders, will want to be sure they are comfortable with their firm's approach, and to revisit and challenge existing activities.

Next steps

The FCA reminds all investment firms that while its findings should be considered by them to strengthen their processes, its review does not change existing FCA policy. The FCA will send the individual firms part of the review feedback letters and follow up with them through usual supervisory activities.

