Financial Services Regulatory Insights

Investment Firm Prudential Regime - FCA consults

AT A GLANCE

April 2021

What's new?

- The FCA published the second IFPR consultation on 19 April 2021, providing much of the remaining detail for firms as they prepare for the new regime which takes effect on 1 January 2022.
- The FCA confirms details of the own funds requirements, including fixed overheads and the remaining K-factors, in addition to liquidity requirements.
- Much focus is given to the new ICARA process. This brings together key FCA priorities, with firms needing to conduct business model analysis, stress-testing, recovery and wind-down planning. This will change how firms manage risk, and could lead to additional capital and liquidity requirements.
- The FCA's own supervisory approach will also change, as it seeks to re-establish its expectations for FCA investment firms' internal governance and risk management.

What does this mean?

- The FCA's new prudential regime for all MiFID investment firms takes effect from 1 January 2022.
- It published its second consultation on 19 April 2021, and expects to publish a third consultation in early Q3 2021.
- While each consultation will be followed by a formal Policy Statement, much of the detail is likely to remain consistent, and this paper provides many of the answers which firms have been waiting for.
- The FCA confirms the capital and liquidity requirements, introduces the new ICARA and associated supervisory approach, the remuneration rules and makes a number of other amendments.

Own funds

- The FCA confirms details of the own funds requirements for firms. This is made up of the greater of the fixed overhead requirement (FOR), the permanent minimum requirement and, for non-SNI firms, the sum of the activity based K-factor requirements.
- The FOR is confirmed as three months' expenses less specific deductions.
- The calculations of the remaining K-factors, which are applicable to all firms, are complex. The FCA highlights the interconnected nature of the calculations - for example whether activity is captured as 'AUM' or 'client orders handled'. Much of the application is specific to the activities of a firm, and in a group structure it is possible to end up double-counting some assets.
- The FCA also confirms how stressed market conditions will be treated under K-DTF.

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Liquidity

- The FCA confirm that the basic liquid asset requirement is set at one third of the FOR, with additional requirements for guarantees. While applying at both solo and group level, firms can apply for an exemption to rely on liquidity elsewhere in a group. The FCA also specifies the underlying assets and treatment of items such as trade receivables including commission, which are partially allowed with relevant haircuts.

ICARA

- The FCA sets out its expectations of the new ICARA process, which applies to all firms. It states that it should be the "centrepiece of firms' risk management processes", and will be a big challenge for all firms, even those already completing its predecessor the ICAAP.
- The ICARA process must be updated at least annually, and will need to be signed off by the board, although should be a continuous process and living document.
- The process will force firms to think about the risks and harms presented by their own businesses. This in turn could lead to additional capital and liquidity requirements to mitigate risks. As part of the process firms will also need to carefully consider wind-down planning at an entity-level.

Supervisory approach

- The FCA will be more reliant on data, and will conduct fewer individual SREP visits. It will use data from reporting, including the new ICARA Questionnaire, to supervise, and will conduct thematic activity which could lead to sub-sector-level additional capital requirements.

Remuneration

- The largest firms will need a remuneration committee, and will have to tackle deferral and non-cash remuneration. But the FCA has taken a more proportionate approach to parts of the scope than in the previous Discussion Paper.

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Next steps

Firms have only five weeks to analyse and respond to the FCA consultation, which closes on 28 May 2021. In the meantime, firms must use the detail to continue with their implementation plans, modeling the impact on capital and liquidity positions, and addressing the new ICARA process. This will be a substantial undertaking, requiring board-level engagement and careful consideration in the business, underpinned by robust data.