The FCA's third (and final) policy statement on the implementation of the Investment Firms Prudential Regime

30 November 2021

On 26 November 2021 the Financial Conduct Authority (FCA) published PS21/17: Implementation of Investment Firms Prudential Regime.

PS21/17 is the FCA's response to its third and final consultation on the new investment firms prudential regime (**IFPR**) (CP21/26) (discussed in our briefing).

It also includes some additional rules, including the rules on disclosure, to supplement the final rules issued by the FCA in October 2021 – please see our briefing for further information.

The new IFPR regime will come into force in the UK on 1 January 2022 and now, with the final outstanding rules published, the countdown is on. All the rules are now available on the website version of the FCA Handbook (by setting the timeline to 1 January 2022).

We discuss the main topics covered in PS21/17 at a very high level below.

Disclosure

Generally

The disclosure requirements in the final rules largely reflect the proposals as consulted on, with some amendments following responses to the consultation.

Under the rules, disclosures must generally be made on an individual basis only (unless a firm has been granted an exemption from individual disclosure requirements by the FCA). They must be made, as a minimum, on an annual basis, either on the date the firm publishes its annual financial statements or, if it does not publish annual financial statements, on the date on which its annual solvency statement is submitted to the FCA.

Firms will be permitted to take a proportionate approach and provide a level of detail in their qualitative disclosures which is appropriate to their size, internal organisation and the nature, scope and complexity of their activities. The FCA does not intend to provide guidance on how firms should interpret this ability to apply proportionality.

The disclosure requirements will be set out in a new MIFIDPRU 8.

See below for further details on the different types of disclosure.

Timing of disclosures and transitional provisions

There are specific transitional provisions for remuneration disclosures. Firms must make their first MIFIDPRU remuneration disclosures on the same date that they publish (at Companies House) their first annual financial statement after the end of the first performance period to which the MIFIDPRU Remuneration Code applies. In addition, and broadly, where a performance period starts before 1 January 2022, the firm may comply with the previous rules on disclosure applicable to the firm (i.e. under BIPRU or the UK Capital Requirements Regulation (**CRR**)) for that particular performance period. This will mean that, for most firms, with performance periods of 12 months, their first MIFIDPRU remuneration disclosures – containing both qualitative and quantitative information - will not be required until some point in 2023, depending on their financial year-end.

The FCA has also introduced some transitional provisions allowing firms not to make risk management or investment policy disclosures where the reference date falls on or before 30 December 2022. This reflects the problems that firms may have in collating the required information in the first year.

Governance and risk management disclosures

The disclosure requirements regarding governance and risk management will apply to non-small and non-interconnected (**non-SNI**) firms (and, in the case of risk management disclosures, also small and non-interconnected (**SNI**) firms that issue additional tier 1 instruments).

Firms subject to the requirements will be required to publish an overview of how they comply with the requirement in SYSC to ensure that their management body defines, oversees and is accountable for the implementation of governance arrangements that ensure effective and prudent management of the firm. Firms will also need to provide information on the risk committee, the number of executive and non-executive directorships held by each member of the management body and a summary of their policy promoting diversity on the management body. The FCA has declined to provide a template for these disclosures on the basis that it would be better for firms to have the flexibility to make the disclosures in the most appropriate way for them.

In terms of the disclosure of directorships, a new rule has been introduced exempting disclosures of directorships held in organisations which do not pursue predominantly commercial objectives or separate directorships held within the same group or within undertakings (including non-financial sector entities) in which the firm holds a qualifying holding.

For risk management, firms will be required to disclose their risk management objectives and policies for the categories of risk addressed by the rules governing own funds requirements, concentration risk and liquidity in MIFIDPRU.

Own funds disclosures

The disclosure requirements regarding own funds will apply to non-SNI firms (and also SNI firms that issue additional tier 1 instruments).

Firms subject to the requirements will be required to disclose in respect of their own funds, in the template specified by the FCA:

- a reconciliation of common equity tier 1 items, additional tier 1 items, tier 2 items, and the applicable filters and deductions applied in order to calculate the own funds of the firm;

- a reconciliation of the above reconciliation with the capital in the balance sheet in the audited financial statements of the firm (unless the firm is not required to publish annual financial statements); and

- a description of the main features of the common equity tier 1 instruments, additional tier 1 instruments and tier 2 instruments issued by the firm.

Firms will also be required to disclose in respect of their compliance with the MIFIDPRU own funds requirements:

- the K-factor requirement, broken down as follows:

    - the sum of the K-AUM requirement, the K-CMH requirement and the K-ASA requirement;

    - the sum of the K-COH requirement and the K-DTF requirement; and

    - the sum of the K-NPR requirement, the K-CMG requirement, the K-TCD requirement and the K-CON requirement; and

- the fixed overheads requirement.

Firms must also disclose their approach to assessing the adequacy of their own funds in accordance with the overall financial adequacy rule.

Remuneration disclosures

The remuneration disclosures apply to non-SNIs and also, on a more limited basis, SNIs.

All firms will be required to disclose a summary of:

- their approach to remuneration for all staff;

- the objectives of their financial incentives; and

- the decision-making procedures and governance around the development of their remuneration policies and procedures.

Firms will be also be required to disclose the key characteristics of their remuneration policies and practices, in sufficient detail to allow the risk profile of the firm and/or the assets it manages to be understood and to provide an overview of the incentives created by the remuneration policies. The rules set out some prescribed information which must be disclosed as a minimum which includes the different components of remuneration (including the categorisation as fixed or variable) and a summary of financial and non-financial criteria used to assess performance. Additional minimum information is also required for non-SNIs including how malus and clawback are applied and the policies and criteria applied for awards of guaranteed variable remuneration and severance pay.

All firms will have to disclose the total amount of remuneration awarded to all staff, split into fixed and variable remuneration. Non-SNIs will additionally have to show those amounts broken down between senior management, other material risk takers (**MRTs**) and other staff, together with information on awards made to MRTs.

With regard to concerns raised about data privacy and that it might be possible to identify individual MRTs as a result of the required quantitative splits, the FCA has introduced new provisions allowing firms to aggregate senior management and MRT information, where splitting the information between those two categories would lead to the disclosure of information about one or two people. Where such aggregation would still lead to the disclosure of information about one or two people, there is an exemption from that particular disclosure requirement.

All non-SNIs will have to disclose the types and number of staff they have identified as MRTs. Controversially, the FCA has resisted a respondent's request for a clarification that the disclosure requirements do not apply to an individual identified as an MRT who is appointed to the firm's board, but who is employed and paid by a parent entity in a third country and located outside of the UK investment firm group. The respondent had argued that since such MRT does not derive any remuneration from the UK investment firm, the disclosure requirements should not apply. The FCA has rejected this argument saying that the MIFIDPRU Remuneration Code applies to *any* form of remuneration awarded to a firm's MRTs and it is irrelevant whether any or all of that remuneration is paid by an entity other than the FCA investment firm. Although the FCA's response relates specifically to the remuneration *disclosure* requirements, the policy stance appears to extend to other aspects of the remuneration requirements (e.g., malus and clawback).

The FCA has also clarified in the MIFIDPRU Remuneration Code that it considers carried interest to be variable remuneration.

Investment policy disclosures

These apply in respect of larger non-SNIs i.e., broadly, where the firm's on-balance sheet assets and off-balance sheet items, on a rolling average basis over the previous 4 years, is £100 million or less or £300 million or less, subject to conditions.

Such firms which hold more than 5% of the voting rights in a company whose shares are traded on a regulated market, will be required to make certain disclosures in accordance with the FCA's template. This information includes the proportion of voting rights attached to the shares, broken down by country or territory and a complete description of voting behaviour in the general meetings.

Own funds - excess drawings by members of LLPs and partners

An additional deduction from common equity tier 1 (CET 1) will be introduced where a firm is a partnership or a limited liability partnership. Such firms will be required to deduct the amount by which the aggregate of any amounts withdrawn by its partners or members exceeds the profits of the firm.

However, this will not apply to the extent that the amount:

- has already been deducted from the firm's own funds as a loss;
- is offset by new capital contributions from other partners where permitted by the rules in MIFIDPRU 3.3; or
- is already reflected in a permitted reduction of the firm's own funds.

This provision is intended to reflect the current position for BIPRU firms.

Depositaries

The eligibility criteria for SNIs will be amended to reflect that a firm cannot be a SNI if it is a depositary for a UCITS or an alternative investment fund (**AIF**). This reflects the interconnected nature of the depositary activity and the importance of safeguarding of client assets.

Application of onshored technical standards

The FCA has also confirmed that the existing binding technical standards (**BTS**) under the UK CRR will, with a few exceptions, continue to apply, where relevant, under the IFPR with certain modifications.

The exceptions are the CRR Own Funds BTS, the CRR BTS on prudent valuation and the CRR BTS on closely correlated currencies. Modified versions of these will be incorporated directly into MIFIDPRU.

Next steps

Firms are reminded that they must start collecting data on K-factor metrics that are relevant to the activities they undertake no later than 1 December 2021.