

Investment Firm Prudential Regime: FCA Second Consultation Paper

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The Financial Conduct Authority (FCA) has now published the second of its three Consultation Papers on the Investment Firm Prudential Regime (IFPR).

Since the UK will not be implementing the EU's Investment Firms Regulation and Directive it will introduce its own regime for UK investment firms: the IFPR. This will introduce a new regulatory capital regime for UK MiFID investment firms and AIFMs/UCITS managers with a MiFID "top-up" permission from **1 January 2022**.

We summarised the first Consultation Paper (CP20/24) [here](#). This second Consultation Paper (CP21/7) looks at the remaining aspects of own funds requirements not covered in the first Consultation Paper, the basic liquid assets requirement, remuneration requirements and the Internal Capital and Risk Assessment (ICARA) process. We set out a very high level summary below. The consultation closes on **28 May 2021**.

While there are still a few aspects of the regime in respect of which the FCA has yet to consult, the overall shape of it is now clear and detailed draft rules have been published. In contrast to the first consultation, the rules in CP21/7 include few transitional provisions. This means firms will need to comply with most of the new requirements in full by 1 January 2022. Firms which have not yet done so should be starting their preparations now.

Own funds requirements

This addresses FCA's proposal to introduce a fixed overheads requirement (**FOR**) that will apply to all firms. The first consultation looked at the K-factors applicable only to firms with permission to deal on own account. This second consultation looks at the remaining K-factors not addressed in the first consultation, i.e.:

- Assets safeguarded and administered (**K-ASA**);
- Client money held (**K-CMH**);
- Assets under management (**K-AUM**);
- Client orders handled (**K-COH**).

Where relevant, these K-factors will also apply to an FCA investment firm group subject to prudential consolidation.

The first consultation had also asked whether there should be an option of an adjustment to calculating the coefficients for the daily trading flow K-factor (**K-DTF**) in periods of extreme market stress – the second consultation sets out proposals as to how this should be done.

Basic liquid assets requirement

All firms will have to maintain a basic liquid asset requirement, based on holding an amount of core liquid assets equivalent to at least equal to one third of the amount of its FOR (plus, if relevant, 1.6% of the total amount of any guarantees provided to clients).

Risk management, ICARA and SREP

In terms of risk management and governance, there will be an Internal Capital Adequacy and Risk Assessment (**ICARA**) process for all firms, through which firms will have to meet an Overall Financial Adequacy Rule (**OFAR**). Through the ICARA process, firms will determine what level of own funds and liquid assets they need over and above the own funds and basic liquid assets requirements outlined above. The FCA will be introducing an ICARA Questionnaire reporting template in support of its move towards "proportionate" prudential supervision based on sectors and risk of potential harm to consumers and markets.

The rules will clarify the risk management responsibilities under the Senior Manager and Certification Regime (**SMCR**).

Governance

The rules will include high level requirements relating to internal governance and controls, clarification as to which firms are required to establish risk, remuneration and nomination committees and, where relevant, the composition and role of those committees.

Remuneration

The second consultation sets out the FCA's proposals on remuneration. In outline, all firms will have to comply with a small number of basic remuneration requirements; beyond that, non-SNI firms will be subject to more detailed requirements (such as identifying material risk takers, the ban on guaranteed variable pay, malus and clawback).

Only the largest non-SNI firms (i.e., for firms without a trading book, those with a rolling average of on- and off- balance sheet assets above £300m over the preceding four year period) would be required to meet the full remuneration requirements by complying with "extended remuneration requirements" (i.e. remuneration committee and payout process rules).

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

The EBA guidelines on sound remuneration policies under the EU IFD will not apply to FCA MiFID investment firms.

Regulatory reporting

The amount of information that firms need to report to the FCA on their remuneration arrangements will be significantly reduced.

The FCA also proposes to simplify the additional reporting form for collective portfolio management investment (**CPMI**) firms (such as AIFMs and UCITS managers which also undertake "top up" MiFID activities).

An ICARA form will replace the existing FSAO19 (Pillar 2) form.

Application of the rules to collective portfolio management investment firms

CPMIs will use a specific methodology for calculating the FOR for the firm as a whole. Other rules will only apply to the MiFID (i.e. "top up") business of the firm. Broadly, the rules that are currently set out in Chapter 11 of IPRU-INV will be carried forward and will therefore be substantially the same (subject to the specific FOR methodology referred to above and some necessary consequential amendments).

Next steps and client webinar

Consultation closes on Friday **28 May 2021**.

The FCA plans to publish the third and final consultation in Q3 2021. This will include consideration of disclosure, consequential amendments to the Handbook and CRR technical standards and final overall application provisions.

The final rules will be published once the Financial Services Bill has completed its passage through Parliament and all the FCA's consultations are complete.

The second consultation includes a significant amount of detail in the draft rules attached to the document, which we will review and update clients as appropriate. **We will be presenting a client webinar on 13 May 2021.**

If you would like further information or assistance in understanding the consultation paper and its potential impact, please speak to your usual Travers Smith contact or any of the individuals below.