Proskauer

The UK Investment Firms Prudential Regime Effective 1 January 2022: Key Considerations for Investment Firms

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1. **What is the IFPR?**

The new UK Investment Firms Prudential Regime ("**IFPR**") will come into force on 1 January 2022 and will apply to UK investment firms authorised under the Markets in Financial Instruments Directive ("**MiFID**") as it is applied in the UK post-Brexit, which will include current "BIPRU" firms and "Exempt CAD" firms, as well as alternative investment fund managers ("**AIFMs**") that have MiFID top-up permissions (known as collective portfolio management investment firms ("**CPMI**")).

The IFPR will introduce new regulatory capital requirements for firms within its scope and, among other things, new remuneration, reporting and disclosure requirements. We have set out below some of the key considerations for firms that will be subject to IFPR.

2. **What is the difference between SNI and non-SNI firms?**

The IFPR regime distinguishes between "small and non-interconnected investment firms" ("**SNI**" firms) and non-SNI firms. The level of compliance with certain rules that will apply to a firm within the scope of the IFPR will be determined by whether or not the firm is an SNI or a non-SNI firm.

SNI firms are defined in Chapter 1 of the prudential sourcebook for MiFID firms, ("**MIFIDPRU 1**"), prescribing a series of permission-based and quantitative thresholds for firms to determine whether they are an SNI, as set out in the table below.

Measure*	***Threshold***

Assets under management (AuM), which is defined for these purposes as: • discretionary portfolio management; and • non-discretionary arrangements constituting investment advice of an ongoing nature.	< £1.2 billion
Client orders handled – cash trades	< £100 million per day
Client orders handled – derivative trades	< £1 billion per day
Assets safeguarded and administered	Zero
Client money held	Zero
On and off-balance sheet total	< £100 million
Total annual gross revenue from investment services and activities	< £30 million

**These thresholds, with the exception of the on-and-off balance sheet total, only relate to the MiFID activities undertake by the firm. Broadly, the calculation must aggregate the amounts arising from MIFID activities from all FCA authorised firms in the same group.*

While the FCA expects approximately 70% of firms to be SNI, firms that exceed the relevant thresholds will be known as non-SNI. Notwithstanding this, firms that have permission to deal as principal will always be considered non-SNI.

Certain firms (which the FCA expects to be approximately 100 in total) will also be considered to be a "larger non-SNI" if: (i) the value of its on and off-balance sheet assets over the preceding four-year period is a rolling average of more than £300 million; or (ii) the value of its on and off-balance sheet assets over the preceding four-year period is a rolling average of more than £100 million (but less than £300 million), and it has a trading book business of over £150 million, and/a derivatives business of over £100 million.

3. **What are the regulatory capital requirements firms will have to comply with?**

Own funds and basic liquid assets

SNI firms will be required to maintain "own funds" that is the higher of a permanent minimum capital requirement ("**PMR**") (which will usually be £75,000) and a fixed overheads requirement ("**FOR**") (an amount equal to one quarter of its relevant expenditure in the previous year). Non-SNI firms will be required to maintain an amount of "own funds" being the higher of their PMR, FOR or a "K Factor" requirement, which involves a specific methodology and calculation relevant to the firm.

All SNI and non-SNI firms will also be required to hold basic liquid assets – typically this will need to be equal to one third of their FOR.

A number of firms will be particularly impacted by the new regulatory capital requirements, such as Exempt CAD firms, which are likely to see their capital requirements significantly increase. Certain firms will be able to benefit from temporary transitional provisions enabling them to gradually adjust to the additional requirements under the IFPR. For example, Exempt CAD firms will be able to gradually increase their capital over the course of five years from 1 January 2022.

Regulatory consolidation

Under the IFPR, all firms will need to consider whether consolidated supervision will apply. Broadly, this will be the case where there is a UK parent entity of an "investment firm group", containing at least one FCA investment firm. Where this is the case, prudential consolidation requirements will apply directly to and at the level of the UK parent entity, which will be categorised as an SNI or non-SNI firm in its own right and be required to comply with various prudential requirements under the IFPR.

There is an exemption available, referred to as the "Group Capital Test", which can be relied on where permitted by the FCA. In these circumstances, the UK parent entity will be exempted from applying the IFPR on a consolidated basis and instead it will be required to hold own funds sufficient to cover the following:

a. the sum of the full book value of its holdings, subordinated claims, and certain other specified instruments, in relevant entities in the investment firm group; and

b. the total amount of its contingent liabilities in favour of the relevant entities in the investment firm group.

4. **What are the remuneration requirements?**

All firms within scope of the IFPR will need to comply with the MIFIDPRU Remuneration Code requirements which will vary, depending on the type of firm. CPMI firms, as referred to above, will also be required to comply with the MIFIDPRU Remuneration Code with respect to their MiFID business. The MiFIDPRU Remuneration Code applies to remuneration, including carried interest, paid to a firm's staff (which has a wide meaning under the FCA rules).

In particular, SNI firms will have to comply with basic remuneration requirements, requiring them to establish and implement remuneration policies, while applying proportionality.

All non-SNI firms, in addition to the requirements that SNI firm will be subject to, will have to:

- identify "material risk takers" (or "**MRTs**") (meaning a staff member whose professional activities have a material impact on the risk profile of the firm or of the assets that the firm manages);
- set ratios between fixed and variable remuneration for each MRT in their policies;
- ensure they have malus and/or clawback arrangements in place in respect of MRTs.

Larger SNI firms will be subject to enhanced remuneration rules, which amongst other things, will also have to establish risk and remuneration committees, comply with pay-out process rules and provide certain additional remuneration disclosure.

5. **What are the new Risk Management and ICARA Requirements?**

All firms (including SNI firms) will need to undertake an Internal Capital Adequacy and Risk Assessment ("**ICARA**") process through which firms will have to meet an Overall Financial Adequacy Rule ("**OFAR**"). Under the ICARA process, firms will determine what level of own funds and liquid assets they may need over and above the own funds and basic liquid assets requirements described in Section 3 above.

6. **What disclosures apply under the IFPR?**

Under the proposed rules on disclosure (which have still not been finalised yet) all firms (SNI and non-SNI) will, at least annually, have to make certain specified disclosures on their websites on the same date on which they publish their annual financial statements (although material changes may require more frequent disclosure to be made).

Disclosures will include, amongst other things, information on remuneration policies and practices including qualitative and quantitative information. All firms will be required, for example, to disclose the total amount of remuneration awarded to all staff, split between fixed and variable remuneration.

While the disclosure requirements are relatively extensive, the FCA has confirmed that there are no proposals at this stage for disclosure in relation to environmental, social and governance matters, which the FCA will consult on separately.

7. **How often will firms need to carry on regulatory reporting?**

The IFPR will introduce a single suite of reporting forms for all firms within scope, in order to allow the FCA to collect appropriate data to supervise firms against the prudential requirements under the IFPR. The reporting requirements, set out in MIFIDPRU 9, will take a proportionate and risk-based approach. However, firms will be expected to be able to produce additional details on how they have calculated the relevant information that they have provided, on request.

All firms (including SNI firms) will be required to report quarterly to the FCA with the relevant reporting reference dates being the last business day in March, June, September and December. All firms will also be required to complete an ICARA questionnaire at least annually, which the firm's governing body must review and approve.

8. **What are the next steps for in-scope firms?**

If they haven't already firms in scope of the new IFPR regime should assess and determine:

- what their IFPR classification will be (either SNI or non-SNI);
- whether they are part of a consolidated group or not for the purposes of IFPR;
- what their new regulatory capital requirement will be; and
- what steps are needed to comply with the new remuneration code and risk management (specifically ICARA) requirements.

A final policy statement on the implementation of the IFPR rules on disclosure is expected to be published in Q4 this year – firms should continue to monitor developments in this regard.

Please contact your usual Proskauer contact or one of our UK Regulatory team if you need any advice on the topics discussed in this briefing.

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