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UK Investment Firms Prudential Regime - FCA publishes results of multi-firm review

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On 27 February 2023, the FCA published a webpage outlining the findings of its multi-firm review of how firms are implementing the Investment Firms Prudential Regime ("IFPR") in terms of the internal capital adequacy and risk assessment ("ICARA") process and reporting. The review is focused on capital adequacy, liquidity adequacy and wind-down planning under the ICARA process, as well as regulatory reporting.

The IFPR and the corresponding prudential standards in the MiFID Investment Firms Prudential Sourcebook ("MIFIDPRU") went into effect on 1 January 2022. For further details about the IFPR regime and its impact on investment firms, please refer to our separate alert on this topic.

The FCA has made the following observations as part of its review of the IFPR regime:

1. **Issues identified in relation to the ICARA process for investment firm groups**: the FCA noted that most investment firm groups have opted to complete a "group ICARA" process. However, for the majority of these, there was insufficient consideration of firm-specific risk and harms. In particular, amongst other things, the FCA noted the following:
    a. the assessment of threshold requirements of individual firms within the group did not always comprehensively consider the risk and harms sustained by each firm individually. Group level numbers based on a consolidated view, were not adjusted to eliminate the effect of intragroup offsets, after they were allocated to the individual firms;
    b. a group level assessment of financial resource requirements was, in some cases, allocated to individual firms without clearly considering whether this was appropriate for the individual firm; and
    c. the financial resource requirements to support a group level wind-down were also often allocated without a clear link to the specific actions required to wind-down each individual firm.

The FCA made clear that, for investment firm groups, an overall group-wide view of risks and harms remains essential in assessing threshold requirements and in managing the financial resources of each individual entity.

2. **Issues identified in relation to ICARA process assessments:** The FCA identified various concerns with the assessments made by a large number of firms as part of their ICARA process, such as:
    1. an absence of unified and integrated assessments – the FCA noted a mismatch between some firms' ICARA analysis between risks assessed and the risk management process used, as well as failures in the way risks are assessed. The FCA further highlighted that some firms are failing to correctly integrate the wind-down planning process into their regulatory capital assessments;
    2. inadequately explained significant reductions in capital requirements – the FCA pointed out that firms should only stop holding capital for risk types, compared to assessments made under the prior regimes, where those risks genuinely do not flow from the business model and explain such a change within the ICARA document. The FCA reminded firms that they should continue to take account and document all material risks faced, including those that were prescribed under previous regimes;
    3. lack of comprehensive own funds and liquid assets triggers – the FCA highlighted that these should clearly link to the firm's understanding of its risk. The FCA also made clear that it expects firms to consider their on-going stress testing when developing their internal limit framework;
    4. previous FCA feedback not fully acted upon – the FCA observed that several firms have not fully acted on feedback previously provided by the FCA, particularly around approaches to capital and liquidity. Feedback under the previous regimes should still be considered by firms; and
    5. insufficient governance and board and executive involvement in the ICARA – the FCA noted differing degrees of engagement of at the senior level of some firms. In-depth training on IFPR to senior executives and boards is important to set out the fundamentals of the new regime.

3. **Improvements to wind-down planning needed by firms:** Wind-down planning assessments remain weak and lacking in consideration of the key requirements. Common gaps include: no consideration of stress backdrop, little consideration of group membership and incomplete analysis of wind-down requirements. This reflects an incomplete understanding of the purpose of the exercise and of guidance previously provided by the FCA. The FCA has reiterated

the expectations outlined in its wind-down planning guide and in FG20/1 on the assessment of resources for an orderly wind-down.

4. **Data reporting issues:** The FCA has seen inconsistent and inaccurate data submitted in regulatory reports. Firms should ensure that all data submitted is accurate and should take the opportunity to review their regulatory reporting processes. The FCA has outlined its expectations related to data accuracy in previous 'Dear CEO' letters on Transforming data collection (February 2021)and Quality of Prudential Regulatory Returns (February 2018).

The FCA will continue carrying on its multi-firm review. It intends to publish a concluding report after completion (and may publish interim observations if appropriate).

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