



Under the Microscope:

UK FCA's Investment Firms Prudential Regime 10 Weeks to Go

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Agenda

- Background, Scope and Timing
- SNI Categorisation
- Regulatory Capital and Consolidation
- Remuneration
- Risk Management and ICARA
- Disclosure and Reporting
- Key Takeaways

What is the IFPR?

- The FCA's Investment Firms Prudential Regime (“**IFPR**”) introduces a new prudential regime for investment firms.
- **Timing:** IFPR will come into force on 1 January 2022.
- **Who it applies to:** applies to all UK investment firms authorised under the Markets in Financial Instruments Directive (“**MiFID**”) (including AIFMs with top-up MIFID permissions).
- **What does it do?:** IFPR introduces a new prudential regime for firms, including new regulatory capital requirements, remuneration, regulatory reporting, risk management and disclosure requirements.
- **Why is it relevant?:** It introduces major changes for many MiFID firms. In scope firms will need to comply with the new requirements under the IFPR from 1 January 2022...

Categories of firms under the IFPR?

- Two main categories:
 - Small and non-interconnected investment firms (“**SNI**”)
 - Non-SNI (including “larger non-SNI”).
- SNI firms are subject to less requirements under the IFPR than non-SNI firms. c.70% of firms expected to be SNI.
- SNI firms are defined in MIFIDPRU 1, being investment firms that fall within certain size/threshold tests, which do not hold client money or assets and are **not** permitted to deal on their own account.
- All other firms will be classified as “non-SNI”. Certain larger firms will be classified as larger non-SNI.

SNI - Thresholds

Measure*	Threshold
Assets under management (AuM), which is defined for these purposes as: <ul style="list-style-type: none"> - 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

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.

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

Regulatory capital under the IFPR

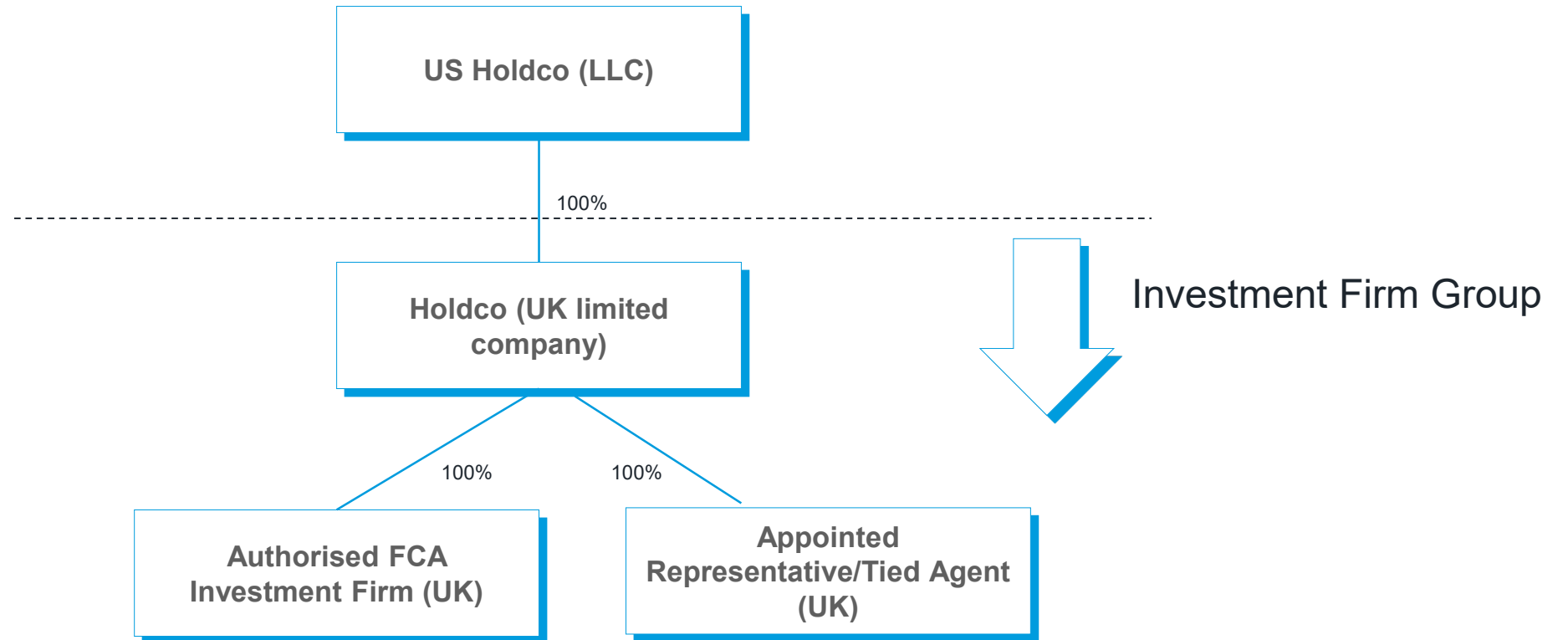
- Overhaul of the prudential capital requirements and associated FCA sourcebooks – all moving to “MIFIDPRU” Sourcebook
- Own funds requirements:
 - **SNI**: higher of a permanent minimum capital requirement (“**PMR**”) (usually £75,000) and a fixed overheads requirement (“**FOR**”).
 - **Non SNI**: higher of their PMR, FOR or a “K Factor” requirement (involving a specific, complex methodology).
- Basic liquid assets requirement for **all** firms (usually equal to 1/3 of FOR).
- Exempt CAD firms – could see a significant increase – although temporary transitional provisions over five years will enable a gradual adjustment to the new requirements

Consolidation

- **Consolidation trigger** - consolidated supervision will apply typically where there is a UK parent entity of an “investment firm group” with at least one FCA MiFID investment firm – relevant to SNI and non-SNI firms
- **Scope of investment firm group** – consists of all subsidiaries and connected undertakings (if applicable) below the level of the top UK parent and which are:
 - investment firms,
 - financial institutions,
 - ancillary services undertakings
 - tied agents

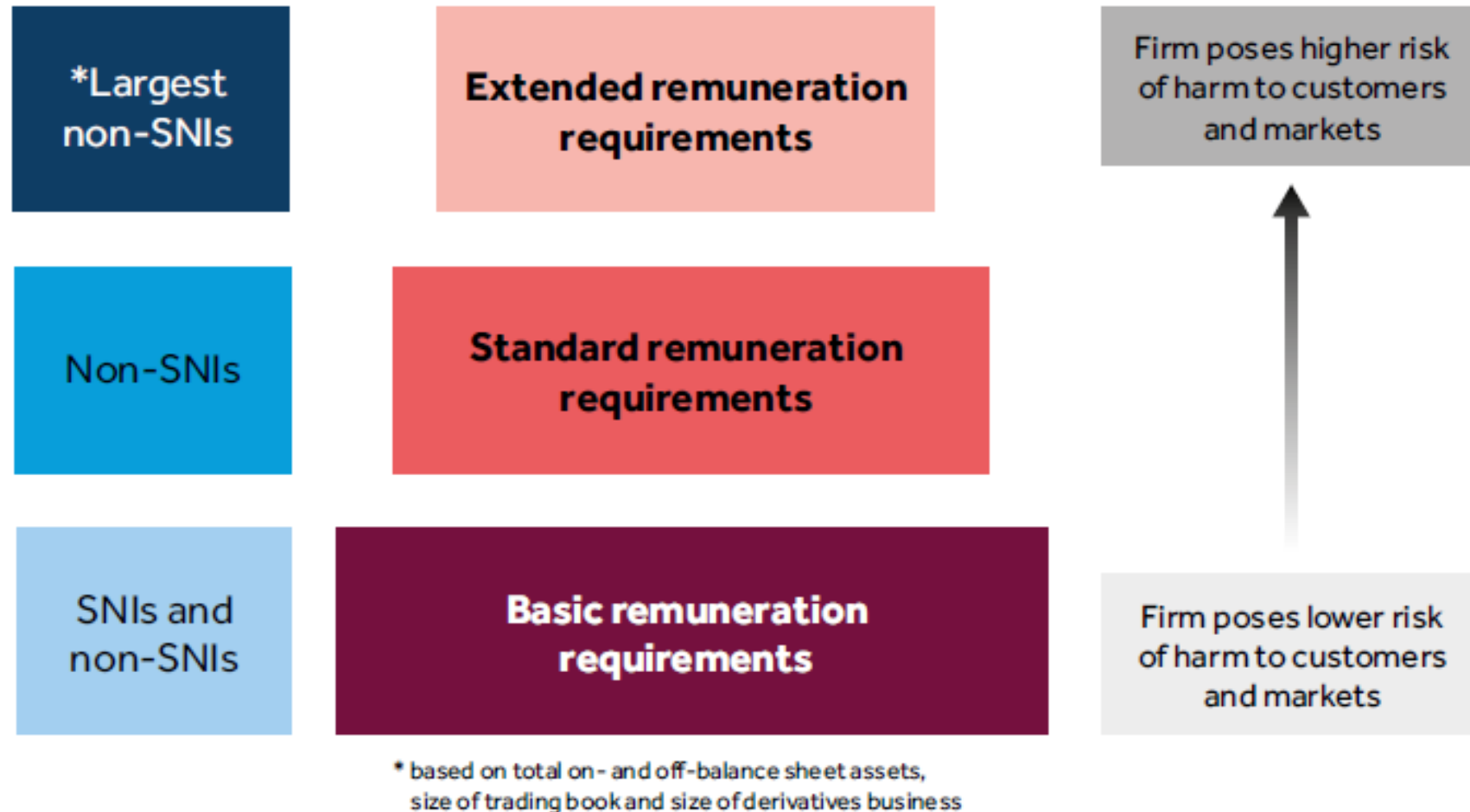
Note: this includes those established outside the UK
- **Consequence of consolidation** - the investment firm group will be treated as one investment firm and regulatory capital requirements will apply to the group on a consolidated basis
- **Group Capital Test** - Potential exemption from the full consolidation requirements is available under the Group Capital Test (GCT) – available to “sufficiently simple” groups that do not pose significant risk to clients or the market – concepts are not defined
- **Where GCT is available** – UK firm must submit an application to the FCA. The UK parent is still required to hold own funds sufficient to cover:
 - 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
 - the total amount of its contingent liabilities in favour of the relevant entities in the investment firm group

Consolidation - Example



Remuneration

Diagram 5: Overview of application of remuneration requirements



New MIFIDPRU Remuneration Code

- New single remuneration code.
- Apply **different levels** of remuneration requirements to different types of FCA investment firms
- Firms to apply the new Remuneration Code from the start of their next performance year beginning **on or after 1 January 2022**
- FCA view remuneration as **key driver of behaviour**:
 - Promote effective risk management
 - Align risk and individual reward
 - Support positive behaviours
 - Discourage misconduct

What is Remuneration?

- What is “**remuneration**”?
 - Any form of remuneration, including salaries, discretionary pension benefits and benefit of any kind
 - Reasonable portion of profit share of a full time partner/member
 - **Carried interest** – valued at the time of the award
 - Certain exceptions
 - **Returns on co-investment**
 - only where made using a loan from firm//member of group

Basic Remuneration Requirements

- Apply to all staff
- All firms should have a remuneration policy
 - **Proportionate** to size of firm
 - Promote sound and effective risk management
 - **Gender neutral**
 - “Equal pay for male and female workers for equal work of equal value”
 - Clear distinction between criteria that determine **fixed and variable pay**
 - “**Appropriately balanced**”
 - Periodically reviewed by management body

Standard Remuneration Requirements

- **Non-SNIs firms** - includes basic requirements.
- Remuneration policy must be reviewed **annually**.
- Identify staff who are **Material Risk Takers (MRTs)**:
 - Identify MRTs annually
 - “staff” member (defined broadly) whose professional activities have a material impact on the risk profile of the firm or of the assets that the firm manages.
 - **Exempt MRTs** which have variable remuneration of £167,000 or less and have variable remuneration which makes up one-third or less of their total remuneration.

Standard Remuneration Requirements

- MRTs' remuneration:

- Restrictions on **non-performance related variable pay** e.g. guaranteed variable remuneration, retention awards, buyouts and severance pay.
- **Malus/Clawback** should apply.
- Set **appropriate ratios** between fixed and variable pay
 - Firms have ***discretion*** to set appropriate ratios and **no prescriptive bonus cap**.

Extended Remuneration Requirements

- **Large Non-SNI firms** (approx. 101 firms) are subject to enhanced remuneration rules.
- These include:
 - requirement to establish risk and remuneration committees;
 - deferral of variable pay;
 - comply with pay-out process rules;
 - comply with additional remuneration disclosure requirements.

Risk Management: ICARA

- **All** firms in scope will need to undertake an Internal Capital Adequacy and Risk Assessment (“**ICARA**”) process.
- ICARA is integral to how firms manage risk, but also to how the FCA manages the risk of the firm that it supervises.
- Replaces ICAAP for BIPRU and IFPRU firms.
- Firms will have to meet an Overall Financial Adequacy Rule.
- 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.



Disclosure

- Extensive disclosure requirements under the IFPR.
- Applies to **all** in-scope firms. All firms must annually (at least) make specified disclosures on their websites on the same date on which they publish their annual financial statements.
- Disclosure requirements include remuneration disclosure, risk management disclosure, as well as disclosure relating to own funds and own funds calculation.
- Remuneration disclosure, in particular, will include disclosure on remuneration policies and practices including qualitative and quantitative information.
- **All** firms to disclose the total amount of remuneration awarded to all staff, split between fixed and variable remuneration.
- No ESG disclosure under the IFPR.

Regulatory reporting

- Requirements set out in MIFIDPRU 9 – proportionate, risk-based approach applied.
- Quarterly reporting for **all** firms.
- **All** firms required to complete ICARA questionnaire at least annually, which the firm's governing body must review and approve.
- Single suite of reporting forms introduced.
- All firms will be required to submit their IFPR returns to the FCA via RegData in an xml file format.



Key Takeaways

- **Scope** - determine if you are in scope of IFPR
- **Categorisation** - determine your IFPR categorisation (SNI or non-SNI)?
- **Regulatory Capital Requirement** - calculate your new regulatory capital requirement factoring in any transitional relief
- **Consolidation** - determine if you are part of a investment firm group triggering consolidation - if so, could CGT be applied?
- **Remuneration** - review remuneration policies and procedures and update to comply with the new rules
- **ICARA** - prepare for the new risk management (ICARA) requirements
- **Disclosure** - prepare for the new disclosure rules and monitor developments

Questions...?



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Thank you for joining us!