

# PS21/9: Investment Firms Prudential Regime implementation



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**On 26 July 2021, the Financial Conduct Authority (FCA) published its second policy statement PS21/9 in relation to the new UK Investment Firms Prudential Regime (IFPR), which will come into force on 1 January 2022. Matthew Hazell and Shazad Khan summarise the key highlights for firms. This article forms part of our IFPR readiness series.**

PS21/9 confirms that the FCA will implement proposals which are largely unchanged from matters consulted in CP21/7 but provides more clarity to the industry in response to feedback received. The FCA will introduce a prudential sourcebook called MIFIDPRU which will replace BIPRU and IFPRU rules and interact with other parts of the FCA Handbook.

## SCOPE

The FCA has confirmed that IFPR and the MIFIDPRU rules only apply to firms authorised under MiFID. It will apply to small authorised alternative investment fund managers who have MiFID top-up permissions and Collective Portfolio Management Investment firms (CPMI). CPMI firms will need to apply MIFIDPRU requirements in parallel to their existing prudential requirements under Chapter 11 of IPRU-INV in relation to their MiFID business. It has been made clear that non-MiFID firms such as Article 3 MiFID exempt firms need not implement the rules that will be released in MIFIDPRU that implement IFPR.



### IMPACT FOR FIRMS

Firms currently classified as Exempt CAD or AIFMs should review whether they are using their MiFID permissions and contact Newgate to discuss whether a variation of permission can be sought to be exempt from MiFID and the IFPR.

## OWN FUNDS ARRANGEMENTS

Rules relating to the calculation of all K-Factor requirements (KFR) and fixed overheads requirements (FOR) have been finalised. Key changes of note to be considered are:

ISSUE	SUMMARY	IMPACT FOR FIRMS
CHANGES TO THE DEFINITION OF AN SNI FIRM: EXECUTION OF ORDERS ON BEHALF OF CLIENTS IN THE NAME OF THE FIRM	<p>The FCA confirmed that transactions executed by a firm in the name of the client will fall under the client orders handled (COH) threshold measure and transactions executed in the name of the firm as agent, and not principal, (even if on behalf of a client) would be captured under a daily trade flow (DTF) measure and will automatically lead to a firm being categorised as a non-SNI firm. As such, daily trading flow (K-DTF) KFR is no longer limited to firms that deal on their own account but will also apply to firms that execute orders in the firm's name as agent on behalf of clients.</p> <p>The FCA give an example of a portfolio manager who might execute a trade in its own name with the intention of subsequently allocating the relevant financial instruments among multiple client portfolios. Irrespective of whether such a trade constitutes dealing on its own account, following the clarification in the rules, the value of the trade would always be recorded in K-DTF as it was executed in the name of the firm.</p>	<p>Firms should review the contractual basis on which they enter into transactions as part of their MiFID business to establish whether it is in their name (or not). If so, this is likely to mean a firm will become subject to requirements as a non-SNI firm and amendments to readiness plans will need to be made.</p>

ISSUE	SUMMARY	IMPACT FOR FIRMS
GUIDANCE ON HOW TO CALCULATE ASSETS UNDER MANAGEMENT (AUM) FOR 'INVESTMENT ADVICE OF AN ONGOING NATURE'	<p>In its consultation, the FCA included 'investment advice of an ongoing nature' to its definition of AUM for the purpose of the quantitative criteria for being an SNI firm and also for the purpose of calculating the KFR for assets under management (K-AUM).</p> <p>There was a lack of certainty around what would constitute 'investment advice of an ongoing nature'. In PS21/9, the FCA amended its definition of 'investment advice of an ongoing nature' to clarify that this type of advice must involve the provision of MiFID investment advice (i.e. personal recommendations) and would not include generic advice about asset allocation.</p>	This point is important to investment consultants who may have a supervisory role over a large pool of AUM, but whose advice is more strategic rather than the provision of recurring investment advice over a specific pool of assets.
FIXED OVERHEADS REQUIREMENTS (FOR)	<p>The calculation of the FOR will be a new concept to some firms and is now a key part of the own funds requirement for all investment firms with the intention of allowing them to wind down or exit the market. The FCA has finalised rules on how the FOR should be calculated by taking <math>\frac{1}{4}</math> of relevant expenditure from audited financial statements where available. Relevant expenditure is to be calculated before, not after, distribution of profits, and various deductions relating to variable expenditure can then be made before determining the FOR. The FOR will need to be recalculated when relevant expenditure materially changes.</p> <p>The FCA has introduced a new provision which allows firms dealing on their own account to deduct 80% of the annual value of fees, brokerage and other charges that they pay to central counterparty clearing houses (CCPs), trading venues and intermediate brokers from relevant expenditure.</p>	Firms who have not previously had to calculate the FOR should familiarise themselves with the calculation methodology as this will feed into both the capital requirement and liquid asset requirements and wind down triggers.

## BASIC LIQUID ASSETS REQUIREMENT

The FCA has finalised policy in relation to the core liquid assets that can be used to meet the basic liquid assets requirement and nuances around trade receivables, sterling and non-sterling currencies amongst other items.



### IMPACT FOR FIRMS

Firms will need to monitor their stock of core liquid assets to meet this requirement. A breach will trigger a notification to the FCA of whether a decision to wind down has been made.

## INTERNAL CAPITAL ADEQUACY AND RISK ASSESSMENT (ICARA) PROCESS

The PS21/9 does not include any significant changes in relation to the ICARA process requirements. However, the FCA indicated that it expects firms to take a proportionate and best efforts approach for 2022 based on their business models. The ICARA process covers a firm's risk management, incorporating business model assessment, forecasting and stress testing, recovery planning and wind down planning.

As part of the ICARA process, firms will need to meet an Overall Financial Adequacy Requirement (OFAR) to ensure they hold sufficient own funds and liquid assets to remain viable through the economic cycle and to allow business to wind down in an orderly way. The FCA confirmed intervention points in terms of being made aware of breaches of OFAR thresholds and wind down triggers. It also confirmed firms are required to be notified of an early warning trigger if a firm's own funds fall below 110% of its own funds requirement.

Firms are expected to review their ICARA once a year and submit their first MIF007 ICARA report to the FCA in 2022. The FCA will support firms with more guidance and best practices on the ICARA process throughout 2022. Firms are encouraged to sign up to the FCA's IFPR newsletter by emailing [IFPR-newsletter@fca.org.uk](mailto:IFPR-newsletter@fca.org.uk) with 'sign up' in the subject line to receive latest updates.



## IMPACT FOR FIRMS

Firms are encouraged to sign up for FCA newsletters. Newgate will be assisting firms put in place documentation to evidence the ICARA process and assist with the MIF007 submissions in 2022.

## REMUNERATION

The FCA has confirmed their proposals for introducing a basic remuneration policy for all firms, a standard remuneration policy relating to material risk takers for non-SNI firms, and extended remuneration requirements for the largest non-SNI firms.



## IMPACT FOR FIRMS

It is likely that the FCA will release optional policy templates to enable firms to document their remuneration policies and procedures. Newgate will assist in completing these for firms in line with their performance periods commencing under the new regime.

## REPORTING

The FCA has confirmed their final suite of reporting templates and confirmed IFPR returns will be submitted through RegData. Financial data will need to be reported quarterly and overlaid with annual ICARA and remuneration reports.



## IMPACT FOR FIRMS

Firms should familiarise themselves with the reporting suite so that data required will be available.

## APPLICATIONS AND NOTIFICATIONS

The FCA has confirmed its intention to introduce bespoke forms for each MIFIDPRU permission application and notification. It has also introduced a new MIFIDPRU supplement in CONNECT for firms to complete when seeking initial authorisation or a variation of permission. The FCA has created a page on its website dedicated to IFPR which will contain details of all MIFIDPRU application and notification forms. This will contain practical information for firms and further guidance on what is expected of them ahead of the new regime taking effect.

Firms should note that existing limitations or requirements on their scope of permission will continue to apply unless you apply a Variation of Permission to remove them. This is particularly relevant to matched principal firms, who should note that the matched principal exemption conditions will continue to restrict their activities as a result of the standard matched principal limitation.



## IMPACT FOR FIRMS

Firms should familiarise themselves with the new application and notification forms. If a matched principal firm wants to take on market positions beyond what is envisaged by its current limitation, it should apply for a Variation of Permission.

## NEXT STEPS FOR FIRMS

The next consultation paper is expected to be released in Q3 2021 whilst the new regime is expected to come into force on 1 January 2022. Please get in touch with a Newgate Consultant to complete an IFPR readiness assessment if you haven't already done so.

## CONTACT US

Please do not hesitate to get in touch to discuss how we can support your authorisation application, implementing a compliance framework if you are a newly authorised firm, or updating your existing policies and procedures in light of the priority areas highlighted in the Business Plan.



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