FCA Policy Statement PS21/6 on the Investment Firm Prudential Regime

The Financial Conduct Authority (FCA) has published its first (of three) Policy Statement on the introduction of the Investment Firm Prudential Regime (IFPR). This follows the FCA's first (of three) consultations papers, CP20/24, on which the FCA sought industry views in early 2021. This Policy Statement contains feedback on the issues raised by respondents, including AIMA and the ACC, with respect to CP20/24 and a set of related "near-final" rules on the aspects of IFPR covered in that consultation paper. CP20/24 consulted on (i) investment firm categorisation; (ii) own funds requirements; (iii) prudential consolidation and the group capital test; and (iv) reporting requirements. Please note that the FCA has, in general, implemented their proposals as previously consulted on, with only a few minor amendments made. Below is a summary of the Policy Statement and the key amendments/clarifications made.

Categorisation of investment firms

The near-final rules contain the quantitative SNI thresholds originally proposed by the FCA. We also argued that firms that deal on own account should not be automatically considered a non-SNI as long as they meet the quantitative thresholds. According to the Policy Statement, the FCA continues to believe that firms that deal on own account should be considered non-SNIs as these firms reflect the fact that they may be inter-connected to other FCA firms and other counterparties in the financial markets. The FCA has indicated that it does not expect to make any changes to the quantitative criteria (SNI/non-SNI thresholds) for at least five years.

For the purposes of determining whether or not a firm is an SNI, the FCA has confirmed that AUM, COH, on-and off-balance sheet and the total gross annual revenue must be calculated on a combined, group basis.

Prudential consolidation and the group capital test

The FCA has amended the definition of both an 'investment firm group' and 'consolidated basis' to make it clearer that the FCA investment firm group consists of a UK parent and its subsidiaries (and where applicable, connected undertakings). It believes that this ensures that the definition of 'investment firm group' does not inadvertently capture non-UK entities above the UK parent entity. The FCA also reminds firms that where a non-UK entity is included within an investment firm group, neither the consolidation requirements nor the group capital test ('GCT') impose any obligations directly on that non-UK entity. Therefore, there is no possibility of direct conflict between the MIFIDPRU rules and the prudential requirements that may apply in the non-UK jurisdiction. However, the UK parent entity or, in the case of the GCT, the responsible UK parent, may incur obligations by reference to the position of the non-UK entity. This enables group risks to be adequately taken into account, irrespective of whether they arise in a UK or non-UK undertaking.

On the GCT, the FCA notes the feedback it received on its proposed rules in CP20/24 that the inclusion of a 'connected undertaking' would exclude the use of the GCT. The Policy Statement points out that if the FCA were to grant a GCT permission to a group structure in which there were material connected undertakings linked by non-shareholding relationships, the GCT obligations would not adequately capture the risks associated with such relationships and that the existence of such relationships is evidence that a group is not simple enough to use the GCT. The FCA has, however, amended its rules to clarify that this is not the case where an entity is a connected undertaking by virtue of a participation since, in that instance, there will be shareholdings or capital ties and the GCT can therefore apply so the mere existence of participants does not mean that the group is complex. Note, however, that there may be cases where the connected undertaking is immaterial in comparison to the business of the group and firms can demonstrate that applying the GCT would not result in additional prudential risks. If that is the case, the FCA will consider all relevant factors when determining an application, but the FCA notes that such situations will be rare.

The FCA has provided additional guidance on the "soft" consolidation tests for connected undertakings. According to feedback to CP20/24, the ‘connected undertaking’ tests materially broadened the concepts of ‘unified management’ and ‘significant influence’ that already exist under company law and in other regulatory contexts which could create uncertainty for firms. The FCA has now provided a clearer definition of ‘significant influence’ in order to seek greater alignment with (international) accounting standards. The concept of "sufficiently simple" remains undefined. Note that the GCT rules have been modified in the light of the FCA's new powers in relation to entities that are intermediate unregulated parent undertakings of financial undertakings but are not parent undertakings of FCA investment firms. These will now also be subject to the GCT.

Finally, the Policy Statement further clarifies that CPMs and CPMIs will be considered ‘financial institutions’ and thus caught by the investment firm group rules. In addition, credit institutions may be considered ‘connected undertakings’ and, as a result, will be in scope of prudential consolidation.

Own funds, own funds requirements and K-CON

These rules address the definition and composition of own funds, but the FCA has largely implemented the provisions as originally proposed, with a few minor amendments and clarifications. For example, the Policy Statement clarifies that interim dividends can be deducted from interim profits without reducing own funds.

In addition to provisions on ongoing permanent minimum capital requirements and initial capital requirements, the FCA provides a considerable level of detail on the K-factors which are applicable only for firms with permission to deal on own account. These are: K-NPR (net position risk), K-CMG (clearing margin given), K-TCD (trading counterparty default) and K-DTF (daily trading flow). The remainder of the K-factors were consulted on in the second consultation paper (CP21/7).

The FCA confirms that non-SNIs with a trading book are expected to notify the FCA without delay of exposures that exceed the concentration risk soft limit. The FCA argues that the prompt notification requirements are similar to already existing limits and does not believe that it would be an onerous requirement for firms to comply with. It is currently unclear whether firms are required to provide information on all concentration risks events that occur during a reporting period, or only on the level of this risk outstanding as at each reporting date. The FCA has not addressed this point in the Policy Statement. The concentration risk limits and the K-CON are applicable only to firms with permission to deal on own account.

The FCA will adopt the transitional regime for CPMIs as suggested, meaning that no additional transitional relief will be offered for these firms to provide additional own funds requirements resulting from the ICARA process. Note, however, that the FCA will publish its near-final rules on the ICARA process requirements in its next Policy Statement. The transitional provisions will also apply to the calculation of capital on a consolidated basis, provided that the relevant transitional is available to the firm on an individual, solo basis.

Reporting

The FCA will continue to require SNIs to report on a quarterly basis, as proposed in CP20/24. The FCA believes that quarterly reporting supports more agile supervision and allows them to identify and respond to trends more quickly. According to the FCA, firms are more likely to submit correct information if they are required to do this on a more frequent basis. In response to the feedback that the suggested reporting requirements go beyond those under the IFR/IFD, the FCA argues that the volume of data required by the IFR is considerably larger and more detailed than under the IFPR.

There is currently no clarity on whether the FCA will continue to require firms to convert their reports in XBRL format and if they will either need to submit electronic XML returns or enter the data items directly in Gabriel (or to its successor, RegData). They may address this in future Policy Statements.

The FCA are considering whether to introduce new reports for securitisations. Finally, the Policy Statement confirms that all returns will need to be completed in GBP.

Next steps

The FCA will publish its third and final consultation on the introduction of the IFPR during the summer. The second Policy statement, following the second consultation (CP21/7) is also expected to be published then. The IFPR is effective as of 1 January 2022. AIMA will publish an IFPR implementation guide in the summer to assist members in transitioning to the new regime.