THE
INVESTMENT
ASSOCIATION

IA response to consultation paper 21/7

A new UK prudential regime for MiFID investment firms

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £7.7trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 40% of this is for overseas customers. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

The IA welcomes the FCA's approach to creating a tailored UK prudential regime for MiFID investment firms and the further clarity on how firms are expected to implement aspects of the regime. We look forward to the publication of the third consultation paper in due course.

The IA recommends that for the definition of material changes to the Fixed Overhead Requirement (FOR), the FCA removes the £2m threshold in order to take account of the substantial variance in the quantum of FOR across the industry. This would provide for an appropriate change that is proportionate for all sizes of firms. We also propose that allowable deductions for expenses include other items deducted from own funds, such as amortisation of customer contracts.

The IA proposes that delegated assets from third countries that have a strong prudential regime and comparable investor protection be excluded from the K-AUM calculation in the same way as from countries with an AUM-based financial resources requirement. For this purpose, the IA urges the FCA to provide a list of other regimes that would be deemed to provide sufficient investor protection where there is a memorandum of understanding in place with other jurisdictions. We would urge that delegated assets from entities subject to other prudential regimes (e.g. Solvency II) also be excluded from the K-AUM calculation.

The IA would urge the FCA to remove the requirement to calculate COH where there is more than one level of delegation of AUM or ongoing advice.

The IA proposes that groups with centralised order processing should not be required to calculate COH where the firm handling orders has been indemnified by the firm calculating K-AUM. Under the proposed rules, groups that have centralised order processing in order to obtain best execution on behalf of clients will be disadvantaged compared with groups where order processing is not centralised, or solo firms who handle their own client orders.

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The IA requests further guidance on how firms transition existing Individual Capital Guidance (ICGs) into the new regime. Where remedial actions have been implemented following a previous Supervisory Review and Evaluation Process (SREP), the IA recommends that existing ICGs lapse, provided that governing bodies provide assurance that remedial actions have been implemented and SREP comments have been taken into account in the firms' own assessments of capital and liquidity under IFPR.

In regard to assessing the adequacy of own funds and liquid assets, the IA request further guidance on how risks from firms' activities should be treated where they would impact more than one harm relating to more than one K-factor component. The IA also requests further clarity regarding the extent to which firms can allow for diversification between risks and, within a group, between entities.

Questions

1. Do you agree that CPMIs should apply MIFIDPRU requirements to their MiFID business? If not, please provide details of an appropriate prudential regime for the MiFID business of a CPMI.

The IA welcomes the alignment of the FOR calculations between UCITS / AIFMD firms and MIFIDPRU firms. However, it will be cumbersome to separate the collective portfolio management business and MiFID business of a firm in order to apply the provisions of IPRU-INV 11 and MIFIDPRU respectively. There will be instances where segregated client assets with discretionary mandates (MiFID business) will be invested in collective portfolios (CPM business) managed by another MiFID firm. In this case, CPMI will be required to maintain capital under both regulations: clients' discretionary mandate delegated to another investment firm (MIFIDPRU rules) and assets in collective portfolio (IPRU-INV 11 rules).

The MIFIDPRU requires investment firms to maintain a capital which is the higher of permanent minimum capital, FOR and K-factor requirement. It will be disproportionate to compare the FOR for both CPM and MiFID business activities against the K-factor requirement for MiFID business only. The definition of own funds differs between MIFIDPRU and IPRU-INV 11, which means the own funds of collective portfolio management business of CPMIs will be subject to MIFIDPRU rules whereas their capital requirement will be governed by IPRU-INV 11.

Further, the definition of liquid assets under IPRU-INV and MIFIDPRU is different. If CPMIs are required to assess liquidity requirements for a portion of MiFID business, then the firm needs to split the FOR by CPM and MiFID business and then by foreign currency. That portion of liquidity requirement can be maintained by core liquid assets defined in MIFIDPRU.

The segregation of business by CPM and MiFID activities may force some firms to run both businesses from different entities to be able to apply different sets of regulatory requirements. It is operationally difficult to keep both activities separate whilst running as a part of same entity.

In line with the IA's response to the FCA Discussion Paper, we would welcome the ability for firms to 'opt-in' to regimes to avoid the application of separate regulatory regimes within the same entity or sub-group. Without clarity on this point, it will be difficult for firms to try and divide up operations and follow two sets of rules.

2. Do you have any specific comments on our proposed approach to the calculation of the fixed overheads requirement (FOR) and the specific items of expenditure that may be deducted from total expenses? If yes, what items would you suggest are/are not deducted, and why?

Material changes

The IA is supportive of the broad alignment of the FCA IFPR requirements with both the EBA and UK CRR rules. The deductions are broadly in line with expectations, and we welcome the explicit inclusion of expenditure from taxes that are related to the annual profit of the investment firm. We also welcome the approach taken in relation to material changes whereby firms are expected to increase the requirement when costs increase and apply to reduce the requirement in the event that costs decrease materially. We would welcome some clarity on the ability of firms to apply to reduce their FOR when the decrease in costs is below the threshold specified, but the reduction in the FOR would allow firms to maintain capital ratios in excess of the intervention amounts discussed in section 7 of the CP.

4.5.7R(1) and 4.5.9R(1) define a material change in the FOR as being an increase/decrease of 30% or £2m. While we support the 30% increase in relevant expenditure as being representative of material change, we note that £2m will be very low for larger investment firms and groups and would necessitate continual recalculation (and potentially formal FCA Approval) every time expenses are reforecast, perhaps monthly. Changes to the FOR also impact liquid asset requirements, and therefore continual changes would make liquidity management challenging and impractical. We would encourage the FCA to remove the £2m threshold in order to take account of the substantial variance in the quantum of FOR across the industry. This would provide for an appropriate change that is proportionate for all sizes of firm. If this threshold were retained, we would expect even medium sized firms to recalculate the FOR throughout the year regardless of whether there has in fact been any material change in the business.

We would also welcome clarity from the FCA on whether the thresholds for changes in the FOR apply on both an individual entity and a consolidated basis.

Expenses

To ensure the consistent application of the rules, we would welcome some additional guidance on the FCA's expectations on the nature of costs that may fall within the scope of "non-recurring expenses from non-ordinary activities" as there is potential for judgement to be exercised on what could be significant costs, such as restructuring or impairment of intangible assets.

We welcome the proposed approach of using unaudited financial statements for previous financial year until the audited financial statements are available. This will enable the firms to report latest FOR immediately after the end of financial year. The IA would also propose

that firms be able to compare their forecast/budgeted expenditure for the current year against the audited annual financial statements for the prior year and apply the forecast/budgeted expenditure for the current year if it meets the material increase criteria in paragraph 4.13 or the material decrease criteria in paragraph 4.15. Given that firms must obtain permission from the FCA to decrease the FOR per paragraph 4.14, firms would require valid motivation to reduce their FOR. This approach would have two benefits: (1) Alignment of FOR to current business levels (if materially different to the previous year's expenditure); and (2) Remove uncertainty as to what constitutes a significant event as described in paragraph 4.11.

We request the FCA to provide examples of following expenses to ensure all investment firms have clarity and follow a consistent approach:

- **Shared commission and fee payable** - if these are directly related to commission and fee receivable which are included in total revenue and the payments are dependent on actual receipt of the commission and fee receivable.
- **Expenditure incurred on behalf of investment firm by third parties -** some investment firms have multiple regulated entities. The expenses are incurred by intragroup entities on behalf of other group entities and the cost is charged via transfer pricing mechanism. In such instances, we ask that the FCA deem it sufficient for each firm to consider its transfer pricing expense to account for third party costs.

We would also welcome the FCA to consider the treatment of losses on non-trading book financial instruments. Investment firms are likely to maintain a portfolio of investments in products, either for the purposes of providing a track record of performance to potential investors, or to incubate the fund while marketing to investors. The investments in the products will be carried at market value on the firm's balance sheet and losses may be recognised in the profit and loss of the firm. While most investment firms do not have trading permissions, the nature of the expenses are similar to the trading book losses.

Allowable deductions

We welcome the inclusion of the FOR methodology in the MIFIDPRU sourcebook rather than through reference to previous European regulation. A note is also made of the exclusion from relevant expenditure of software amortisation costs where the assets have been deducted from own funds. While this is a welcome addition, we consider that this deduction should be broadened to include other costs related to own funds deductions. For example, other intangibles, subject to similar recognition and valuation requirements as software assets, should also be included in the scope. These intangibles may relate to assets recognised as part of business combinations and would be required to be reviewed regularly for indicators of impairment.

The IA proposes that the calculation of the FOR should also exclude expenses relating to amortisation of customer contracts and expenses related to other items deducted from own funds, as per EBA form IF03.00 'Expenses related to items that have already been deducted from own funds.' Without this revision, UK firms will be at a competitive disadvantage compared with EU firms. In addition, not allowing deductions from the FOR for items already deducted from own funds disincentivises firms from making investments where this would lead to a double count of the capital impact via both own funds and the FOR and is therefore detrimental to the clients of investment firms regulated under IFPR.

3. Do you agree with our proposals for calculating K-ASA and that this should address the potential risk of harm from an FCA investment firm's direct safeguarding responsibilities, including where it is safeguarding assets delegated to it by another entity ASA? If you disagree, please explain why.

Investment firms are required to maintain capital for the safe custody business contracted by the firm and delegated to the firm. However, unlike K-AUM, the FCA does not consider it to be a double counting of assets.

It should be noted that some non-MiFID firms are engaged in the safe custody business by acting as a depository for alternative investment funds. While on a solo basis, such firms are not in scope of the IFR, but if they are part of a UK group where one of the subsidiaries is an investment firm, the parent holding company in the UK will be required to maintain K-ASA capital for such non-MiFID firm. If this understanding is correct, we would like the scope of K-ASA to be limited to apply on the unregulated parent holding company, only in the event it is relevant for a MiFID subsidiary in the group.

Should there be no practical way of avoiding the concept the of double counting as the firm is still bearing a risk if it holds customer assets, we would request alignment with the CASS rules for consistency.

4. Are our proposals on the calculation of K-CMH, especially when amounts of CMH should be treated as being in a segregated account, sufficiently clear? If not, what specific suggestions do you have for improvement?

We welcome the clarification that CMH reporting should be consistent with CASS reporting requirements.

It would be useful to clarify if the method to identify CMH should be aligned with the CMAR return with the only exception that CMAR reports month end values whereas for K-CMH, the firms will source day end values.

5. Do you agree with our proposals on how the value of assets should be calculated, and for when formal delegation takes place, when calculating K-AUM? If not, please explain any alternative suggestions you may have.

The IA welcomes the proposals on valuing assets which reflects the practices of investment management firms. In addition, we agree that the FCA investment firm must include in its measurement of AUM, any assets where it has delegated the management to another entity. We also agree with the proposal to exclude entities already subject to K-AUM requirements as per this regulation or similar third country AUM based financial resources requirements (e.g. EU entities).

K-AUM will be one of the main factors for investment firms. Whilst we understand that it is not feasible to capture all business scenarios on how the value of assets should be calculated, a detailed guidance covering complex real time business scenarios will ensure consistent application of IFPR across investment firms in the UK.

Commingled Funds

Detailed regulatory guidance on K-AUM is required for commingled funds where the fund is managed by the investment firm but the clients in such funds are not contracted with the investment firm. In such cases, should the investment firm calculate K-AUM on all assets of the commingled fund or on assets attributable to the clients contracted with the investment firm? Even if we limit the scope of K-AUM requirement to the contracted clients, it should be noted that by managing the commingled fund, the UK investment firm is posing risk to all contracted and non-contracted clients participating in the fund.

SMA investing in commingled funds

Further, the firm could have separately managed accounts (SMA) with discretionary mandates that invest in commingled funds for which the firm is appointed as an investment manager. In this case, should the value of assets be included in SMA and deducted from commingled fund to avoid double counting of assets.

Fund of Funds

Another layer of business complexity stands where portion of such commingled funds are further invested in a fund i.e., how should the firms value the assets in Fund of funds structure under IFR, especially when different jurisdictions and client types (financial/ non-financial) are involved.

Financial entity

We support the principle to avoid "double counting" in calculating capital to support AUM but believe insufficient regard has been paid to the innovation of the K-factor calculation. This is in particular regard to the delegation of assets from firms outside the UK or the EU that, while retaining capital in line with broadly recognised global standards, do not have a specific AUM based requirement.

With regards to the delegation of portfolio management, there is no mechanism available to identify if the third country firms are subject to AUM based capital requirements to avoid double counting of assets. Therefore, we ask the FCA to consider adding third party countries which, while not having a requirement similar to K-AUM, have recognised robust and mature regulatory regimes, including, but not limited to the United States, Canada, Switzerland, Hong Kong, Singapore, Japan, and Australia. Without broader application of this mechanism, we foresee the elimination of double counting of assets across industry being difficult to implement accurately.

As an alternative, we propose that delegated assets be excluded from the AUM calculation where they are delegated from a jurisdiction that holds capital under a regime that is deemed to provide comparable capital and liquidity to the UK regime. The IA's view is that it would be appropriate to exclude AUM delegated from firms in other jurisdictions or covered by other regimes that provide comparable investor protection. For this purpose, the IA would like the FCA to provide a list of other regimes that would be deemed to provide sufficient investor protection and where there is a memorandum of understanding in place with other jurisdictions.

We seek clarity around business that is delegated from firms that are regulated as insurance firms under the Solvency II (SII) regime. Such firms are also subject to robust capital obligations in their own right. We propose that business delegated from SII firms should be excluded from the K-AUM measure.

Finally, we are unclear on the rationale for limiting exemptions to one delegated level under paragraph 4.61. It is common to have sub delegation in the industry. At the very least, where these entities roll up to a consolidated entity, the relief should apply irrespective of the levels of delegation in the firm.

Look back period
CP21/7 clarifies that an FCA investment firm which has been managing assets for less than the 15-month period ordinarily required for the average AUM valuation may be required to adopt an alternative approach for performing the K-AUM calculation. CP21/7 notes that the FCA may use "business projections that the FCA investment firm gave us when getting permission to perform the relevant activities". It would be helpful to clarify if there is an alternative approach available for other potential circumstances that may arise which impact the 15-month look-back period. For example, in the event of an organisational restructure, while business projections would be available, it is unlikely that they would be submitted to the regulator. Guidance on the approach to be adopted in such circumstances would be welcomed.

6. Do you agree with our proposals for calculating K-COH? Especially for measuring the value of cash trades, and for when certain transactions may be excluded from the measurement of COH? If not, please explain why and provide evidence to support any alternative suggested treatments.

Definitions of COH
The definitions for COH continue to remain subjective based upon individual member firms' interpretations of very broad-based principles set out in the regulations. Different member firms have different business models and structures and hence guidance to cover all matters is probably unrealistic. There is a significant risk that firms and the FCA take different interpretations of the rules on implementation.

It would be helpful to get further guidance between the standalone calculation and the consolidated situation.

Transactions that can be excluded from K-COH
The IA welcomes further guidance on paragraph 4.76 of the consultation paper covering K-COH requirement for an operator of MTF/ OTF submitting an order on trading venue on behalf of a client. It is not clear if the operator of MTF/ OTF is required to maintain K-COH for orders transacted on the platform.

Further, in relation to commingled funds, where the clients in fund are not contracted by the reporting firm, should trades on those assets be included in K-COH even though the reporting firm manages the commingled fund as an investment manager.

A clarification is required on use of FX rates to convert transactions denominated in foreign currency into the functional currency of the firm, including whether firms should use end of day or month-end FX rates to convert daily cash and derivative orders.

Treatment of Solvency II firms for K-COH
As highlighted under Q5 for K-AUM, business that is delegated from firms that are regulated as insurance firms under the SII regime are subject to robust capital obligations in their own right. We propose that business delegated from SII firms should be excluded from the K-COH measure.

Also, it is not fully clear from the FCA proposals, if UK investment firms and UK investment firm groups need to capture trades where the client is not contracted to a firm within the UK Group i.e., for clients contracted with entities outside the UK and EU. Further guidance on this would be valuable.

7. Are our proposals that cover the interaction between K-AUM and K-COH clear and prudent? If not, what specific suggestions do you have to improve this?

We welcome the scenarios provided by the FCA in Table 2 as an aid to interpretation. We agree that the basis for such scenarios should be the formal delegation agreement between financial entities which sets out the ongoing services being provided. However, while this is useful guidance for firms delegating to/from other external firms, various scenarios (e.g. 2, 6, 7, 9, 10, 13) could result in double counting of assets under the K-AUM and K-COH calculations if applied to delegation within a consolidated group. This seems contrary to the FCA's intention to avoid double counting as stated in paragraph 4.59.
With respect to the interaction between K-AUM and K-COH it appears that FCA and the EU diverge in their approach. The EU in Article 20(2) of EU IFR states: *COH shall exclude transactions handled by the investment firm that arise from the servicing of a client's investment portfolio where the investment firm already calculates K-AUM in respect of that client's investments or where that activity relates to the delegation of management of assets to the investment firm not contributing to the AUM of that investment firm by virtue of Article 17(2).*

This suggests that in the EU, under the FCA's scenario 2 in the table, IF2 would not have to include the K-COH requirement. In this regard, the EU's approach avoids 'double-counting' more than the UK's approach. We believe that scenario 2 results in a "double count" of capital where the same client business is captured under both the K-AUM and K-COH requirements. In addition, scenario 3 poses no less risk overall, but results in only IF1 holding capital.

The UK's approach as set out at 4.10.28R of its draft rules (p.304 of CP) creates a potential disadvantage for UK firms versus their EU peers. The FCA says that when portfolio management is delegated, K-COH must be counted when the delegate executes the order, but not when it passes the order on to another entity for execution or back to the delegating entity. This may mean that a fixed income trade executed with a dealer is counted but not an equity trade that is passed on to a broker when a firm is acting as a delegated portfolio manager.

We request more guidance on paragraph 4.60. We are not clear in what circumstance an FCA investment firm would act as a delegated manager but would not include these assets from the calculation of its own capital requirements. We assume this refers to a third, external investment firm.

The IA notes that under the proposed rules, groups that have centralised order processing in order to obtain best execution on behalf of clients will be disadvantaged compared with groups where order processing is not centralised, or solo firms who handle their own client orders. This is as, under the current proposals, groups with centralised order processing will calculate K-AUM for the firm that provides the investment management or ongoing advice and calculate K-COH for the firm that handles the client orders.

Where an investment firm within a group is calculating K-AUM in respect of an order, there should be no requirement for another investment firm within the same group to calculate K-COH in respect of that order where the firm processing client orders on behalf of another firm within the same group is acting as agent of the firm reporting the K-AUM, provided that the principal firm indemnifies the firm handling the orders from losses other than losses arising from negligence, wilful default or reckless disregard. Under the current proposals, firms would be required to calculate a K-COH capital requirement despite that firm not being at risk of suffering losses for which capital is being held.

8. Do you foresee any issues with our proposals for how to calculate an adjusted coefficient for use in times of stressed market conditions? If so, how might we address them, or what alternative practical suggestions do you have for achieving the desired outcome without unnecessary complexity?

No comments.

9. Do you agree with our proposed treatment of FCA investment firms when acting as clearing members and indirect clearing firms? If not, what alternatives could be used to calculate the own funds requirements for such activity? Are there any other circumstances in which FCA investment firms may have exposures to a CCP that should be captured by K-TCD?

No comments.

10. Do you agree with our proposals for a basic liquid asset requirement, to be met by holding core liquid assets? If not, please explain what alternative proposal you would suggest and why.

The IA agrees with adopting a simple approach for liquidity requirements. The basic liquid asset requirement seems to be a reasonable and a proportionate minimum requirement

that FCA investment firms should be able to meet. We also welcome the inclusion of Money Market Funds as liquid assets (without haircut or maximum limit).

However, the definition of core liquid assets needs to be elaborated in following cases:

- Do liquid assets include nostro balances held for meeting operating expenses? As per the LCR Delegated Act, assets used to cover operating expenses are not considered as liquid assets.
- How to define "short term" deposits for core liquid assets?
- Can the FCA confirm that the following instruments are included within the definition of deposits – bank deposits, certificates of deposit, commercial paper, floating rate notes, T-bills, reverse repos.
- Do "intragroup deposits" qualify as short-term deposits held at banks or should the firms consider deposits held with external banks only for core and non-core liquid assets?
- Do deposits denominated in non-GBP currency at a UK bank qualify for core liquid assets in full or is it restricted to the proportion of expenses incurred in foreign currency?
- Should the firm consider original or residual maturity of trade receivables for 30-day bucket, and should we apply 50% haircut after reducing provision for bad debts?
- Can committed banking facilities be included as non-core liquid assets used to meet the additional liquidity requirements of a firm?

The IA welcomes the ability for firms subject to prudential consolidation being able to apply for an exemption from this requirement on an individual basis to enable firms to rely on liquidity support provided by other entities within its group but would welcome guidance on the circumstances necessary for firms to be granted this exemption.

Can the FCA confirm that it is appropriate to use month end valuations of receivables for the purposes of liquidity workings given that receivables balances are generally not determined daily.

Although a firm can count receivables due within 30 days as core liquid assets, they are restricted to only covering the FOR derived requirement and are subject to a haircut of 50%. We propose that intercompany receivables can be counted as non-core liquid assets to cover the liquid assets threshold requirement.

Can the FCA please confirm what they mean by ring-fenced, quoted in comments below: Paragraph 7.45 'The concept of wind-down triggers will be new to FCA investment firms, so it is important that they familiarise themselves with our proposals. They are the minimum ring-fenced amount of financial resources that an FCA investment firm should hold at all times to ensure that wind-down can begin in an orderly way.'

Paragraph 16.104 'Our proposed rules are therefore likely to raise the requirements for a number of firms. However, we believe these requirements deliver considerable benefits, including that all firms should now have a ring-fenced pool of liquid assets, which gives both their counterparties and the market confidence.'

The IA would also welcome further examples of client guarantees captured by the liquid asset requirement, including whether settlement guarantees might be captured.

11. Are our expectations of firms regarding the ICARA and meeting the OFAR sufficiently clear? If not, which areas would benefit from further clarification?

The expected approach to implementing the ICARA remains unclear as to whether the FCA expects a fundamental overhaul of their entire risk management processes which will require a great deal of work, or firms should be mapping current risk frameworks to the new regime. A fundamental bottom-up approach will include making changes to risk taxonomy, risk appetites, risk reporting, templates, and MI, as well as possible technology changes that are likely to take several years. If the intention of the FCA is for a fundamental overhaul of risk assessment, then the IA requests that firms be allowed a transition period of 5 years during which risk assessments can be adapted from their existing processes to the new ICARA expectations.

Individual Capital Guidance
Where firms have an existing ICG, they are requested to contact the FCA to discuss transferring this to the new regime. It remains unclear what scope there will be for changing the size or nature of the ICG. OFAR will require firms to always hold adequate own funds and liquid assets by the introduction of the 'own funds threshold requirement' and 'liquid assets threshold requirement'. Whilst it is expected that firms will determine these requirements through their ICARA process, it is not clear whether the proposed methodology to adjust a firm's existing ICG to the OFAR will ensure it remains appropriate under the new regime. Firms will also benefit from further guidance and timelines if they are to apply to the FCA for a VREQ, confirming it has rebased its current ICG appropriately.

The IA requests further guidance on how firms transition existing ICGs to the new regime. Where remedial actions have been implemented following previous SREPs, the IA recommends that existing ICGs lapse, provided that governing bodies provide assurance that remedial actions have been implemented and SREP comments have been taken into account in the firms' own assessments of capital and liquidity under IFPR.

Business model assessment, forecasting and stress testing
MIFIDPRU 7.10.5 G (7) states that the FCA will, amongst other things, normally consider whether the business model analysis conducted by a firm or investment firm group is based on plausible scenarios that are relevant to the business it undertakes. The IA believes that guidance should be provided within MIFIDPRU on what is to be covered by "business model analysis" as no definition or guidance is provided. Providing a definition or guidance within MIFIDPRU is required in order that firms have clarity on the FCA's expectations and can ensure their ICARA process and ICARA document address these expectations appropriately.

In setting out the OFAR, MIFIDPRU 7.4.7 R (1)(a) highlights the need for firms "to remain financially viable throughout the economic cycle". There are numerous other references within MIFIDPRU to "the economic cycle", however, no guidance is provided on what is meant by this. The IA believes that guidance should be provided on what timeframe is intended to be covered by "the economic cycle". In the absence of such guidance, different firms will be forced to form their own views on what is meant by this phrase resulting in an inconsistent approach to complying with the OFAR across firms.

MIFIDPRU 7.5.4G (1) states that the FCA expects that "firms with larger or more complex businesses" will also undertake more in-depth stress testing and reverse stress testing. The IA requests further guidance on what is meant by "firms with larger or more complex businesses" much as it has for the definition of SNI. Providing this guidance within MIFIDPRU is required in order that firms have clarity on whether the FCA expects them to undertake this additional activity.

MIFIDPRU 7 Annex 1. 16G states that the FCA would normally expect stress testing to involve, amongst other things, considering the impact of scenarios against a firm's risk appetite "by reference to (a) individual business lines or portfolios; and (b) the overall position of the firm as a whole". Based on MIFIDPRU 7.5.4G (1) it is possible that firms seeking to follow the guidance in MIFIDPRU 7 Annex 1. 16G are large firms who only operate a single business line and who do not deal on their own account. It is unclear how such firms would address the requirement to consider "individual business lines or portfolios".

The IA believes that clarity on this point would be provided by re-wording MIFIDPRU 7.5.4G (1) to state that the FCA would normally expect stress testing to involve, amongst other things, considering the impact of scenarios against a firm's risk appetite "by reference to individual business lines and portfolios, if relevant, as well as the overall position of the firm as a whole". This would provide greater alignment with the wording used in Finalised Guidance FG20/1 which MIFIDPRU 7.5.3G instructs firms to refer to.

MIFIDPRU 7.5.2R states that as part of its ICARA process, a firm must "consider relevant severe but plausible stresses that could affect the firm's business…". The IA proposes that guidance be provided on the FCA's expectations regarding the calibration of severe but plausible stresses including the time period over which stresses should be explored. For example, should market stresses be determined by views of market volatility, or should they be designed to take firms beyond early warning indicator thresholds, noting the latter would result in firms who are similar, other than having different levels of pre-stress financial strength, requiring different sized stresses. In the absence of guidance, it is noted that the situation regarding the time period for stresses is further confused by CP21/7 (paragraph 7.32) which provides an example of how a firm might consider its own funds resources and requirements under a scenario of economic stress: the example shows the scenario covering 4 quarters which might be interpreted as implying stresses only need to cover a one-year horizon. Without guidance on the calibration of severe but plausible stresses and the time periods to be covered, different firms will perform stress testing to different degrees of severity and over different time periods resulting in inconsistent conclusions being drawn as to whether firms are able to meet the OFAR under stressed circumstances.

CP21/7 (paragraph 7.31) states that the FCA's proposals require forward-looking assessment of capital and liquidity requirements including an assessment of "how a severe but plausible economic or idiosyncratic stress" could affect a firm's ability to meet the OFAR. This wording is not repeated within MIFIDPRU. In light of the above, the IA suggests further clarification would be beneficial on whether the FCA has amended their requirement for firms to undertake stress testing covering the range of scenarios previously set out under IFPRU 2.2.37R (2), namely circumstances including:
(a) circumstances and events occurring over a protracted period of time;
(b) sudden and severe events, such as market shocks or other similar events; and

(c) some combination of the circumstances and events described in (a) and (b), which may include a sudden and severe market event followed by an economic recession.

It is noted that Finalised Guidance FG20/1 (which MIFIDPRU 7.5.3G instructs firms to refer to) does not explicitly require any combined scenarios to be explored.

Reverse Stress Testing

Reverse stress testing is to be completed by “larger or more complex” firms [7.5.4G(1)(b)] but as noted previously there is no definition of this qualitative trigger level. We note that 7.33 of the consultation gives one example of larger trading investment firms, implying the threshold is well above the SNI/non-SNI division and so a different set of criteria are required.

The IA ask that guidance is provided on the criteria which should be applied to allow firms to understand the FCA’s expectations and so to avoid inconsistent adoption of reverse stress testing between different firms. We would also like to know how the FCA will inform firms if they need conduct reverse stress testing.

It is stated that recovery planning needs to be linked to the firm’s own business model forecasting and scenarios. IA members would request further clarity for how recovery planning be embedded within the ICARA document or whether this be a separate but linked exercise.

Wind-down

MIFIDPRU should include a definition of disorderly and orderly wind-down. The IA considers that more than a Plain English articulation is required to ensure firms appropriately treat the range of interests in their businesses in line with the FCA’s expectations.

It is necessary to hypothecate a scenario that requires a firm to wind-down having exhausted potential recovery actions. This means that a stronger firm will need to assume a greater degree of stress than a less strong firm in order for it to enter into the wind-down environment. It is likely that the wind-down cost could be much higher (e.g. because revenues are lower or payments are higher) for a more materially stressed position meaning that the approach penalises firms for financial strength by imposing higher threshold requirements on them than would be set for an equivalent (but less strong) firm. It seems unlikely this is the FCA’s intention as this would materially distort the apparent prudential strength and consumer protection provided between different firms to the detriment of both the FCA’s competition and consumer protection objectives.

The IA suggests an alternative approach to require consistent scenarios under which wind-down costs should be assessed by all firms regardless of the financial strength and depth of potential recovery actions available – this cost would then set the thresholds requiring recovery actions if possible or for wind-down otherwise.

The IA would also like the FCA to clarify expectations for smaller firms and that recovery plans may not be appropriate for a smaller firm under stress and that wind-down would be the appropriate solution, but that they would still be required to demonstrate that this had been considered as part of the ICARA.

Assessing the adequacy of own funds and liquid assets

It is not clear, where underlying risks from a firm's activities contribute to multiple types of harm, whether they should be split into those various harms and compared to multiple K-factors or whether they should be compared to the K-factor for the lead harm. For example, failure in a particular investment process may lead to client harm with associated remediation costs as well as investigation and internal project costs and also potentially fines. Should all these impacts be aligned to K-AUM, or should the different impacts be aligned to different elements across RtC and RtF?

Under the ICARA process, firms should internally calculate requirements which are in line with K-factors. It is not clear how a firm should go about calculating risk in relation to K-factors specifically. If a firm calculates harm in a different way (not directly based on K-factors such as AUM or COH) how should firms approach allocating it amongst k-factors? If firms are to consider calculating risk requirements for each K-factor under the ICARA process, can a framework be provided on how firms should go about this?

The IA requests further guidance to avoid different firms adopting different interpretations. Otherwise, given additional own funds requirements cannot be offset between components (per 7.6.3R), this could result in different firms operating to different prudential standards.

The assessment of additional own funds should be based on severe but plausible assumptions [7.4.16G(2)] and scenarios [MIFIDPRU 7, Annex 1, 1.2G(1)]. Given the use of "severe but plausible" terminology in this context the IA encourages the FCA to take the opportunity, when setting out IFPR, to provide guidance on their expectations regarding the calibration of severe but plausible assumptions and scenarios. Without this different firms will calibrate their assessments to different degrees of severity.

It is unlikely that all potential harms could manifest at the same time, yet the consultation and draft rules make no mention of allowing for this in the ICARA. We note the guidance does set out that an ICARA assessment below one K-factor component cannot use the difference to offset an assessment above a different K-factor component [7.6.3R]. However, can firms allow for diversification between all harms before comparing the harms to K-factor components? If not, can firms allow for diversification between different risks contributing to each K-factor component? The FCA should recognise that the more granular the risk of harm assessment a firm performs, the greater the need for diversification between those risks to avoid creating an overall additional own funds requirement beyond the 'severe but plausible' range.

Many of the larger firms have developed statistical models under CRD Pillar 2. These typically use statistical techniques to extrapolate from ERM data and subject matter experts' scenarios to an extreme calibration for each risk and then apply a set of dependency assumptions to arrive at an appropriate calibration for the firm as a whole. The guidance we are calling for above, on the FCA's expectations regarding the calibration and the approach to diversification for the additional own funds assessment, is needed to allow firms to assess the suitability of their models to serve the ICARA and whether, and how, they should be updated. Without this, different firms may diverge materially in their approaches to assessing the residual risks of harms from their operations.

7.5.2R (5) requires firms to consider whether, under stress testing, own funds are sufficient to meet the overall financial adequacy rule. This raises a question whether additional own funds capital requirements need to be held for changes in value to balance sheet assets. As

an example, many investment firms will hold seed capital as part of their product development cycle, and this exposes the firm to market risk. If the firm were to hold risk capital against a fall in the value of seed capital and then also perform the stress testing to determine if sufficient capital was held over an economic cycle, then there would be a double allowance for the exposure to market risk on that seed capital: the firm would hold capital requirements and also stress own funds. Does the FCA intend that market risk to balance sheet assets is only explored in the stress and scenario testing exercise, or that the potential double count be eliminated in some other way?

ICARA as all-encompassing document
It seems that the ICARA will become an all-encompassing document doing away with separate ICAAP, ILAAP, LCP, Wind down plan and Recovery Plan etc. Is this the intention of the FCA that separate documents will no longer be required? How will this fit with the stated intention of proportionality?

Reviewing the adequacy of the ICARA process
Certain firms/groups currently undertake ICAAP processes throughout the year in order to avoid condensing a large amount of activity into a small time period (typically following the year-end). In addition to spreading the workload this also allows their management bodies to give greater consideration to the individual processes than would be the case were they to review the full range of processes at the same time.

The FCA is asked to confirm that firms/groups may continue with such an approach for ICARA. As an example, this may result in a firm/group calculating K-factors following year-end reporting but undertaking OFAR calculations at another time as the OFAR calculation is a forward view which does not relate closely to a particular reporting date. Furthermore, assuming that a firm/group's management body is satisfied that this rolling program of ICARA activity provides it with the insight required for governance, the FCA is asked to confirm that it would be acceptable for the firm/group's ICARA Document to comprise the results of ICARA processes performed since the production of the last ICARA Document (i.e. the ICARA Document can contain analysis which is up to 12 months old where the management body considers this still provides the insight required for governance).

Half yearly reviews
7.8.3G the FCA indicates that firms with significant scale or complexity may find it more appropriate to review the ICARA process on a half-yearly basis, and 7.8.2R (2) requires firms to conduct an out of cycle review following material change to the business. The IA regards it as overly onerous to expect all the activity set out in the ICARA document to be repeated on a half yearly or ad hoc basis, and proposes that firms should be able to meet both these requirements by reviewing the validity of the most recent full ICARA reporting, updating components as necessary and with the conclusions of this review approved by the governing body.

SREP cycle
We would welcome further clarity on the following points:

- For firms requiring a minimum SREP cycle, can the FCA outline when it intends to advise firms if they fall into this category?
- For firms subject to the SREP cycle, if additional amounts of OFAR are set e.g. for governance/risk management reasons, and subsequent remedial work is completed within 12 months, that the FCA would reassess /reset OFAR.

- For benchmarking, if a firm disagrees with the amount of OFAR set as part of the exercise, that they can request a SREP.

12. Is the rationale for and explanation of the own funds and liquid assets wind-down trigger sufficiently clear? If not, which areas would benefit from further clarification.

When considered within the overall intervention framework, the rationale and explanation of the own funds and liquid assets wind-down trigger are clear. We understand that the wind-down trigger represents the final step in a process that the firm and the FCA will have been working through to assess the ability of the firm, when in financial distress, to take actions to recover and to allow the firm to continue trading.

The framework focuses on the scenario where there is a gradual decline in the financial position of the firm, while this may be one route to the wind-down trigger, we would like to understand expectations in the event of a short-sharp decline in resources, potentially caused by a single very large event putting pressure on both own funds and liquidity. One such scenario could be a significant operating event occurring immediately after the payment of a distribution of profits, leading to a material interim loss, reducing own funds and a reduction in liquidity resource, both of which may reverse upon the settlement of any claim with the firm's insurers.

The IA understands that a key element of recovery is understanding regulatory expectations of firms/groups around the timeframes within which recovery above the trigger level must be achieved. We suggest the guidance make it clear that direction would be given to a firm at the time of triggering taking into account the situation of the firm at that time.

13. Do you agree with our proposal to use an early warning indicator?

The IA notes that the FCA may wish to specify an indicator different to the 110% of a firm's own funds threshold requirement (MIFIDPRU 7.6.12G) and asks that, should this be the case, the specification be provided to those firms in advance of 1 Jan 2022.

We note that the consultations paper (paragraph 7.79) says the intention that early warning indicator should not be seen as an additional FCA-set Own Funds requirement. However, we believe that in practice it will equate to a grossing up of the Own Funds threshold requirement. The Board members of the majority of firms will naturally consider the point of notifying the FCA as breach of their risk appetite in respect of regulatory risk and will therefore in most cases require an internal early warning indicator to be set higher than the FCA early warning indicator which creates a buffer on a buffer effect.

In our view, the frequency of reporting requirements under MIFIDPRU and the principle 11 obligations are already adequate in providing data that can be used for early warning without creating the need for a prescribed additional buffer. For example, the profitability and own funds position will be reported quarterly via FSA030 and MIF001 respectively and the ICARA questionnaire is required after each review. This should already give all the data

required to monitor the percentage buffer of each investment firm on a quarterly basis. It should then be reasonable to assume that any material updates between these periods would be notifiable under principle 11.

In addition, large firms would typically have early warning indicators (EWIs) and internal risk reporting to allow management to take corrective actions where required. Therefore, we do not believe there is additional value for large firms of imposing early warning indicators with obligation to share with the regulator.

Lastly, the consultation paper in paragraph 7.32 shows consideration of EWIs in stress testing exercises (rather than simply BAU). This is unlikely to be useful, since the scenarios are designed to be severe, and breach the minimum requirement (therefore will naturally breach EWIs).

14. Do you agree with our proposed approach to the ICARA for firms forming part of a group?

The IA is supportive of the proposal to allow group ICARAs consistent with the risk management organisation of the group. However, there are a number of areas where we believe further consideration and guidance is required as set out below.

Group ICARA process
Whether or not a group ICARA is permitted. 7.9.5R and 7.9.7R set out that some criteria relate to FCA directions. When will such directions be provided so that firms can prepare their approach? The IA asks the FCA to note that a significant lead time may be needed by many firms.

MIFIDPRU 7.9.6R states MIFIDPRU investment firms included within a group ICARA process are not required to comply with the requirements of MIFIDPRU 7.4 to MIFIDPRU 7.8 except as specified in MIFIDPRU 7.9.5R. The IA suggests that MIFIDPRU 7.1.3R should be clarified to reflect this in order to avoid confusion and the potential inconsistent application of rules by MIFIDPRU investments in different investment firm groups.

The IA recommends that this is addressed by the table in MIFIDPRU 7.1.3R being amended as follows:

- The column heading “Application to SNI MIFIDPRU investment firms” is replaced with “Application to SNI MIFIDPRU investment firms not included within a group ICARA process”;
- The column heading “Application to non-SNI MIFIDPRU investment firms” is replaced with “Application to non-SNI MIFIDPRU investment firms not included within a group ICARA process”;
- An additional column is inserted re ““Application to SNI MIFIDPRU investment firms that are included within a group ICARA process”; and
- An additional column is inserted re ““Application to non-SNI MIFIDPRU investment firms that are included within a group ICARA process”.

The additional columns would then be populated to show how the application of MIFIDPRU 7.9.5R and 7.9.6R leads to different requirements compared to the existing two columns which cover MIFIDPRU investment firms.

Using MIFIDPRU 7.5 as an example, updating the table in MIFIDPRU 7.1.3R in this way would provide clarity in demonstrating that MIFIDPRU 7.5 applies to MIFIDPRU investment firms that are not included within a group ICARA process but does not apply to MIFIDPRU investment firms which are included within a group ICARA process.

Where an investment firm group undertakes a group ICARA process our understanding is that, taken together, the application of MIFIDPRU 7.9.5R (2), MIFIDPRU 7.9.5R (3), and MIFIDPRU 7.9.6R means that MIFIDPRU investment firms within that investment firm group:

- Would comply with the OFAR where they maintain sufficient own funds and liquid resources to cover their allocation of Own Fund requirements and liquid assets requirements arising from the group ICARA process; and
- Do not need to undertake their own assessment of own funds or liquid assets that are required to cover the identified risks within their own funds.

Based on MIFIDPRU 7.9.5R (3) and MIFIDPRU 7.9.9G (2), where an individual MIFIDPRU investment firm fails to comply with the overall financial adequacy rule on an individual basis this would result in the entire investment firm group being unable to operate a group ICARA process. The IA does not agree with this approach and notes that rendering an investment firm group unable to operate a group ICARA process for this reason is excessive and would result in unduly onerous consequences for the group. In light of this the FCA is asked to consider amending MIFIDPRU 7.9.5R (3) such that an investment firm group may operate a group ICARA process provided that the following conditions are satisfied: "… (3) each MIFIDPRU investment firm covered by the group ICARA process monitors its compliance with the overall financial adequacy rule on an individual basis and observes the notification requirements referred to in MIFIDPRU 7.6.11R;".

MIFIDPRU 7.9.9G (2) states that a group ICARA process must satisfy the requirements in MIFIDPRU 7.9.5R on an ongoing basis and that if any of the conditions specified in MIFIDPRU 7.9.5R for the use of the group ICARA process are not met all MIFIDPRU investment firms covered by that group ICARA process will need to operate individual ICARA processes instead. Where an investment firm group acquires an investment firm, there is likely to be a period of time required for the integration of the new investment firm and that, during this period, this may result in the group ICARA failing to meet the conditions specified in MIFIDPRU 7.9.5R. The IA does not agree with this approach and believes that rendering an investment firm group unable to operate a group ICARA process for this reason is excessive and would result in unduly onerous consequences for the group. In light of this the FCA is asked to consider amending MIFIDPRU 7.9.9G (2) to ensure that the conditions specified in MIFIDPRU 7.9.5R would not be considered to be breached as a result of an investment firm group having acquired a new investment firm that is in the process of being integrated within the group. Failing this, the FCA is asked to consider allowing a group ICARA process to continue to be performed for the existing investment firm group with the newly acquired investment firm treated as a SNI/non-SNI not subject to a group ICARA process as per MIFIDPRU 7.1.3R.

Business model assessment, forecasting and stress testing

It is not clear for firms in a group to what extent they may rely on the strength of the wider group under stress testing. For example, if a firm cannot meet the threshold requirements some time into the future of a stressed environment (i.e., well into a future planning period), do they need to capitalise their balance sheet immediately for any short fall?

Reverse Stress Testing
Reverse stress testing is to be completed by "larger or more complex" firms [7.5.4G(1)(b)] but there is no definition of this qualitative trigger level. We have asked under question 11 that guidance on this be provided however further guidance is required for groups performing a group ICARA. Does the FCA expect a similar definition of large or complex to be applied to the group as a whole, or would the FCA consider all groups to be large and complex, and therefore always expect a group ICARA to include reverse stress testing?

Conversely where reverse stress testing is carried out at group level, the IA proposes that "large or complex" solo firms within a group should be able to rely on the insights provided by a group reverse stress test provided that stress test is relevant for that firm, i.e., separate reverse stress tests are not required.

Wind-down
Where an investment firm group undertakes a group ICARA process our understanding is that, taken together, the application of MIFIDPRU 7.9.5R (4) and MIFIDPRU 7.9.6R means that, whilst MIFIDPRU investment firms within that investment firm group must maintain a separate wind-down plan, it would be appropriate for these MIFIDPRU investment firms to determine the resources required to ensure an orderly wind-down if they were to use their allocation of the costs of winding down the entire investment firm group (such costs being allocated on a reasonable basis and the potential harms from winding down all firms within the investment firm group having been evaluated within this process). The FCA is asked to confirm the above understanding or provide clarity within MIFIDPRU 7.9.5R (4).

On the same point, the IA asks that further clarity be provided on the FCA's expectations for the approach to individual firms within a group in terms of what should be assumed for the rest of the group in a firm's wind-down assessment. For example, in the group assessment the whole group is winding down. Whereas in a solo firm assessment, as examples, clients may be transferred to another firm within the group, or lease termination costs might not be triggered in a large group building. This means that looking across the group, the group wind-down assessment may genuinely be greater than the sum of the individual firms' wind-down components. The IA believes this would be a sensible interpretation as the larger group wind-down cost would contribute to capital requirements at group level rather than trapping capital in the subsidiary entities due to those larger group wind-down costs.

Groups may expect firms to allow for certain management actions of parent entities to support the funding of wind-down including costs at solo firm level. Does the FCA agree with this approach, and if so, would any criteria be imposed?

It is not clear if firms forming part of a group can adopt multiple risk assessment approaches to reflect the risk profile and complexity of each individual legal entity and the group. For example, adopt an advanced bottom-up approach to assessing risk at consolidated group level and a standardized top-down approach at the individual solo entity level. For large firms, the requirement to produce individual legal entity assessments imposes practical challenges with minimal value to improving risk management. This is because the business is set up, run, and managed as a group and individual entity assessments may increase the level of subjectivity in the risk assessment process particularly for risks that are not restricted to individual legal entities e.g. cyber security etc.

The requirements to conduct wind down plans on an individual regulated entity basis would represent a significant change for large firms with multiple entities currently producing a consolidated wind down plan. It is not clear if firms forming part of a group can adopt multiple wind down approaches to reflect the risk profile and complexity of each individual legal entity and the group. For example, adopt a detailed high touch approach to wind down planning at consolidated group level and a top-down light touch approach at the individual solo entity level.

Assessing the adequacy of own funds and liquid assets

For firms where the ICARA is performed at a group level, guidance is required on the FCA's intention for how own funds or liquid assets should be "allocated between individual firms… on a reasonable basis" [7.9.5R (2)] in the context of the need for solo firms in the group to hold own funds and liquid resources on their own balance sheets. Is the intention for the group assessment to be divided between constituent firms, or does the FCA intend that firms may need a higher capitalisation on some type of hypothetical stand-alone basis?

The IA notes there is an unintended consequence of requiring additional own funds to be held at the level of each firm rather than higher up a group structure. Allowing capital and liquidity to be held at the group parent level means that resources can flow to the firm which requires it in a particular stressed event. Allocating additional own funds to each entity instead prevents groups from being able to do this.

This is analogous to the principle of insurance, i.e., the pooling of risk so that the stakeholders have greater protections than if they were by themselves. If all firms in a group hold capital to a certain probability level, then they cannot survive if a larger event occurs unless resources flow from the group. But under the IFPR proposals, groups could not take resources from one firm in the group and give to the other as the ceding firm would then breach OFAR.

For example, each of a number of firms could be capitalised to have < P% chance of harm events they could not survive. Across the group there would however be a >P% chance of this happening to some firm somewhere – the whole group has more exposure than any one firm. Holding the additional own funds at group would enable the whole group to remain below the P% chance of failure, while conversely locking the additional own funds into each firm would prevent this.

The implications are that either a) groups should hold further additional own funds above the sum of their entities', or b) that firms in groups will be less secure than under CRD (as secure as solo firms but no longer benefitting from the risk pooling that members of groups previously benefitted from).

It would be more appropriate (as under IFPRU) to be able to perform ICARA at group level (allowing for diversification between firms within the group), determine the capital requirement contribution from each entity and demonstrate the ability to flow capital around the group as required; but not require the firms within the group to have the capital ring-fenced on their balance sheets.

The IA asks that the FCA consider this and provide further guidance as to their intended outcomes in this regard.

Guidance should be included for the FCA's expectations regarding the role of a subsidiary firm's management body when the group ICARA is owned by a parent's management body.

Consideration is required for the treatment of participations that a group may hold in third party entities they do not control. It does not feel appropriate to consolidate the harms of those entities where there is no obligation upon the holding entity within the consolidation group to provide capital support.

15. Do you have any comments on our proposals for high-level rules on internal governance and controls?

Given the capital and regulatory reporting rules are at the consolidated level, is it the expectation that the governance rules will be at the consolidated level even if the parent itself is unregulated? Ultimately the risk management framework will be driven by the underlying subsidiaries, therefore it would feel more appropriate the internal governance measures lies where the risk sits. The complication becomes however as well if there are regulated subsidiaries within the group that on a solo basis are not in scope for IFD.

The FCA should make clear how the responsibilities of Senior Managers for solo firms within a group performing a group ICARA are expected to be met given the role articulated in 7.9.5 R (7) for the governing body of the investment firm group.

16. Do you agree with our proposals to require certain non-SNI firms to have a risk committee, remuneration committee and nomination committee?

The IA is supportive of the proposal to have additional criteria to determine the requirement for committees for non-SNI firms. It is particularly important for investment firm groups that committees can be established at group level to support the efficient and consistent governance across the investment firm group.

The IA notes that the FCA have responded to feedback, as a result of DP20/2, and have provided a mechanism in the IFPR to allow firms to apply for group committees rather than set-up committees at all/some of the entities within the group. This is important for larger investment firm groups which may have several non-SNIs which meet the criteria for committees. For such firms establishing those committees at the entity level could lead to a fragmented approach to the firm's remuneration and risk management.

We also note the firms in scope at paragraph 8.8 of the CP. Where a group only has one firm in scope, and that is the parent entity, we should be grateful for clarification that the firm would meet the entity-level committee requirements by having an entity-level Remuneration Committee etc., which was also the group committee for other firms within the group. In our view, that application of requirements should be acceptable.

We also query the need for some non-SNIs to have a nomination committee. We believe this should be optional, as in many cases, the board will be able to deal with nominations itself (without the need for a separate committee), given the strategic nature of the decisions and the relative infrequency of decisions.

In terms of application to groups:

- It is not clear whether the additional requirements for certain non-SNI firms apply just to those firms, or all the firms in its prudential consolidation group. In our view, the requirements should only apply on a solo basis to those certain non-SNI firms, and not to consolidation groups. However, firms/groups should have flexibility to apply the additional requirements for all firms in the consolidation group if they so choose.
- Furthermore, it should be possible for such groups to establish a single risk committee, a single remuneration committee and a single nomination committee (if nomination committees will be required) to cover all the entities in the group. This would enable a more efficient allocation of resources (including INEDs) and would also assist in developing a consistent approach to risk and remuneration in the relevant consolidation group.

Whilst we agree with the basic principle that certain non-SNI firms have a risk, remuneration and nomination committee, the requirement that a remuneration committee would need to be established at individual legal entity level will be particularly burdensome for groups with an overseas parent, and more than one regulated entity in the UK. As noted in the CP, groups primarily operate their remuneration policy at group level. Whilst the FCA have indicated that it will be possible to apply for a waiver from this requirement, if it were able to demonstrate that the requirement was "unduly burdensome", we consider that the proposal ought to be amended to allow firms to rely on a global remuneration committee (without the need to make an application).

With regard to existing modifications or waivers (paragraph 8.18), we think that the appropriate approach would be to allow firms who have an existing waiver from the requirement to have any designated remuneration committee to continue to benefit from that waiver. Otherwise the result would be that stricter governance requirements are being applied under the IFPR than those applicable under the CRD rules – this is not a logical outcome in view of the fact that the CRD rules apply to systemically important banks. For example, under the proposed IFPR rules, the chair of a group remuneration committee based abroad could become subject to both local regulatory rules and SMCR. This level of regulation seems excessive.

17. Do you agree with our proposal for firms to apply the new MIFIDPRU Remuneration Code from the start of their next performance year beginning on or after 1 January 2022?

The IA has no specific comments, but the implementation timing seems appropriate.

18. Do you agree that SNI firms should be subject to the 'basic remuneration requirements? If not, please explain why not.

We agree that a proportionate approach is necessary on the basis of the size, internal organisation, nature as well as the scope and complexity of its activities and we consider that the suggested thresholds are appropriate to ensure such proportionality is in place. While it remains important that all firms are equipped to attract competitive talent and

human resources, the different characteristics of firms need to be taken into account and avoid a one-size-fits all approach. Therefore, this is less of a question of a level playing field – given the important differences of the business model – and more about capturing the different levels of ability to impact risk profiles and managerial responsibility; we see that firms of different sizes and complexity are a strong indicator to determining proportionality.

19. Do you agree that only certain non-SNI firms should be required to apply the remuneration rules on deferral, pay-out in instruments and discretionary pension benefits? Do you have any comments on the thresholds we propose?

The IA agrees that specific remuneration requirements need to be justified by the activities and size of business of a firm. In that context and given the need for a proportionate approach, we believe that rules such as deferrals and pay-out in instruments aren't fit or justified for all investment firms and they should apply for firms only above a certain threshold. We agree that the threshold set by the FCA is sufficient to capture all firms and employees with additional risks which would justify the application of these rules.

20. Do you have any comments on our proposed approach to identifying material risk takers?

The IA welcomes the proposals in paragraph 9.59. Based on that we consider that the list in paragraph 9.56 should be considered in combination to the risks such functions and roles have for the assets managed by the firm. It remains important that the identification of MRTs is a risk-based process rather than a tick box exercise on the basis of a function or seniority, but the IA is concerned that the FCA's wording that the "categories of staff are intended to be a starting point only" may create an unlevel playing field as firms take differing approaches to identification of MRTs. Therefore, further examples of how to identify staff would be welcomed.

21. Do you agree with our proposals for exempting certain individuals from the rules on deferral, pay-out in instruments and discretionary pension benefits? Do you have any evidence that may assist us in defining the scope of the exemption?

The proposal at paragraph 9.74 of CP21/7, as reflected in draft rule SYSC19G 5.9R, is that firms may disapply certain of the remuneration requirements in respect of Material Risk Takers whose variable remuneration both (a) does not exceed £167,000 and (b) does not represent more than one-third of their total remuneration.

In our view the requirement in (b) that remuneration must also represent one-third or less of total remuneration, does not reflect the remuneration structures in investment firms, which are varied and do not follow the same model as in the banking sector from which this approach to defining the de minimis threshold is derived. In our view the more appropriate approach would be to define the de minimis threshold simply on the level of

variable remuneration in (a) as above. [Alternatively, if the FCA determines to apply the additional limb based on the proportion of pay which is variable, this proportion should be set at materially higher than one-third.]

22. Do you have any other comments on the proposed scope and application of the remuneration rules?

The IA has no comments.

23. Do you have any comments on the specific remuneration rules which we propose to apply to all FCA investment firms ('basic remuneration requirements')?

We are comfortable with the basic remuneration requirements being proposed to all FCA investment firms as part of a new MIFIDPRU Remuneration Code and welcome the consistency in approach. We also understand and support the requirement to have a balance between financial and non-financial criteria as part of the individual performance assessment process. However, with regards to the proposal at paragraph 10.36, we do not think that requiring some investment firms to be subject to applying an equal split is appropriate. For example, some roles may require more qualitative metrics than others, where it would be more appropriate for the individual firm to determine the allocation of the performance criteria. Therefore, we would recommend the removal of the reference to 'equal split' within paragraph 10.36 and either remove the sentence entirely or amend to reference an 'appropriate balance' between financial and non-financial criteria.

Paragraph 10.33 implies that carried interest should be included as a component of remuneration. We would welcome clarification that the calculation of "value" will follow EBA guidelines for CRD IV. In our view, carried interest is inherently performance based and risk adjusted by virtue of all capital and an amount in profits having to be returned to investors before identified staff may receive any returns. As such, it should be treated as inherently meeting the objectives of the pay-out process rules without needing to be subject to further requirements on deferral and pay-out in instruments where firms are subject to those requirements. This approach is in line with the position taken under the ESMA guidelines on sound remuneration policies under the AIFMD (see paragraph 159 of those guidelines).

In addition, we would welcome clarification that the calculation of "value" for carried interest will follow the EBA guidelines for CRD IV, i.e. *"all payments made by the alternative investment funds to these staff members through carried interest vehicles which are not representing a pro-rata return on the investment made by these staff members should be considered as variable remuneration and be valued at the time of their award."* (Please see paragraph 126(a) of the CRD IV EBA Guidelines). We would also welcome confirmation that the value awards under Long Term Incentive Plans ("LTIPs") will also be calculated by reference to the EBA guidelines.

24. Do you have any comments on the specific remuneration rules we are proposing to apply to all non-SNI firms (‘standard remuneration rules’)?

The IA generally agrees with the “standard remuneration rules”. However, in relation to buy-out awards, we disagree with the principle at paragraph 11.34, which is reflected in draft rule SYSC19G 6.12R(2), that such awards remain “subject to the same malus and/or clawback provisions” as operated by the previous employer.

We acknowledge that reflecting the same deferral and vesting schedule is often appropriate (although the wording would be clearer if it referred to buy-out awards being subject to a deferral and vesting schedule that vests “no faster than” that set by the previous employer, to avoid any suggestion that the new employer is not able to set its own (longer) schedule). However, we do not think a proposal to have to replicate malus/clawback triggers is appropriate given it will mean replicating malus /clawback triggers and provisions that have not been designed with the current employer’s long-term goals / interests in mind.

Instead, we propose that, as with CRD V firms: (i) a firm should apply (to buy-out awards) deferral, malus and clawback arrangements that align with its long term interests, rather than replicating those of the previous employer (see SYSC 19D 3.45R); but, (ii) the duration of the vesting and malus/clawback periods should not be shorter than what remained outstanding on the periods applied by the previous employer (see rule 15A.3(2) of the Remuneration Part of the PRA Rulebook).

As a further point, we note the draft rule in SYSC 19G.3.4R and 19G.3.5G which would require a non-SNI investment firm to ensure that the implementation of its remuneration policy is, at least annually, subject to central and independent internal review by staff engaged in control functions, and that this should be conducted by the internal audit function, where one exists.

The operation of internal audit functions will differ widely across firms, with some firms operating in-house internal audit functions, but others outsourcing the function to professional internal or financial auditors. Given the high degree of independent assurance provided by the latter arrangement, when compared to a fully in-house function, it would be appreciated if the FCA could clarify the acceptability of such independent reviews being undertaken both by independent internal auditors and by financial auditors.

The proposals in paragraph11.8 Performance assessment on a multi-year period do not align with how the industry generally pay bonuses, i.e. annually, and multi-year measurement is not appropriate/ available for some MRT roles (e.g. HR Director, COO). Where multi-year performance is less appropriate and the risks relevant to the role (e.g. operational and reputational risk) can be assessed on an annual basis, is one year performance measurement considered acceptable? Where deferral applies, this will be over a period of time in which malus can be applied. Would this not be sufficient to satisfy the “variable remuneration is spread over an appropriate period” point? Overall, we consider that sufficient flexibility is necessary as to how the multi-year performance assessment is implemented by each firm and for different roles.

25. Do you agree with our proposal to extend the existing non-Handbook guidance on ex post risk adjustment to FCA investment firms?

We welcome the clarification set out in paragraphs 11.13 – 11.16.

26. Do you agree with our proposals for rules on paying out variable remuneration in shares, other instruments or using alternative arrangements?

FCA CP21/7, paragraph 12.18 states that "since the firm remains the legal owner of any deferred shares or instrument until the remuneration vests, any interest and dividends paid on the shares or instrument during the deferral period are received and owned by the firm. They must not be paid to the MRT either during or after the deferral period."

The IA does not agree that the restriction on interests and dividends is appropriate, especially in the context of a deferral into interest and/or dividend generating funds into which the MRTs pay is deferred. In this case there could be a potential misalignment of interests with the client. The IA proposes that it is fair and reasonable for interest and dividends on deferred compensation to be paid to MRTs after the deferral period. Please also see further reasoning on this point in the response to question 27 below.

The IA understands the original purpose of this rule is to avoid variable pay being 'enhanced' to the extent it may exceed the CRD bonus cap or fixed/variable ratios and recognises this concern but believes that an alternative mechanism that does not undermine the alignment of MRT and client interests would be preferable. A solution may be for the ratio to be inclusive of dividend/interest payments such that rolled up payments at vesting may be capped or for variable pay, for the purposes of the ratio, to include the value of prior years' vested dividends/interest. The FCA is aware that many banks have enhanced the value of their initial deferred instrument awards by the expected dividend value for the duration of the deferral, aiming to re-align the experience of MRTs to shareholders. However, for firms that cut dividend payments in 2020, an unintended consequence is that MRTs will receive more favourable treatment than shareholders/clients."

Clarity is sought on the position regarding incremental value that accrues to accumulation units used as deferred instruments. If such incremental value is considered to be equivalent to dividend/interest, it may not be practicable to use such units as a deferred instrument, resulting in a further detachment of alignment between the interests of MRTs and the client.

Under the draft MIFIDPRU Remuneration Code (16G.6.18), the regulation states that 50% of the variable remuneration paid to a material risk taker will need to consist of certain instruments. Specifically, 19.G.6.18 R(4) refers to "non-cash instruments which reflect the instruments of the portfolios managed". We suggest the words "non-cash" can lead to confusion in the application of the rules. For example, for operational and administrative reasons (i.e., in some jurisdictions outside the UK, it may not be possible to have these individuals registered as owners of the funds due to local regulatory constraints or without incurring significant costs), it is possible that some firms may grant employees notional

units, which track the performance of the instruments of the portfolios managed during the relevant vesting and the post-vesting retention period. The value of these units would go up/down in line with the price of units in the underlying portfolio and the value at the end of the post-vesting retention period is then used to settle the awards in cash. Such units (settled in cash at the end of the post-vesting retention period) achieve the purpose of aligning the interest of the employees with the performance of the underlying portfolio. This is accepted practice under the existing remuneration regimes, so if possible, the wording could be updated to avoid the term “non-cash” to make it clearer.

We understand 19.G.6.18 R(4) is seeking to capture these situations, but the words “non-cash” can inadvertently lead to an interpretation that such instruments cannot be used as employees receive cash, albeit based on the value of the units in the underlying portfolio. We would appreciate clarity or additional guidance that such notional units which track the performance of units in the underlying portfolio but ultimately settled in cash can be used.

27. Do you have any comments on our proposals on deferral, vesting and retention?

Paragraph 12.15 implies that members of the senior management body or senior management be subject to a deferral period of longer than 3 years. We are of the opinion that the application of the requirement of a deferral period of longer than 3 years should be restricted to the senior management body (which we understand as Board members). These are the risk takers managing the overall risk profile of the business and accountable for agreeing for determining the strategic direction of the firm.

It is our opinion that other senior management (below Board) should be subject to a deferral period of at least 3 years with firms given flexibility to extend as appropriate for the risk profile. There is otherwise a risk that the extended time period diminishes the value of upfront awards and will create additional pressure for fixed and variable pay, thereby creating pressure to increase the overall quantum to compete for talent (especially senior, non-industry specific support roles such as Finance, Risk and Compliance, and HR that can move to non-regulated industries).

Paragraph 12.18 implies that institutions should not pay any interest or dividend on instruments which have been awarded as variable remuneration under deferral/incentive arrangements to staff. We would welcome further clarification on the rationale for disallowing dividends on instruments because, as mentioned in our response to question 26, we do not agree that this restriction is appropriate. This is because, in addition to resulting in a potential misalignment of interests with the client (please see our response at question 26 above), it is also not compatible with the general aim of remuneration policies to align the interests of employees and shareholders as closely as possible, thereby supporting a “stewardship and ownership” culture, in particular for senior management. Longer term incentive plans are designed to reward employees against longer term business objectives and “value” for the shareholder. By not allowing employees to participate alongside shareholders in their “success” in real time, it erodes the link between the employee and the shareholder and reduces the economic value of a deferred instrument such as a share plan as an incentive/retention plan. This may have the unintended consequence of driving up the quantum of remuneration.

Dividends are only paid to the extent considered appropriate and their quantum is subject to express approval of the full Board (including non-executive Directors) and subject to an independent third-party audit. Not allowing employees to participate does not seem to have any positive behavioural consequences. Any potentially negative behavioural consequences of paying dividends are effectively risk managed through existing controls as set out above.

28. Do you have any feedback on our reporting proposals? Please particularly provide details of any areas where you consider additional guidance on how to complete them is needed.

We note that some investment firms of banking groups will have to produce similar reporting twice, as they will be required to produce a High Earners and Benchmarking report for their banking group, as well as the MIF008 report for their investment firm. We would like to request the flexibility for investment firms of banking groups to only submit a High Earners and Benchmarking report in order to reduce operational complexity.

We note that any public or investor disclosure in relation to remuneration is not covered in CP21/7. However, when it is addressed, in our view it would be appropriate for the FCA not to include in any public or investor disclosures a requirement to publicly disclose any ratios set in relation to fixed and variable pay. This is because such disclosure could impact on the ability of firms to attract/retain talent where disclosed ratios (set to support the business plan and risk profile) may differ significantly between competitors. Disclosure may also, over time, have a counter-intuitive impact of driving ratios up as firms compete for talent.

The IA also proposes that the information collected via MIF008 is submitted to the FCA but not published in any public aggregated report. Such information may often be commercially sensitive and, on an individual level, particularly where firms have a low number of MRTs, could infringe MRTs' right to privacy with respect to their pay levels. Further, to the extent that any such remuneration disclosures require disclosure of the total amounts of fixed and variable remuneration actually paid to material risk takers, requiring a separate disclosure of any set ratios of fixed to variable remuneration seems superfluous and not to provide meaningful additional information.

For MIF004 Non-K-CON concentration risk reporting, the IA requests that the FCA advises that connected counterparties should be grouped together, and the LEI reported for the connected parties should reflect the LEI of the parent of those connected counterparties where this is available.

Given the nature of concentration risk can vary significantly the IA believes that it would be helpful to allow for firms to address material risks only in reporting on form MIF004. For example, where there is no significant concentration of client revenue, firms should be able to indicate that amounts are immaterial in relation to concentration risk.

The MIF004 template also requires firms to report concentration risk for custody assets where these relate to MiFID investment business of the firm. It will be useful to understand if the unregulated parent of a group with a mix of MiFID and non-MiFID firms, while reporting on a consolidated basis, is required to calculate K-ASA and report concentration risk merely due to the custody business being run by a non-MiFID firm which is an FCA regulated firm acting as a depository of alternative investment fund.

Additional guidance on MIF003 template is required for T, T-1 and T-2 months. Do firms need to report AUM/ CMH/ ASA at the end of respective months in the reporting quarter or historic averages of AUM/ CMH/ ASA calculated in accordance with MIFIDPRU rules for each month in the quarter? The European templates have been designed to calculate the rolling average of respective K-factors at T, T-1 and T-2 months. We would like to understand if this is a known difference between EU and UK reporting templates.

For first quarterly reporting period ending 31 March 2022, should the firms calculate K-COH on 01 March 2022 (1st day of month) by including clients orders handled from 01 September 2021 to 28 February 2022 (6 months) and exclude 01 December 2021 to 28 February 2022 (latest 3 months). Thereby, taking daily client orders from 1 Sep 2021 to 30 Nov 2021 converted in functional currency [at the end of day spot rates or month end spot rates -to be advised by the FCA] and dividing by number of days in the 3 months. Some examples showing calculation of K-factors and completion of MIF003 will be useful for the firms.

Under paragraph 13.21 we would welcome confirmation that the disclosure of the top 3 earners will be limited to remuneration and will not require them to be named and made visible to competitors.

29. Do you agree with our proposals for consequential changes to our other prudential sourcebooks? If not, please identify which specific provisions you believe are not consequential changes that are needed.

The IA has no comments.

30. Do you agree with our proposal for a three-year transitional provision (set out in MIPRU TP 2) to give former exempt-CAD firms time to comply with any new requirements in MIPRU 3.2? If not, what alternative proposal would you suggest?

The IA has no comments.

31. Have you identified any specific cross-references that we may have missed where a consequential amendment could be needed to ensure the relevant provision still operates once IFPR is implemented? If so, please provide details.

The IA has no comments.

32. Do you have any feedback on the applications and notifications forms covered in this chapter, including our proposals for any

supporting information or documentation? Please indicate the specific form or forms your feedback relates to.

The IA has no comments.

33. If you think you might want to apply for any of the permissions that need to be determined before 1 January 2022, please indicate which ones.

The IA has no comments.

34. Do you agree it is fair and appropriate that we charge fees for the applications in certain circumstances where we have deemed it justifiable to do so? Please suggest what you believe would be an appropriate charge for the applications we have listed in section 11.19. Please indicate which permissions from that list you might be applying for.

The IA has no comments.

35. Do you agree with our proposed approach to publishing MIFIDPRU permissions on the FS Register?

The IA agrees with this proposal.