A new UK prudential regime for MiFID investment firms

Consultation Paper
CP20/24***

December 2020

How to respond

We are asking for comments on this Consultation Paper (CP) by **5 February 2021**.

You can send them to us using the form on our website at: www.fca.org.uk/cp20-24-response-form

Or in writing to:
Paul Rich/Hillary Neale
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Telephone:
020 7066 1000

Email:
cp20-24@fca.org.uk

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1 Summary

Why we are consulting

1.1 We are seeking views on the first tranche of our proposed rules to introduce the UK Investment Firm Prudential Regime (IFPR), a new prudential regime for UK firms authorised under the Markets in Financial Instruments Directive (MiFID). This is the first in a programme of Consultation Papers (CPs) and Policy Statements (PSs) that we will issue to introduce the regime, subject to progress and amendments to the Financial Services Bill (FS Bill), on 1 January 2022.

1.2 The new regime will streamline and simplify the prudential requirements for solo-regulated investment firms in the UK (FCA investment firms). In line with FCA objectives and our Mission, it will refocus prudential requirements and expectations away from risks the firm faces, to also consider and look to mitigate the potential for harm the firm can pose to consumers and markets.

1.3 The new regime represents a major change for FCA investment firms. It is critical that firms adequately prepare for the regime. We are keen to receive feedback from stakeholders through this and later consultations. Your feedback will allow us to draft final rules that achieve our and Parliamentary objectives for the regime, but that are also workable for FCA investment firms.

Who this applies to

1.4 The draft rules will apply to:

- any MIFID investment firm authorised and regulated by the FCA that is currently subject to any part of the Capital Requirements Directive (CRD) and the Capital Requirements Regulation (CRR) including:
  - investment firms that are currently subject to BIPRU and GENPRU
  - 'full scope', 'limited activity' and 'limited licence' investment firms currently subject to IFPRU and CRR
  - 'local' investment firms
  - matched principal dealers
  - specialist commodities derivatives investment firms that benefit from the current exemptions on capital requirements and large exposures including:
    - oil market participants (OMPs)
    - energy market participants (EMPs)
  - 'exempt-CAD' firms
  - investment firms that would be exempt from MiFID under Article 3 but have 'opted-in' to MiFID
- regulated and unregulated holding companies of groups that contain an investment firm authorised and regulated by the FCA and that is currently authorised under MiFID and/or a Collective Portfolio Management Investment (CPMI)

1.5 We will explain how our draft rules will apply to CPMI firms in a subsequent consultation, but these firms may wish to provide feedback on our proposals in this Consultation Paper (CP) to help inform our future work in this area.

1.6 Our proposals on capital requirements for the activities of trading firms may also be of broader interest to exchanges, central counterparties and clearing members. We would welcome feedback from these entities.

1.7 Prudential Regulation Authority (PRA) designated investment firms may also be impacted and so we also welcome comments on our proposals from these firms.

The wider context of this consultation

1.8 This CP follows the Discussion Paper 'DP20/2: Prudential Requirements for MIFID Investment Firms' we issued in June 2020. That set out our initial views on introducing the IFPR, as well as technical details on the European Union's (EU) Investment Firm Directive (IFD) and the Investment Firm Regulation (IFR). It requested feedback to support our development of a UK version of the EU's proposed regime. We have taken this feedback into account when developing this, and subsequent consultations.

1.9 The EU IFD and IFR came into force on 26 December 2019 and will enter into effect on 26 June 2021. When the UK was a member of the EU, we strongly advocated introducing such a regime, and we were heavily involved in policy discussions on creating the regime that took place through the EU and European Banking Authority (EBA) papers and consultations.

1.10 We support the aims of the IFD/IFR. We propose that the IFPR will achieve the same overall outcomes. We believe that this is consistent with our statutory objectives and our Mission. However, as we are introducing the regime after the UK has exited the EU, we believe it is right that we also consider what amendments are appropriate to account for the specifics of the UK market, and our duties to have regard to certain factors, including those set out in the Government's recently introduced FS Bill. We explain in more detail how we approach the new duties in the FS Bill in Chapter 9 of this CP.

1.11 This CP is the first in a series of consultations on the IFPR. We plan to publish two further consultations in 2021. After each one, we will produce a PS and near-final rules.

1.12 As set out in the consultation map (see Table 1), our approach is to stagger the topics on which we consult. We are consulting earlier on those topics that we think investment firms require the most time to prepare for. This approach has the benefit of allowing firms to absorb and respond to our proposals in a more manageable way.

*Table 1: Our consulatation map**

CP1 – December 2020	CP2 – start Q2 2021	CP3 – start Q3 2021
MIFIDPRU1: Application (aspects of)	MIFIDPRU1: Application (remainder)	MIFIDPRU8 – Disclosure & ESG
MIFIDPRU2: Prudential consolidation and the group capital test	MIFIDPRU4 – Own funds requirements (remainder)	OTHER – Consequential amendments to Handbook and CRR technical standards
MIFIDPRU3 – Own funds resources	MIFIDPRU6 – Liquidity	OTHER – Approach to existing BRRD and FICOD provisions
MIFIDPRU4 – Own funds requirements (aspects of)	MIFIDPRU7 – Risk Mngt & Governance, ICARA and SREP	OTHER – Final overall application provisions
MIFIDPRU5 – Concentration risk	MIFIDPRU9 – Regulatory reporting (remainder)	
MIFIDPRU9 – Regulatory reporting (aspects of)	OTHER – Remuneration requirements	
	OTHER – Interaction between MIFIDPRU and other prudential sourcebooks	
	OTHER – Permissions and application forms	

* Please note that this is a provisional plan and subject to change based on feedback received to this CP, progress of the FS Bill, and other factors.

1.13 By the time we publish our second PS next summer, we intend that stakeholders will have seen near-final rules setting out the key points of the new regime. We intend for the third consultation and the subsequent PS to address final points of the regime, consequential amendments to the Handbook, and any gaps or issues identified through our consultation process.

1.14 A consequence of this approach is that in this and the next consultation, our cost-benefit analysis (CBA) and our approach to our new accountability measures as set out in the FS Bill will only cover the draft rules we are publishing in that consultation. We intend in the third consultation to present our view on the impact of our rules and the basis on which we have drafted them over all three consultations.

Equality and diversity considerations

1.15 We have considered the equality and diversity issues that may arise from the proposals in this CP.

1.16 Overall, we do not consider that the proposals have a differential impact on any group sharing one of the characteristics protected under the Equality Act 2010. But we will continue to consider the equality and diversity implications of the proposals during the consultation period, and will revisit them when making the final rules.

1.17 In the meantime, we welcome your feedback to this CP.

What we want to change

1.18 There are approximately 3,200 FCA investment firms in the UK. Many people will have products with investment firms, ranging from workplace or personal pensions and investment ISAs to those who use a platform to trade stocks themselves or who use spreadbetters. This means it is important that FCA investment firms minimise the harm they could cause for consumers. This could be directly, such as a portfolio manager incorrectly carrying out its mandate, or a platform being unavailable for customers to manage their stocks. Or it could be indirectly, such as a proprietary trader who makes an error with a trade and affects market prices or liquidity.

1.19 The current prudential regime for FCA investment firms is based on requirements designed for globally active systemically important banks. The main aim of this regime is to protect depositors by ensuring that it is difficult for a bank to fail. Investment firms do not have depositors that need to be protected. This means that the current requirements are not designed to address the potential harm posed by FCA investment firms, to their clients and the markets in which they operate.

1.20 By contrast, the IFPR considers the harm an FCA investment firm can cause to others based on the activities that the firm carries out. It also considers the amount of capital and liquid assets the FCA investment firm should hold so that if it does have to wind down, it can do so in an orderly manner.

1.21 Introducing the IFPR means that there will be a single prudential regime for all FCA investment firms, simplifying the current approach. It should reduce barriers to entry and allow for better competition between investment firms. Some FCA investment firms will have meaningful capital and liquidity requirements for the first time, commensurate with the potential harm they can cause.

Specific changes to the existing prudential regime for FCA investment firms

Categorisation of investment firms

1.22 We are proposing that all the current definitions of FCA investment firms, such as BIPRU, IFPRU, exempt-CAD, will cease to exist. There will instead be two broad categories of FCA investment firm. Firms will either be a 'small and non-interconnected' (SNI) investment firm, or they will not. The prudential requirements in the IFPR are designed to scale with the size and complexity of the firm.

1.23 More detail is provided in Chapter 2 of this CP.

Prudential consolidation

1.24 We are proposing that prudential consolidation will apply to investment firm groups, except if the FCA has granted permission to a group to use the alternative of the group capital test. How requirements should be calculated on a consolidated basis will differ from the current regime.

1.25 We are proposing to introduce a group capital test for FCA investment firm groups that do not wish to be subject to prudential consolidation and meet certain specified conditions. This is to ensure that parent entities hold appropriate amounts of capital to support their investments in subsidiaries.

1.26 More detail is provided in Chapter 3 of this CP.

Own funds

1.27 We are proposing that the own funds of FCA investment firms should be made up solely of common equity tier 1 capital, additional tier 1 capital and tier 2 capital. We believe that using this higher quality of capital for all FCA investment firms will lead to them being more resilient and having an increased capacity to absorb losses.

1.28 More detail is provided in Chapter 4 of this CP.

Own funds requirements

1.29 We are proposing to introduce a new permanent minimum requirement as one of the floors below which its own funds must not fall. This will be based on the activities that an FCA investment firm undertakes. We are also proposing to increase the initial capital that required for a firm to become authorised as an FCA investment firm. This will be to the same level and quality of capital as for its ongoing permanent minimum requirement once authorised.

1.30 We are proposing to introduce a new approach to calculating capital requirements – 'K-factors'. This is a capital calculation based on the activities that an FCA investment firm undertakes. In this CP, we are providing more information on the K-factors that will only apply to FCA investment firms with permission to deal in investments as principal. We are setting out our rules for these K-factors first as they are generally the more complex to calculate.

1.31 More detail is provided in Chapter 5 of this CP.

1.32 Chapter 6 sets out the transitional provisions we are proposing to put in place to allow FCA investment firms time to move towards their new own funds requirements.

Concentration risk monitoring and related own funds requirements

1.33 We are proposing new monitoring requirements for general concentration risk that will apply to all FCA investment firms. This includes the entities with which FCA investment firms place their client assets and their own cash. Non-SNI firms will also be required to report on this general concentration risk.

1.34 For FCA investment firms that trade in their own name we are introducing K-CON. This is an additional K-factor for assessing concentration risk that could lead to an increased own funds requirement.

1.35 We also set out rules on maximum levels of concentration risk permitted for trading book exposures.

1.36 See Chapter 7 of this CP for more detail.

Reporting requirements

1.37 Through the IFPR, FCA investment firms will be required to assess and hold financial resources against the potential for harm that they present to markets and consumers. We will need different information from FCA investment firms to support this, and we are proposing an appropriate and proportionate data collection to capture this information. We are also intending to remove reporting requirements that are no longer necessary or appropriate.

1.38 The reporting on remuneration requirements will be included in our second consultation, along with our proposals for the new remuneration regime.

1.39 See Chapter 8 of this CP for more detail.

Currency

1.40 Respondents to DP20/2 asked us to provide clarity on the functional currency of various requirements now covered by this CP. For all the changes proposed above which have fixed amounts, we use the absolute amounts used in the IFR but in Sterling.

Outcome we are seeking

1.41 The three consultations we plan to publish will each address different topics in the proposed regime. Across the consultations, the outcomes we are seeking are as follows:

- The prudential regime for FCA investment firms is more aligned to the way that investment firms run their business. The regime will take account of the different business models of FCA investment firms, and better protect consumers and markets from the harm these may pose.
- All FCA investment firms are subject to meaningful and consistent prudential requirements, not just those subject to the current CRR regime. This will help reduce the potential harm to consumers and markets, and ensure a more level playing field between FCA investment firms.
- FCA investment firms spend less time on complex capital requirement calculations that do little to help them to manage risk. This will free up management time to focus on running the business and managing and mitigating any harm and risk. The FCA will also be able to focus on how a firm is managing itself.
- The relevant prudential rules for FCA investment firms are understandable and accessible, with most rules brought into a new single prudential sourcebook (MIFIDPRU).

Next steps

1.42 We want your feedback on our proposed rules and other issues discussed in this CP. Please send your answers to the questions in this CP by Friday 5 February 2021 using one of the methods in the 'How to respond' section on page 2. We are particularly interested in any suggestions for making the IFPR work better for different business models.

1.43 We plan to publish two further consultations in 2021, as set out in Table 1 above. Following each consultation, we will consider your feedback, and publish a PS and near final rules. The final rules will be published once the FS Bill has passed through Parliament and all the consultations are complete.

2 Categorisation of investment firms

2.1 In this chapter, we set out the criteria that we are proposing an FCA investment firm needs to meet to be treated as an SNI. FCA investment firms that meet these criteria will be able to use additional proportionality in the IFPR. We also cover procedures for transitioning between the SNI and non-SNI categories.

2.2 The proposed rules are in MIFIDPRU 1.

Small and non-interconnected FCA investment firms (SNIs)

2.3 The IFPR already contains some proportionality as the prudential requirements scale with the size and complexity of the firm. However, in line with our regulatory principles, we also believe that the smallest and least complex FCA investment firms should be provided additional proportionality. This additional proportionality is not just related to the calculation of prudential requirements, but also applies to other areas of the IFPR such as disclosure and remuneration. Further details on the differences in requirements will be included in the relevant chapters of this and subsequent consultations.

2.4 To qualify as an SNI, an FCA investment firm:

- must not carry out activities that have the greatest potential to cause harm to its customers or to the markets in which it operates, and
- must not carry out any activities on such a scale that would cause significant harm to customers or to the markets in which it operates

Activities with the potential to cause particular harm to traded markets

2.5 We consider that an FCA investment firm that has permission to deal on its own account, whether for itself or on behalf of clients, has the potential to cause particular harm to traded markets. We proposed that these firms cannot be considered an SNI. We believe that, for this activity, using permissions is the simplest way of making the distinction.

2.6 This will include FCA investment firms that are currently able to take advantage of the matched principal exemption and organised trading facility (OTFs) that are not restricted from conducting the activities set out in MAR 5A.3.5R (dealing on own account and matched principal trading).

2.7 Operational failure by these FCA investment firms can cause harm to markets. Such failures can also affect the firm's own balance sheet and, potentially, its viability, if miscalculations are large enough.

Scale of activities

2.8 The larger the FCA investment firm, the greater the potential harm that any operational failure will have and the larger the number of customers that could be adversely affected.

2.9 To take account of the scale of activities the FCA investment firm carries out, we are proposing quantitative thresholds. This will prevent those FCA investment firms with potential to cause greater harm from being able to take advantage of the less onerous requirements. We are also proposing balance sheet and revenue thresholds to account for firms that do not exceed the other thresholds but, due to the overall combination of activities, have the potential to cause consumer detriment if they had to wind down.

2.10 **Table 2** shows the quantitative thresholds that we are proposing an FCA investment firm must be below to be considered an SNI.

Table 2: Quantitative criteria for being an SNI

Measure*	Threshold
Assets under management	< £1.2 billion
Client orders handled – cash trades	< £100 million per day
Client orders handled – derivative trades	< £1 billion per day
Assets safeguarded and administered	zero
Client money held	zero
On- and off-balance sheet total	< £100 million
Total annual gross revenue from investment services and activities	< £30 million

* These thresholds, with the exception of the on- and off-balance sheet total, only relate to the MiFID activities the firm undertakes. A firm may manage assets without undertaking portfolio management or ongoing investment advice under MiFID, or hold client money or client assets in relation to non-MiFID activities. These should be excluded from the threshold measurement.

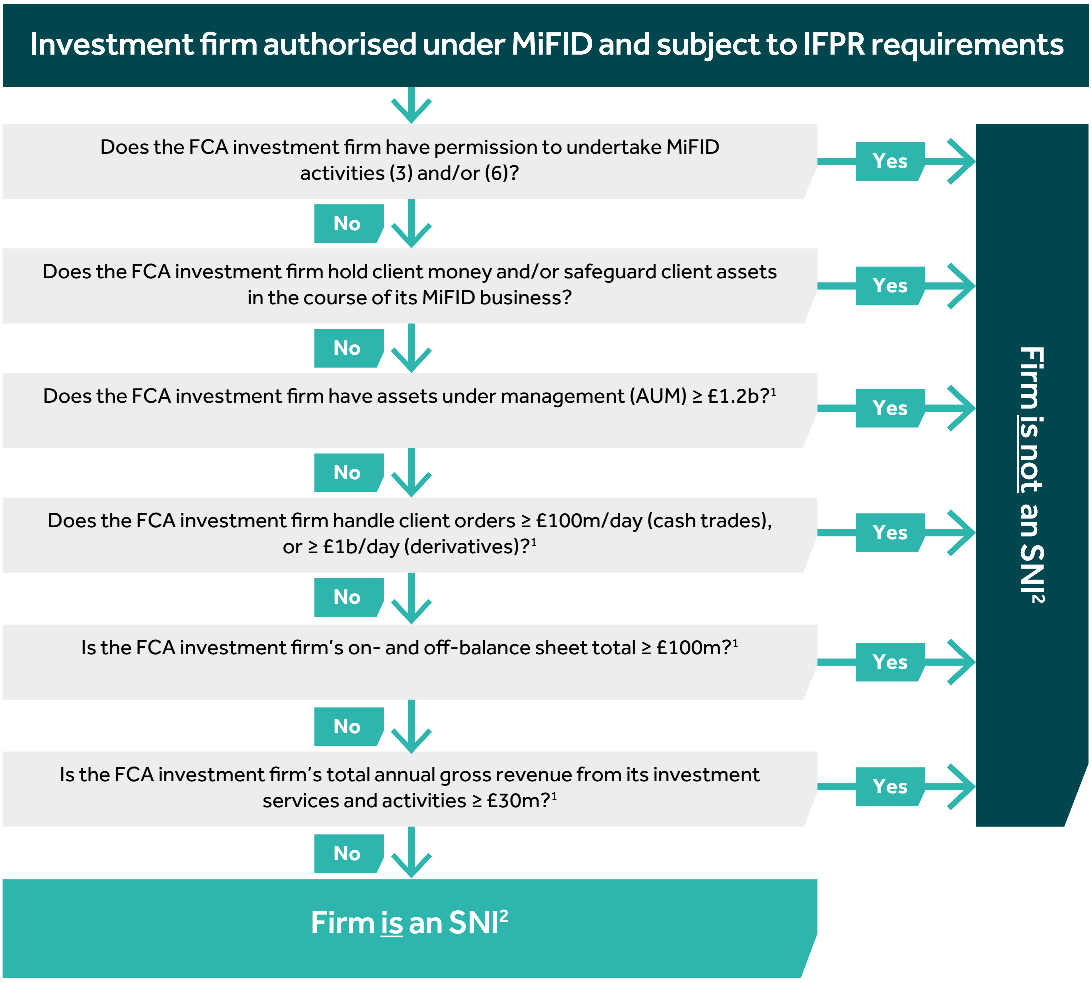
2.11 These thresholds are in addition to the requirement that the FCA investment firm must not be permitted to deal on own account and (with the exception of the client money and client assets thresholds) should be assessed on a group basis, taking account of the MiFID activities of the following types of firm:

- FCA investment firms
- designated investment firms
- collective portfolio management investment firms
- third-country investment firms, but only for the investment services and activities they carry on in the UK

Gross revenues that are generated within the group may be excluded where this would lead to double counting.

2.12 **Figure 1** shows how an individual FCA investment firm can determine if it is an SNI.

Figure 1: SNI or non-SNI investment firm



[1] These metrics are assessed on a combined/group basis.

[2] Small and non-interconnected FCA investment firm.

Our proposal for transition from non-SNI to SNI FCA investment firm

2.13 A non-SNI FCA investment firm can become an SNI FCA investment firm if it:

- meets all the requirements for being an SNI FCA investment firm, and
- continues to meet all the requirements for being an SNI FCA investment firm for a continuous 6-month period, and
- has notified us that it has met all the conditions for being an SNI FCA investment firm for a continuous 6-month period

The more proportionate remuneration, governance and risk management requirements will apply once all the above criteria have been met.

Our proposal for transition from SNI to non-SNI FCA investment firm

2.14 A firm will no longer be an SNI FCA investment firm 3 months after the date on which the relevant threshold was first exceeded if it no longer meets the:

- assets under management threshold, or
- either or both of the client orders handled threshold, or
- the on- and off-balance sheet threshold, or
- the total annual gross revenue threshold

2.15 An SNI FCA investment firm that no longer meets any of the other criteria for being an SNI FCA investment firm will immediately become a non-SNI FCA investment firm. An FCA investment firm must notify us immediately if it no longer meets any of the SNI thresholds.

2.16 If an SNI FCA investment firm no longer meets the SNI thresholds (ie, it becomes a non-SNI firm), it must comply with the remuneration, governance and risk management provisions in full within 12 months. We will be consulting on which remuneration, governance and risk management provisions will be dis-applied for SNI FCA investment firms.

Q1: **Do you agree that FCA investment firms with permission to deal on own account and/or underwrite or place financial instruments on a firm commitment basis (as indicated by a permission to deal as principal in financial instruments) should not be considered an SNI? If not, please include in your response what you consider to be a suitable quantitative threshold for these activities.**

Q2: **Do you agree with the quantitative thresholds, as set out in Figure 1, that we are proposing? If not, please include in your response what you consider to be suitable quantitative thresholds.**

Q3: **Do you think that any other criteria should be considered for determining if an FCA investment firm can be an SNI? Please provide examples and thresholds as appropriate.**

3 Prudential consolidation and the group capital test

3.1 In this chapter, we cover our proposed prudential requirements for FCA investment firm groups.

3.2 For prudential consolidation, this section explains:

- the scope of application of prudential consolidation for FCA investment firms
- how prudential consolidation interacts under the IFPR and the UK CRR
- what the consolidated situation means
- how we treat tied agents included in the consolidated situation
- the main obligations for prudential consolidation
- methods of consolidation
- proportional consolidation of participations
- the UK parent as an SNI or non-SNI when applying prudential consolidation
- consolidated own funds and consolidated own funds requirements
- how to apply:
  - the consolidated fixed overheads requirement
  - the consolidated permanent minimum capital requirement
  - the consolidated K-factor requirement
- consolidated liquidity requirements
- other requirements that apply on a consolidated basis

3.3 For the group capital test, this section explains:

- how the group capital test is applied
- what an application for permission to use the group capital test should contain
- a transitional arrangement for the temporary use of the group capital test

3.4 Other requirements apply to investment holding companies, mixed financial holding companies and mixed activity holding companies.

3.5 The proposed rules for all these requirements are in MIFIDPRU 2.

Scope of application of prudential consolidation

3.6 Under our proposed rules, prudential consolidation will apply where there is an investment firm group, except where the FCA has granted permission to that group to use the alternative of the group capital test.

3.7 An FCA investment firm group will comprise a UK parent undertaking and its relevant subsidiaries, where at least one entity is an FCA investment firm. The FCA investment firm may be the parent or a subsidiary entity. An investment holding company or a mixed financial holding company may also be the UK parent.

3.8 In the form in which it was introduced to Parliament, the FS Bill would give the FCA the power to make rules which apply directly to unregulated parent undertakings which are either incorporated in the UK or have a place of business in the UK. For the purposes of our rules on prudential consolidation, we consider that it is necessary to include a parent undertaking only where it is:

- incorporated in the UK, or
- has its registered office (or if it has no registered office, its head office) in the UK

3.9 This will ensure that parent undertakings structured as bodies corporate, partnerships or unincorporated associations are included in the scope of consolidation where they have sufficient territorial connection to the UK.

3.10 The general definition of an FCA investment firm group also includes connected undertakings that are not subsidiaries. If one of the subsidiaries or connected undertakings is a UK credit institution then the group will not be an FCA investment firm group.

3.11 A relevant subsidiary and a connected undertaking is any of the following:

- an investment firm
- a financial institution
- an ancillary services undertaking
- a tied agent

3.12 The responsibility for complying with prudential consolidation (or the group capital test) will rest with the parent entity, whether or not it is an authorised firm.

The types of relationship which may result in an entity being in scope

3.13 The following sections outline our proposals for where an entity should be considered a subsidiary or a connected undertaking.

Subsidiary

3.14 A subsidiary undertaking is defined in section 1162 of the Companies Act 2006. This includes:

- where one entity holds a majority of voting rights in another entity
- where one entity is a shareholder of the other entity and can appoint or remove a majority of its board of directors
- an entity over which another entity has the power to exercise, or exercises, dominant influence or control
- where two entities are managed on a unified basis

3.15 The definition of a subsidiary includes subsidiaries of subsidiaries.

Connected undertaking

3.16 To explain this, consider two entities. An entity (CU) will be a connected undertaking of another entity (P1) and P1 will be a parent undertaking, where any of the following relationships apply:

- P1 and CU share majority common management

- P1 exercises significant influence over CU (without participation or capital ties). Indicators of this may be:
  - the ability to make appointments to the management body
  - being part of the policy-making process of CU, including on distributions
  - material transactions between P1 and CU
  - exchange of management between P1 and CU
  - having rights that could affect the management of decision-making of CU
  - having instruments that when converted increase P1's voting power or decrease another party's voting power over CU
- P1 and CU have been placed under single management (other than for a contract, clauses in memoranda or articles of association). The following are indicators that this may exist:
  - P1 and CU are controlled by:
    - the same natural person
    - the same group of natural persons
    - an entity or the same group of entities that do not otherwise belong to the FCA investment firm group
    - an entity or group of entities that are not established in the UK
  - The majority of the management bodies of P1 and CU have been appointed by the same natural person or the same group of natural persons, even if the same people are not appointed to each management body
- P1 holds a participation in CU. The following are indicators of this:
  - P1 has direct or indirect ownership of 20% or more of the voting rights in CU
  - P1 has rights in the capital of CU which create a durable link that is intended to contribute to the activities of CU
- CU is a subsidiary of a different parent undertaking (P2) and:
  - P2 and P1 share majority common management, or
  - P2 and P1 have been placed under single management (other than for a contract, clauses in memoranda or articles of association)

3.17 If there is an FCA investment firm group, all other relevant financial undertakings need to be identified that may form part of the group. These may be subsidiaries or connected undertakings.

How prudential consolidation interacts under the IFPR and the UK CRR

3.18 As previously stated, an FCA investment firm group cannot include a UK credit institution. Prudential consolidation for a group that includes a UK credit institution is set out in the UK CRR and the PRA Rulebook.

3.19 An investment firm group may be subject to consolidation under both the UK CRR and the IFPR if the group contains a PRA-designated investment firm and an FCA investment firm. These different prudential consolidations have different consolidated requirements, as each focuses on different types of risk or harm. This means that the group must satisfy both sets of consolidated requirements.

What the consolidated situation means

3.20 The application of prudential consolidation to an FCA investment firm group is based on the consolidated situation of a UK parent.

3.21 The consolidated situation is the result of treating the UK parent, along with all of the relevant entities within the investment firm group, as if it were a single FCA investment firm.

3.22 The relevant entities in the FCA investment firm group include:

- investment firms
- financial institutions
- ancillary services undertakings
- tied agents

3.23 A firm established outside the UK will also be a relevant entity where, were it established in the UK, it would meet the definition of one of those terms.

How we treat tied agents included in the consolidated situation

3.24 If a tied agent forms part of the consolidated situation of a UK parent (for example, as a subsidiary), we propose that the relevant activities and expenditure of that tied agent must be included to calculate the consolidated fixed overheads requirement (consolidated FOR) and the consolidated K-factor requirement (consolidated KFR). It does not matter whether the activities carried on by the tied agent are undertaken, or the expenses are incurred, on behalf of another entity included within the FCA investment firm group, or on behalf of a third-party that is not included in the FCA investment firm group.

3.25 It is possible that a tied agent is included in the consolidated situation and incurs expenses and/or provides activities on behalf of an FCA investment firm that is also in the consolidation situation. If so, the tied agent's contribution to the consolidated FOR and the consolidated KFR may be adjusted. This is to avoid double counting of any amounts already included through the contribution of the FCA investment firm. The FCA investment firm is required to capture the amount of such expenditure and/or activities as part of calculating its fixed overheads requirement and K-factor requirement on an individual basis.

The main obligations for prudential consolidation

3.26 We propose that a UK parent to which consolidation applies must comply, on the basis of its consolidated situation, with obligations in these areas:

- composition of own funds
- own funds requirements
- concentration risk
- liquidity
- disclosure
- reporting

3.27 It must also ensure that any subsidiaries that are not FCA investment firms have in place the necessary arrangements, processes and mechanisms so that the UK parent may comply with the consolidated requirements.

Methods of consolidation

3.28 The default consolidation method is that the UK parent carries out a full consolidation of all the relevant entities that form part of its investment firm group.

3.29 However, if an entity forms part of an FCA investment firm group due to being a participation, proportional consolidation may be appropriate (see below).

3.30 A UK parent may make an application to the FCA to apply an alternative method of consolidation (to full consolidation) in other cases. The FCA would generally expect any alternative method of consolidation to be proportional consolidation or consolidation of an appropriate alternative fixed percentage of the relevant metrics that are attributable to the relevant subsidiary or connected undertaking.

Proportional consolidation of participations

3.31 Under our proposals, a UK parent may only apply proportional consolidation when including an entity which is a participation within its consolidated situation where certain conditions are met, including:

- the parent's liability is limited to the share of capital that it holds in the participation
- the liability of other shareholders or members of the participation is clearly established by means of a legally binding and enforceable contract. This does not result in the parent undertaking bearing losses disproportionately to its share in the capital of the participation, and there are no other agreements or arrangements that undermine this
- any participating undertakings that do not form part of the same FCA investment firm group are either subject to prudential supervision, or can reasonably be expected to have sufficient resources to fund any contribution for which they may be liable if the entity in which the participation is held is recapitalised
- the solvency of the participating undertakings is satisfactory and can be expected to remain so
- before applying proportional consolidation, the UK parent has notified the FCA that it intends to do so

3.32 If the conditions are not met, full consolidation should be applied.

3.33 If proportional consolidation is allowed, the relevant proportion would be the proportion of capital or voting rights that is held in the participation.

The UK parent as an SNI or non-SNI when applying prudential consolidation

3.34 It is possible that a UK parent could be considered as an SNI when applying the relevant requirements on a consolidated basis. Under our proposals, this could only happen if:

- none of the FCA investment firms in the investment firm group are non-SNIs (including on a combined basis, where that approach is required for assessing any of the criteria for being an SNI), and
- the UK parent satisfies all the criteria for being an SNI, when applied on the basis of the consolidated situation

3.35 In all other situations, the UK parent must apply the requirements to its consolidated situation as if it were a non-SNI FCA investment firm.

3.36 See Chapter 2 of this CP for the proposed criteria for being an SNI.

3.37 If any entity included in the consolidated situation is dealing on own account, the UK parent will apply the consolidated requirements as if it were a non-SNI.

3.38 When calculating the contribution of a CPMI firm to the consolidated situation, the UK parent would be required to include only amounts that are attributable to the investment services and/or activities that CPMI firm undertakes.

Consolidated own funds and consolidated own funds requirement

3.39 Under our proposals, the total consolidated own funds requirement of an FCA investment firm group must be met with consolidated own funds.

3.40 Consolidated own funds must satisfy the proposed requirements for own funds of an FCA investment firm as set out in Chapter 4 of this CP; the deductions from consolidated own funds must be applied as in that chapter as it applies on a consolidated basis. These proposals include treating minority interests and additional 'Tier 1' and 'Tier 2' own funds instruments issued by subsidiaries as set out in Title II of Part Two of the UK CRR to a UK parent entity, but modified to reflect the general application of the IFPR.

3.41 The consolidated own funds requirement of an FCA investment firm group will be the highest of:

- the consolidated fixed overheads requirement (consolidated fixed overhead requirement FOR)
- the consolidated permanent minimum capital requirement (consolidated PMR), or
- if the UK parent entity is treated as a non-SNI FCA investment firm, the consolidated K-factor requirement (consolidated KFR)

Consolidated fixed overheads requirement (consolidated FOR)

3.42 We would expect a UK parent to use audited consolidated annual financial statements after the distribution of profits, as the basis for arriving at the total of its fixed overheads. It may use unaudited consolidated annual financial statements if audited financial statements are not available.

3.43 If neither of those are available, the consolidated fixed overheads are calculated as the sum of:

- the fixed overheads of the UK parent
- the total fixed overheads of each entity that is fully consolidated, and
- the relevant proportion of the fixed overheads of each entity that is consolidated on a proportional basis

3.44 To arrive at the total, the above sum can be adjusted to avoid double counting expenses between entities included.

3.45 Our proposed rules will require the UK parent to include any fixed expenses incurred by a third party, such as a tied agent, on behalf of itself or of any other entity included in the consolidated situation.

3.46 The UK parent will then calculate its consolidated FOR following the same approach an investment firm uses to calculate the FOR on an individual basis. We will consult on our proposals for the FOR as part of a subsequent consultation.

Consolidated permanent minimum capital requirement (consolidated PMR)

3.47 Generally, the consolidated PMR is calculated as the sum of:

- the individual PMRs of each FCA investment firm, and
- where relevant, the base own funds requirement or initial capital requirement of any other relevant financial undertaking that forms part of the FCA investment firm group. This includes any third-country entity that would be an FCA investment firm if it were established in the UK; the amount to be included should be what would apply if it were established in the UK.

3.48 If an entity is subject to proportional consolidation, the relevant proportion of the amount should be included.

3.49 See Chapter 5 of this CP for the levels of PMR.

Consolidated K-factor requirement (consolidated KFR)

3.50 Our proposed rules require that, generally, the consolidated K-factor requirement should be calculated on the basis of the 'consolidated situation' of a UK parent, ie as if all the entities in the investment firm group formed a single FCA investment firm.

3.51 As is the case when calculating the K-factor requirement on an individual investment firm basis, the K-factor metrics that are relevant to the consolidated situation will depend on the investment services and/or activities (or equivalent activities in the case of a third-country entity) that relevant entities in the FCA investment firm group undertake. The consolidated K-factor requirement should be calculated using the relevant proposals (see Chapter 5) applicable to those K-factor metrics, but on the basis of the consolidated situation.

3.52 The total consolidated K-factor requirement amount will be the sum of the amounts for each relevant K-factor that is relevant to the consolidated situation of the FCA investment firm group.

Consolidated K-AUM, K-COH and K-DTF requirements

3.53 To calculate consolidated K-AUM, K-COH, and K-DTF requirements, a UK parent must apply the rules for the metrics AUM, COH and DTF that will apply on an individual FCA investment firm basis. We will set out our proposals for AUM and COH in our next consultation.

3.54 The consolidated AUM, COH or DTF is the sum of the amount of the relevant metric of each FCA investment firm included in the consolidated situation. This will include any amount that would be attributable to a third-country entity if that entity were established in the UK.

3.55 If an entity is subject to proportional consolidation, the relevant proportion of the metric should be used.

3.56 Where the consolidated metric includes transactions between two or more entities included in the consolidation situation, it may be adjusted to avoid double counting these amounts.

Consolidated K-CMH and K-ASA requirements

3.57 To calculate consolidated K-CMH and consolidated K-ASA requirements, we propose that a UK parent must apply the rules for the metrics CMH and ASA that will apply on an individual FCA investment firm basis. We will consult on our proposals for CMH and ASA in a subsequent consultation.

3.58 The total CMH and ASA of the consolidated situation will comprise a contribution for any individual FCA investment firm and a contribution for any other entity in the FCA investment firm group. The contribution for any entity that is not an FCA investment firm should cover any money held that was received from clients and any assets held that belong to clients; this is for business which would be MiFID investment business if it were carried on in the UK by an FCA investment firm.

3.59 There may be situations where the UK parent cannot determine whether any money or assets are held or received by an entity within the FCA investment firm group are for business that would be treated as MiFID investment business if it were carried on in the UK by an FCA investment firm. If so, the UK parent must treat such amounts as if they are received or held for such business.

3.60 If the UK parent cannot determine that monies received by an entity within the FCA investment firm group are held in an account that meets the conditions to be classified as a segregated account, it must treat such monies as if they are non-segregated.

3.61 In some circumstances, an entity in the FCA investment firm group may invest client money in a fund (such as a money market fund) as a means of segregating that money. This could result in potential arbitrage of the consolidated K-ASA and K-CMH requirements because, if the resulting units in such a fund were treated as ASA, this would result in a lower coefficient than if they were treated as CMH. We are therefore proposing that if an entity receives client money and subsequently invests it in a fund for the purposes of segregation (rather than to achieve the investment objectives under a mandate or a client order), that amount must be allocated to:

- ASA if, on the insolvency of that entity, the client would have a direct proprietary interest in the units of the fund, or
- CMH in any other circumstance

3.62 If the UK parent cannot determine that money received by an entity in the FCA investment firm group that has been placed into assets (for example, a money market fund) results in the client having a direct interest in that asset, that amount must be treated as if it were CMH (and not ASA).

Consolidated K-NPR requirement

3.63 Under our proposed rules, a UK parent entity must apply the relevant proposed rules for calculating the K-NPR requirement on an individual FCA investment firm basis to a position or exposure included in the consolidated situation. The exception is where the UK parent entity is permitted to include that position or exposure in the calculation of the consolidated K-CMG requirement, or where the proposed rules allow the position or exposure to be excluded from calculation of the consolidated K-NPR requirement.

3.64 The consolidated K-NPR requirement applies to all trading book positions, and to positions other than trading book positions where they give rise to foreign exchange risk or commodity risk.

3.65 When calculating the consolidated K-NPR requirement, the UK parent will not be able to automatically offset positions in one entity with those of another entity in the consolidation group. To do so it must obtain permission from the FCA, and in its application for permission must demonstrate to the satisfaction of the FCA that the conditions in article 325b of the UK CRR have been met.

Consolidated K-CMG requirement

3.66 We propose that if a UK parent entity has been granted permission to calculate a K-CMG requirement for a relevant portfolio of positions in its consolidated situation, it will not need to include that portfolio when it calculates the consolidated K-NPR requirement.

3.67 Either the UK parent entity or an FCA investment firm in the consolidated situation may apply for permission to calculate a consolidated K-CMG requirement. The application may cover portfolios of third-country entities in the consolidated situation. When calculating a consolidated K-CMG requirement, the proposed rules as for calculating K-CMG on an individual FCA investment firm basis will apply, except where expressly modified.

3.68 Under our proposals, where the FCA has already granted permission to an investment firm for a portfolio to calculate the K-CMG requirement on an individual basis, a UK parent does not need to seek additional permission to include that portfolio when it calculates its consolidated K-CMG.

3.69 We will not give permission for the portfolio of an FCA investment firm to use K-CMG solely for consolidated purposes. If a portfolio of an FCA investment firm is to be included in the consolidated K-CMG requirement, permission must have been sought and the K-CMG applied to that portfolio on an individual basis. This reflects the FCA's view that the choice of whether to calculate a K-NPR requirement or a K-CMG requirement for a specific portfolio must be applied consistently on both an individual and consolidated level.

Consolidated K-TCD requirement

3.70 We propose that, to calculate a consolidated K-TCD requirement for a UK parent, the relevant proposed rules for calculating K-TCD on an individual FCA investment firm basis must be applied to all transactions included in the consolidated situation.

3.71 If a transaction occurs between two counterparties that are both included in the consolidated situation, it may be disregarded for the purposes of consolidated K-TCD.

3.72 If a transaction occurs between one or more entities in the consolidation group and a third-party counterparty, the transaction may be netted in certain circumstances when calculating the consolidated K-TCD requirement. Any netting agreement or contract must cover all the entities included in the consolidated situation whose transactions with that third-party are being netted.

Consolidated K-CON requirement

3.73 See Chapter 7 of this CP on concentration risk for our proposals on how to calculate a K-CON requirement on an individual investment firm level.

3.74 When the UK parent entity is calculating a consolidated K-CON requirement, the exposure value to an individual client or a group of connected clients should be calculated using all relevant exposures in the consolidated situation. To the extent that K-NPR or K-TCD are relevant to calculating an exposure value and K-CON, the UK parent entity must apply the methods for calculating consolidated K-NPR and consolidated K-TCD (outlined earlier in this chapter).

3.75 The amount of own funds used for calculating the concentration risk limits on a consolidated basis will be the consolidated own funds of the FCA investment firm group.

Consolidated liquidity requirements

3.76 Our proposals on the consolidated liquidity requirement will require the consolidation group to hold an amount of liquid assets equal to or greater than one third of the amount of the consolidated FOR, plus 1.6% of the guarantees provided to clients by entities in the consolidation group.

3.77 The required amount of consolidated liquid assets must be held by UK entities in the consolidation group.

3.78 What will count as a liquid asset will follow in a subsequent consultation to be consulted on as part of individual firm liquidity requirements.

3.79 Note that there is no consolidated liquidity requirement for FCA investment firm groups that use the GCT, rather than prudential consolidation. Individual liquidity requirements will still apply.

3.80 A UK parent may apply to be exempted from consolidated liquidity requirements. An application to the FCA must demonstrate that all FCA investment firms in the consolidation group meet the liquidity requirement on an individual basis. The exemption must also be appropriate, taking into account the nature, scale and complexity of the FCA investment firm group.

Consolidated disclosure requirements

3.81 Our proposals for consolidated disclosure requirements will follow in a subsequent consultation, to be consulted on alongside individual firm disclosure requirements.

Consolidated reporting requirements

3.82 We are proposing that a UK parent to which prudential consolidation applies must comply with reporting requirements on the basis of its consolidated situation. The same type of information will be required from an FCA investment firm group as from an individual FCA investment firm, but for its consolidated situation. See Chapter 8 of this CP for further information on our proposals for reporting.

Consolidated governance and remuneration requirements

3.83 Our proposals for consolidated governance and remuneration requirements will follow in a subsequent consultation to be consulted on alongside individual firm governance and remuneration requirements.

Application of the Individual Capital and Risk Assessment (ICARA) process on a consolidated basis

3.84 Our proposals for how the ICARA process will work on a consolidated basis will be consulted on alongside the ICARA process for an individual FCA investment firm in our next consultation.

The Group Capital Test (GCT)

3.85 The group capital test (GCT) is an alternative to prudential consolidation for an FCA investment firm group. The GCT's purpose is to ensure that a parent entity holds sufficient regulatory capital to support its capital investment in its subsidiaries, and therefore to create a stable group capital structure.

3.86 We propose that to be able to use the alternative of the GCT, either the ultimate UK parent of the investment firm group, or an investment firm in that group, must apply to the FCA for permission. The application must satisfy the FCA that:

- the investment firm group has a sufficiently simple structure to justify applying the group capital test, and
- there is no significant risk of harm to others that means that the investment firm group should be supervised on a consolidated basis

3.87 The GCT uses the same terms and concepts as prudential consolidation to identify an investment firm group and its constituent parts.

3.88 The actual application of the GCT does not, however, include group entities that are 'connected undertakings' (see under prudential consolidation above for an explanation of what is a connected undertaking). The presence of material connected undertakings in an FCA investment firm group means that it is therefore unlikely that the investment firm group will have a sufficiently simple structure to justify the use of the GCT.

3.89 Under the GCT, we propose that a UK parent must hold enough own funds to cover at least:

- the sum of the full book value of their holdings, subordinated claims and instruments in subsidiaries, and
- the total amount of their contingent liabilities in the investment firm group

3.90 The GCT has a modified definition of 'own funds instruments'. The difference from the definition used by an individual investment firm is that any significant investments in common equity tier 1, additional tier 1 and tier 2 capital instruments of financial sector entities in the investment firm group do not need to be deducted by a parent undertaking when applying the GCT. This is to avoid any 'double counting' of the same amount.

3.91 The proposed rules on the required overall composition of own funds instruments when applying the GCT are set out in MIFIDPRU 3. These are summarised in Chapter 4 of this CP.

3.92 If an investment firm group contains more than one parent entity, each parent entity in that group must satisfy its own GCT, ie a separate GCT applies to each entity in the group which is itself a parent.

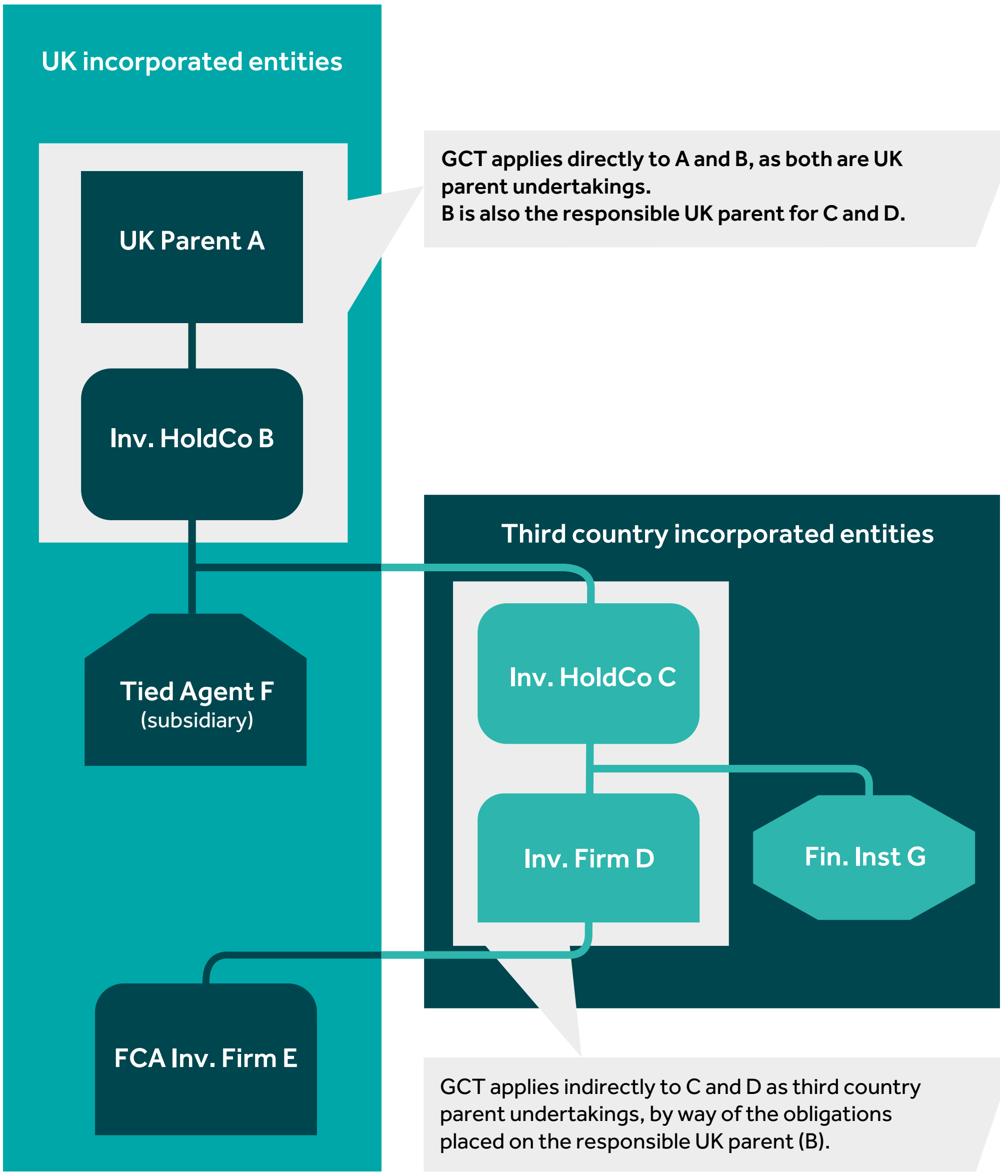
3.93 If an investment firm group contains a parent entity that is established outside the UK, we propose that its parent in the UK, known as a responsible UK parent, must ensure compliance with the GCT. This is to ensure that leverage and capital gearing are not introduced into the investment firm group through intermediate parent undertakings established in a third country. The responsible UK parent must either:

- ensure that the non-UK parent entity holds sufficient own funds to meet its own GCT, or
- itself hold an additional amount of own funds in respect of (i) above as part of its own GCT

3.94 The following diagram (**Figure 2**) provides an example of where a UK parent may also be a responsible UK parent. This means where a UK parent is responsible for ensuring that the obligations of the GCT are not otherwise avoided by introducing third-country parent entities in the investment firm group.

3.95 In Figure 2 the solid lines linking the entities indicate whole or majority ownership or control.

Figure 2: Example of where a UK parent may also be a responsible UK parent for the purposes of applying the group capital test



Applying for permission to use the group capital test

3.96 We propose that an application for permission to use the GCT must include:

- a structure chart including information on each entity in the FCA investment firm group
- an explanation of why the group structure is sufficiently simple to justify applying the group capital test
- an explanation of why there are no significant risks to clients or to the market stemming from the FCA investment firm group that would require supervision on a consolidated basis
- calculations to show how each parent in the investment firm group would satisfy the group capital test
- evidence that the book value of each parent's investment in a subsidiary, whether that subsidiary forms part of the investment firm group or not, reflects fairly the consideration paid by the parent for that subsidiary

- calculations which demonstrate the consolidated own funds and liquid assets requirements that would apply on the basis of the consolidated situation of the FCA investment firm group if prudential consolidation applied instead
- an explanation of:
  - how the investment firm group would comply with the requirements for prudential consolidation if the FCA did not grant permission to use the GCT and
  - the timeframe in which the FCA investment firm group would expect to achieve compliance with such consolidated requirements
- an explanation of how the UK parent entity of the FCA investment firm group would comply with the system and control requirements for prudential consolidation

Group capital test reporting requirements

3.97 Each UK parent firm in an FCA investment firm group must report individually on how it is meeting the GCT.

3.98 A UK responsible parent must report on behalf of any third-country parent to show that either:

- the third-country parent holds enough own funds for the purposes of the GCT, or
- the UK responsible parent holds enough own funds to include the amount that would otherwise be held by the third-country parent

3.99 The investment firm group can nominate one parent firm to report to the FCA on behalf of the other parent firms in the group.

Transitional arrangement for temporary use of the group capital test

3.100 We propose that an FCA investment firm group can choose to apply the requirements of the GCT, rather than those of prudential consolidation, on a temporary basis before we have granted it permission to do so, if the following conditions are met:

- the parent of, or an investment firm within, the investment firm group has applied to the FCA for permission to use the group capital test within a month of the date on which the new IFPR rules first apply
- the management body of the applicant UK parent or FCA investment firm thinks there is a reasonable basis to conclude the investment firm group would satisfy the criteria to be granted permission to use the GCT

3.101 This transitional arrangement will apply for up to two years after the rules apply, or the date specified by the FCA in the notification of its decision to the UK parent or FCA investment firm on its application, whichever is earlier.

Holding companies

3.102 Various other requirements apply to UK investment holding companies, UK mixed financial holding companies and UK mixed activity holding companies. This includes a mixed activity holding company, even though this would not be part of an investment firm group for the purposes of prudential consolidation or the GCT.

Qualifications of directors

3.103 Clause 143K of the FS Bill provides that a UK parent must take reasonable care that the members of its management body are of sufficiently good repute and have sufficient knowledge, skills and experience to carry out their duties effectively. Guidance in our proposed rules refers to this provision, but this remains subject to Parliamentary approval of the FS Bill in its current form. If this provision in the FS Bill were to be amended, we would amend our guidance accordingly.

Additional requirements on parent firms

3.104 Under our draft rules, the FCA can require the parent of an FCA investment firm to provide relevant information so that we can effectively supervise the authorised firm.

3.105 If the parent is a UK mixed-activity holding company, the FCA investment firm must be able to identify, measure, monitor and control transactions between the firm, its parent and other subsidiaries of its parent.

3.106 If the FCA identifies a breach of these requirements by a UK parent firm, we can impose disciplinary measures on the parent firm or on the management body of the parent firm.

Q4: **Do you have any specific comments on our proposals for the scope and methods of prudential consolidation? Please provide evidence to support any changes. Is there anything relevant to consolidation that is not covered in our rule proposals?**

Q5: **Are our proposals for how to calculate the consolidated own fund requirements (including the consolidated fixed overheads requirement, the consolidated permanent minimum requirement and the consolidated K-factor requirement) clear and sufficient? If not, do you have any specific suggestions for how to improve this?**

Q6: **Do you agree with our approach to the use of the group capital test (as an alternative to prudential consolidation), including our proposal for a transitional provision to allow its use as part of our initial implementation of the IFPR?**

4 Own funds – definition and composition of capital

4.1 In this chapter, we provide an overview of our proposals for:

- the definition and types or 'tiers' of capital that are eligible as regulatory capital, known as 'own funds', including specific deductions that need to be made from own funds
- prior permissions that are required from the FCA to count certain items as regulatory capital
- specific rules on eligibility of own funds for FCA investment firms that are partnerships and limited liability partnerships
- trigger events in the terms of additional capital instruments that may be used to absorb losses
- the minimum proportions in which own funds must be held to meet the own funds requirements at both individual and consolidated level
- the minimum proportions in which own funds must be held by a parent entity to meet the group capital test
- transitional provisions for certain existing own funds permissions

4.2 Our proposed rules for own funds are in MIFIDPRU 3.

4.3 The text of the EU CRR is amended at the EU level by the EU text of the CRR2 and then the text of the IFPR. All references to the UK CRR in this chapter are references to the on-shored UK CRR in the form in which it would appear if it contained equivalent amendments. The FCA expects that such amendments will largely be made to the UK CRR by UK primary and secondary legislation. This is consistent with HM Treasury's stated legislative approach in its 'Prudential standards in the Financial Services Bill: June update'. The UK CRR is of particular relevance to own funds under the IFPR. This is because the majority of the concepts used are the same, and our rules cross-reference the relevant provisions of the UK CRR.

Definition of own funds

4.4 In general, we are proposing that the types and treatment of own funds under the IFPR will follow the same requirements as under the UK CRR (although with some amendments) and will comprise the following 3 classes of capital:

- Common Equity Tier 1 (or CET1) capital
- Additional Tier 1 (or AT1) capital
- Tier 2 (or T2) capital

4.5 Our proposed definition of capital represents a change for FCA investment firms that have not previously applied the CRR, such as 'BIPRU Firms' and 'Exempt-CAD Firms'. For example, the concept of 'Tier 3' capital (short-term subordinated debt) will no longer apply.

4.6 We have changed the way we propose to apply the detail of the rules on own funds in the UK CRR to FCA investment firms under MIFIDPRU. This is to simplify the calculation of certain deductions, and to remove references to concepts that do not exist in the IFPR, including risk weighted assets.

4.7 The UK CRR contains numerous items that need to be deducted from the different tiers of own funds. This includes the following which, under the UK CRR, have the potential for partial deduction according to a detailed calculation, but that we propose should be deducted in full under the IFPR:

- defined benefit pension fund assets on the balance sheet of the institution
- deferred tax assets that rely on future profitability
- non-significant investments in financial sector entities, as far as they relate to holdings of capital instruments that are not held in the trading book
- significant investments in the CET1 instruments of financial sector entities

4.8 As intangible assets, we propose to require software assets to be deducted in full under IFPR. We are not persuaded by general arguments that FCA investment firms could be allowed some add-back for software assets that are prudently valued. There is no clear prudential basis that we have identified to support this.

4.9 A qualifying holding is where an FCA investment firm has a direct or indirect holding in an entity representing 10% or more of the capital or of the voting rights, or which make it possible to exercise a significant influence over the management of that entity. Under our proposals, an FCA investment firm with qualifying holdings in entities outside the financial sector will be required (subject to a few specific exceptions) to deduct any amount of such holdings from its CET1 capital, where this exceeds the following limits:

- an individual qualifying holding in a non-financial sector entity exceeds 15% of the FCA investment firm's own funds
- the total of all the qualifying holdings in non-financial sector entities exceeds 60% of the FCA investment firm's own funds

4.10 We believe that these proposed changes to enhance the quality of regulatory capital will result in FCA investment firms becoming more resilient, with increased capacity to absorb losses. All FCA investment firms will now apply the same definition of own funds.

4.11 Non-significant holdings of capital instruments of financial sector entities in the trading book will not, however, need to be deducted. This is to avoid discouraging market-making in capital instruments of other regulated entities.

Overview of IFPR capital tiers

4.12 Figures 3, 4, and 5 provide a visual summary of our proposals for the provisions in the UK CRR and MIFIDPRU 3 that relate to each tier of regulatory capital. In each case, references to the UK CRR are to the UK CRR as applied and modified by MIFIDPRU.

Figure 3: Common equity tier 1 (CET1) capital

Common Equity Tier 1 (CET1) Items – Article 26 UK CRR

(a) Capital instruments that meet the conditions of Articles 28 or 29 of UK CRR
(b) Share premium accounts related to the instruments in (a)
(c) Retained earnings*
(d) Accumulated other comprehensive income*
(e) Other reserves*
* Must be available for unrestricted and immediate use to cover risks or losses as soon as these occur
The conditions set out in Articles 27 to 31 of UK CRR must also be met.

↓

Prudential filters – Items to be excluded/deducted from own funds

(a) **Article 32** – any increase in its equity resulting from securitised assets
(b) **Article 33** – cash flow hedges and changes in the value of own liabilities
(c) **Article 34** – additional value adjustments, by applying the requirements of Article 105 to its assets measured at fair value

Prudential filters – Items not to be excluded

Article 35 – unrealised gains or losses on assets or liabilities measured at fair value, unless referred to in Article 33

↓

Deductions from CET1 Items – MIFIDPRU 3.3.6R

(a) Losses for the current financial year
(b) Intangible assets – including goodwill
(c) Deferred tax assets that rely on future profitability[1]
(e) Defined benefit pension fund assets on the balance sheet of the firm[2]
(f) Holding of own CET1 instruments (direct/indirect/synthetic holdings)
(g) Holdings of CET1 instruments of financial sector entities (FSE) where there is a reciprocal cross holding
(h) Holdings of non-significant investments in FSEs[3,4]
(i) Holdings of significant investments in FSEs[5]
(j) Deductions to account for holdings of third party AT1 instruments in excess of issuance of own AT1 instruments
(k) Foreseeable tax charges relating to CET1 instruments
(l) Qualifying holdings outside the financial sector that are:
1) For a single entity > 15% of the firm's own funds
2) For all entities > 60% of the firm's own funds

1. Article 39 and Article 48 of the UK CRR do not apply
2. Article 41 of the UK CRR does not apply
3. Article 46 of the UK CRR does not apply
4. This does not apply where held in the trading book
5. Article 48 of the UK CRR does not apply

In addition, Article 49 does not apply

↓

Temporary waiver from deduction from own funds and eligible liabilities – Article 79

May be granted where these are deemed to be held as part of a financial assistance operation.

↓

CET1 capital – Article 50

Figure 4: Additional tier 1 (AT1) capital

Additional Tier 1 (AT1) Items – Article 51 UK CRR

(a) Capital instruments that meet the conditions of Article 52 of UK CRR
(b) Share premium accounts related to the instruments in (a)

The conditions set out in Articles 52 to 55 of UK CRR must also be met.

NB. Article 54(1)(a) and Article 54(4)(a) of UK CRR do not apply. Instead, MIFIDPRU 3.4.3R applies. A firm specifies the trigger events, one of which must be when the CET1 of the firm falls below 64% of the firm's own funds requirement.

Deductions from AT1 Items – MIFIDPRU 3.4

(a) Holdings of own AT1 instruments (direct/indirect/synthetic holdings)
(b) Holdings of AT1 instruments of financial sector entities (FSE) where there is a reciprocal cross holding
(c) Holdings of non-significant investments in FSEs[1,2]
(d) Holdings of significant investments in FSEs
(e) Deductions to account for holdings of third party T2 instruments in excess of issuance of own T2 instruments
(f) Foreseeable tax charges relating to AT1 instruments

1. Article 60 of the UK CRR does not apply
2. This does not apply where held in the trading book.

Temporary waiver from deduction from own funds and eligible liabilities – Article 79 UK CRR

May be granted where these are deemed to be held as part of a financial assistance operation.

AT1 capital – Article 61 UK CRR

Figure 5: Tier 2 (T2) capital

Tier 2 (T2) Items – Article 62

(a) Capital instruments that meet the conditions of Article 63 of CRR
(b) Share premium accounts related to the instruments in (a)
Article 64 deals with the amortisation of T2 instruments during the final 5 years of maturity
Article 65 sets out what happens when an instrument no longer meets the T2 requirements

↓

Deductions from T2 Items – Article 6

(a) Holdings of own T2 instruments (direct/indirect/synthetic holdings)
(b) Holdings of T2 instruments of financial sector entities (FSE) where there is a reciprocal cross holding
(c) Holdings of non-significant investments in FSEs[1,2]
(d) Holdings of significant investments in FSEs
(e) Deductions to account for holdings of eligible liabilities items in excess of issuance of own eligible liabilities items

1. Article 70 of the UK CRR does not apply
2. This does not aply where held in the trading book

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Temporary waiver from deduction from own funds and eligible liabilities – Article 79 UK CRR

May be granted where these are deemed to be held as part of a financial assistance operation.

↓

T2 capital – Article 71 UK CRR

4.13 In each case, the chart is only expected to be an overview of the most relevant proposals from MIFIDPRU that may apply, rather than an exhaustive statement of all potentially applicable requirements and conditions. The charts are not intended to be a substitute for detailed analysis of the proposed rules.

Prior permissions required from the FCA for CET1 capital

4.14 Under our proposed rules, FCA investment firms will require prior permission from us to:

- include interim profits or year-end profits in CET1 before the investment firm has taken a formal decision confirming the final profit or loss for the year
- classify an issuance of capital instruments as CET1 capital

4.15 If an investment firm has already obtained permission for a previous issuance of instruments that have been classified as CET1 capital, we do not propose that it should be required to obtain permission for a subsequent issuance of the same form of instruments provided that the provisions of the new instruments are substantially the same. Sufficient notice of the issuance must also be given to the FCA.

4.16 The section below on transitional provisions for existing own funds instruments may also be relevant.

Investment firms that are not joint-stock companies

4.17 The detailed conditions of the UK CRR for capital instruments to qualify as CET1 are, in general, easier to understand from the perspective of a joint-stock company issuing share capital. However, the same conditions apply to FCA investment firms with legal forms that are not joint-stock companies. We therefore propose to clarify our rules for CET1 instruments of partnerships (including both general and limited partnerships) and limited liability partnerships.

4.18 For an FCA investment firm that is a partnership or a limited liability partnership (LLP), we propose that a partner's or member's account will meet the conditions in article 28(1)(e) (perpetual) and article 28(1)(f) (reduction or repayment) of the UK CRR where the account is one:

- into which capital contributed by the partners or members is paid, and
- from which, under the terms of the partnership agreement or limited liability agreement, an amount representing capital may be withdrawn by a partner or member (P) only if:
  - P ceases to be a partner or member and an equal amount is transferred to another such account by Q's former partners or members or any person replacing P as a partner or member
  - the partnership or LLP is wound up or otherwise dissolved, or
  - the firm has ceased to be authorised or no longer has a Part 4A permission

Trigger events for Additional Tier 1 (AT1) capital

4.19 The purpose of AT1 is that it can be converted to CET1 to bolster an FCA investment firm's CET1, or otherwise be written down so that it absorbs losses in the same way as CET1 on a going-concern basis. This is to prevent a firm from falling below the amount needed to make up the minimum percentage of own funds required.

4.20 We want to ensure that FCA investment firms can use AT1 for its intended purpose and to avoid any likelihood of an investment firm breaching its minimum CET1 percentage before conversion can take place. So we are proposing that one of these trigger events must be the firm falling below a level of CET1 that is no lower than 64% of its total own funds requirement. This is the same as the trigger event required by the existing CRR but expressed in a different way to reflect the structure of capital under the IFPR.

4.21 FCA investment firms may set the trigger level at a higher level or choose to specify additional trigger events alongside this. The full principal amount of AT1 must be written down or converted when a trigger event occurs.

Calculating the type of own funds held to meet own funds requirements at both individual and consolidated level

4.22 Under our proposals, an FCA investment firm must hold own funds to meet its total own fund requirement (TOFR) in the following proportions:

- CET1 ≥ 56% of TOFR
- CET1 + AT1 ≥ 75% of TOFR, and
- CET1 + AT1 + T2 ≥ 100% of TOFR

4.23 These proportions are essentially the same as those in the UK CRR, but are expressed in a different way.

4.24 An FCA investment firm group that is subject to prudential consolidation will need to meet its consolidated own funds requirement by holding consolidated own funds in at least the same proportions as the above, on the basis of its consolidated situation. (See Chapter 3 for details on prudential consolidation).

Calculating the type of own funds held to meet the group capital test

4.25 The proportions of own funds to be held by a UK parent when subject to the group capital test (GCT) are different from those that will apply at individual FCA investment firm level or under prudential consolidation. (See Chapter 3 for details on the group capital test).

4.26 Our proposals are that when applying the GCT, a parent's CET1 capital must be at least equal to:

- the sum of the book value of the parent's holdings of the CET1 capital of relevant financial undertakings in the FCA investment firm group, plus
- the total amount of all the parent's contingent liabilities in favour of the relevant financial undertakings in the FCA investment firm group

4.27 In addition, the sum of CET1 capital and AT1 capital of the parent must be at least equal to the sum of:

- the minimum amounts of CET1 set out above, plus
- the sum of the book value of the parent's holdings in the AT1 capital of the relevant financial undertakings

4.28 And the sum of the parent's own funds instruments (CET1, AT1 and Tier 2) must be at least equal to the total own funds requirement calculated under the GCT.

4.29 For these purposes, a 'relevant financial undertaking' is an investment firm, a financial institution, an ancillary services undertaking, a tied agent or any equivalent entity in a third country.

4.30 The purpose of the above is to ensure that a parent holds capital of at least the same quality as the capital it invests in its relevant subsidiaries, but without imposing higher requirements than this. This will support a stable group capital structure when the investment firm group uses the GCT.

4.31 The following is a simplified worked example of the above requirement for calculating the minimum composition of capital when a parent is applying the GCT:

Assume a parent 'J' has three subsidiaries, a UK investment firm 'B', a UK financial institution 'C' and a third-country entity that would be an investment firm if it were established in the UK, 'D'. The table shows the amount (in £m) of the book value of J's investments in each subsidiary, and in the different tiers of capital instruments that this represents. Ie J records a book value investment of £10m in CET1 and £2m in AT1 instruments held in subsidiary B, of £5m in CET 1 in C, and of £1m in CET1 and £9m in Tier 2 in D.

	Subsidiary			
Type of capital	**B**	**C**	**D**	**Total**
CET1	10	5	1	16
AT1	2	–	–	2
T2	–	–	9	9
Total	**12**	**5**	**10**	**27**

In this example, the parent J has a total GCT requirement of at least £27m. The total own funds that the parent needs to hold to satisfy this amount must consist of at least £16m in CET1 capital, at least £18m in total tier 1 capital (CET1 + AT1) and at least £27m in total capital (CET1 + AT1 + T2).

Transitional provisions for existing own funds instruments

4.32 We propose to introduce transitional provisions for certain own funds permissions granted by the FCA to IFPRU investment firms before the IFPR applies. These provisions set out where an FCA investment firm with such a permission may continue to rely on it under the IFPR. They cover:

- including interim or year-end profits in CET1 capital before the FCA investment firm has taken a formal decision confirming the final profit or loss for the year (under article 26(2) UK CRR)
- classifying an issuance of capital instruments as CET1 (under article 26(2) UK CRR)

4.33 We also propose a transitional provision which sets out what an FCA investment firm must do to determine whether any existing AT1 instruments issued under the UK CRR would continue to be eligible for inclusion as AT1 capital under the IFPR.

> **Q7:** **Do you agree with the proposals for the definitions and types of, and deductions from, regulatory capital that investment firms should use to calculate their own funds? Do you think that any additional simplification is needed? If yes, please provide suggestions.**

Q8: **Do you agree with our proposals for trigger events for the conversion or write-down of AT1 instruments, including setting the minimum the same as under the UK CRR but expressed in a different way to reflect the structure of capital under the IFPR? If not, please let us know why and what trigger events you think we should include?**

Q9: **Do you agree with our proposed transitional provisions for existing permissions for own funds instruments (under UK CRR)? Do you think that any additional transitional provisions are necessary? If so, please identify what they should be and say why.**

5 Own funds requirements

5.1 In this chapter, we explain:

- what we are proposing should be an FCA investment firm's ongoing permanent minimum capital requirement (PMR)
- how an FCA investment firm's PMR might change depending on the activities carried out
- how the PMR is reflected in the initial capital requirement (ICR) that applies to firms seeking to be authorised as FCA investment firms, and how the PMR applies to FCA investment firms that are currently authorised
- the difference between the own funds requirements that apply to FCA investment firms that meet the criteria to be small and non-interconnected FCA investment firms (SNIs) and to those that do not meet the criteria (ie non-SNI investment firms)

5.2 We then outline our proposals for how to calculate each of the specific K-factors that will only apply to FCA investment firms that trade in their own name (ie deal on own account). This could be trading on its own behalf, or trading on behalf of its clients.

5.3 The final section of this chapter describes the transitional provisions that will allow firms to move from their current own funds requirements to those that will apply under the IFPR. It also sets out how firms should calculate their K-factor requirement when the IFPR initially takes effect where this calculation relies on having historical observations of data.

5.4 We will cover the remaining K-factors and how to calculate the fixed overheads requirement in a subsequent consultation.

Ongoing permanent minimum capital requirement

5.5 We believe that an FCA investment firm should, at all times, operate with a minimum level of own funds based on the MiFID investment services and activities it currently has permission to undertake. This will become its PMR. **Table 3** summarises the amount of the PMR that we propose will apply to an FCA investment firm based on the investment services and activities it carries out.

Table 3: Summary of the PMR by the investment services and activities undertaken

PMR	FCA investment firm service/activity
£750,000	MiFID activities undertaken include one or more of the following services or activities: Dealing on own account Underwriting and/or placing on a firm commitment basis Operating an OTF without a limitation that prevents both matched principal trading and dealing on own account

PMR	FCA investment firm service/activity
£75,000	MiFID activities undertaken only from among the following services or activities: Reception and transmission of orders Execution of orders on behalf of clients Portfolio management Investment advice Placing without a firm commitment basis And, the firm does not have permission to hold client money or securities in the course of MiFID activities
£150,000	All other FCA investment firms, including, but not limited to, firms with permission to: • operate an MTF • operate an OTF, only with a limitation that prevents it from carrying out either of the following: • matched principal trading • dealing on own account

5.6 The activities an FCA investment firm wishes to carry out may change over time meaning its permissions will vary. Any variations in permission may affect that FCA investment firm's PMR. At the point that an FCA investment firm seeks to vary its permissions, we propose to ask it to demonstrate that it can meet the PMR that applies to the new combination of permissions.

5.7 This means, for example, that an FCA investment firm might have a PMR of £75,000. If that FCA investment firm applies in due course to vary its permissions to be able to hold client money in connection with one or more MiFID activities, it will then have a PMR of £150,000. Or, if its new permissions include dealing in its own name, its PMR will then be £750,000.

Initial capital requirement for new FCA investment firms

5.8 The ICR is the amount of capital required for an applicant firm to become authorised as an FCA investment firm. It is based on the activities that the new firm is seeking permission for. We are proposing that the ICR will be the same as the PMR that would apply if the applicant firm is granted the permissions it is seeking. We are also proposing that the ICR should be made up of capital of the same type and quality as would be needed for the applicant firm's PMR, ie in own funds. (See Chapter 4 for details on own funds).

Application to firms that are currently authorised to conduct MiFID business

5.9 The IFPR will not affect the ICR of FCA investment firms that are authorised ahead of the IFPR taking effect. Their ICR will no longer be relevant for the purposes of their capital requirements, or any other requirements, under the IFPR. These FCA investment firms should instead consider what their PMR will be under the IFPR and how they will transition to that new requirement. The PMR will form one of the 'floors' to their capital requirements.

Capital requirements for SNI and non-SNI investment firms

5.10 We propose that an FCA investment firm that meets the criteria to be small and non-interconnected (an SNI) should have an own funds requirement that is the higher of its PMR and its fixed overheads requirement (FOR). (See Chapter 2 for further information on the definition of an SNI). We cover how an FCA investment firm should calculate the FOR in a subsequent consultation.

5.11 We propose that an FCA investment firm that does not meet the criteria to become an SNI – so is a 'non-SNI' – should have an own funds requirement that is the highest of its PMR, its FOR, and its K-factor requirement.

5.12 The remainder of this chapter only covers the K-factors that will apply to firms that trade in their own name (ie have permission to deal on own account, including where they do so on behalf of clients). We will cover the remaining K-factors in a subsequent consultation.

K-factor capital requirements

5.13 The K-factor capital requirements are essentially a mixture of activity- and exposure-based requirements. Which K-factors will apply to an individual FCA investment firm will depend on the MiFID investment services and activities it undertakes.

5.14 In this section, we only cover the K-factors that will apply to FCA investment firms that have permission to deal as principal, ie they trade in their own name, including where they do so on behalf of clients. The remaining K-factors, that could apply to any FCA investment firm (including those that trade in their own name) will be covered in our next consultation.

5.15 For the avoidance of doubt, trading in own name will include, but is not limited to, FCA investment firms that:

- trade in their own name on behalf of a client
- trade in their own name on a matched principal basis
- have permission to operate an OTF. For the reason set out in paragraph 2.6, an OTF operator may deal in illiquid sovereign debt instruments and/or undertake matched principal transactions relying on that permission, unless it has a restriction from doing so.

5.16 The K-factors that only apply to FCA investment firms that have permission to trade in their own name are:

- net position risk (K-NPR) – a requirement based on the FCA investment firm's market risk
- clearing margin given (K-CMG) – an alternative to K-NPR to provide for market risk based on the margins given by the FCA investment firm to a clearing member
- daily trading flow (K-DTF) – a requirement based on the value of the FCA investment firm's daily trading flow
- trading counterparty default (K-TCD) – a requirement based on the risk of a trading counterparty failing to meet their obligations to the FCA investment firm

5.17 Where applicable, these K-factors will also apply to FCA investment firm groups that are subject to prudential consolidation (see Chapter 3 for more information on consolidation).

5.18 We propose that calculating the further K-factor capital requirement, K-CON, will also apply to FCA investment firms that trade in their own name. All firms, including firms that deal on own account, should be required to undertake general concentration risk monitoring. Our proposals relating to concentration risk and K-CON are set out in Chapter 7.

5.19 Other K-factors may also apply to FCA investment firms that trade in their own name. The specific K-factors will depend on any other investment services or activities it carries out. These are K-factors for:

- individual portfolio management and on-going advice (K-AUM)
- holding client money or client assets, (K-CMH and K-ASA)
- handling client orders (K-COH).

We will provide additional detail on our proposals for the remaining K-factors in our next consultation.

Net position risk – K-NPR

5.20 The K-factor capital requirement for net position risk, K-NPR, applies to an FCA investment firm's trading book positions and is intended to capture market risk. It also applies to positions not in the trading book which give rise to foreign exchange or commodities risk.

5.21 The calculation methodology for K-NPR is also used to calculate K-CON for concentration risk on all portfolios. See Chapter 7 for more information on calculating K-CON.

5.22 We propose that the K-NPR requirement is to be calculated using the own funds requirements for market risk set out in Title VI of Part Three of the UK CRR – reading references to 'own funds requirement' as references to 'K-NPR requirement'. This provides for an FCA investment firm to either apply the current standardised approach to market risk or to apply to us for permission to use the current internal models approach.

5.23 To preserve the existing CRR market risk regime, we propose that any reference to the UK CRR in our K-NPR rules is to the form of the UK CRR in which it stood on the day immediately before the earlier of

a. the date on which IFPR begins to apply' or
b. the date that the CRR2 equivalent amendments to the UK CRR take effect.

5.24 On 16 November 2021, HM Treasury, the PRA and the FCA announced the target date for both IFPR and the CRR 2 equivalent amendment to take effect is 1 January 2022. Our proposed rules for K-NPR in MIFIDPRU 4 also modify the basic UK CRR provisions in certain respects and references to the UK CRR will therefore include the UK CRR text as modified.

Additional rules and guidance on market risk

5.25 The approach for K-NPR is essentially to carry forward the current market risk requirements under the UK CRR. We therefore also propose to carry forward relevant rules and guidance on market risk from our current IFPRU sourcebook (and in some cases, appropriate parts of our BIPRU sourcebook) to calculate the K-NPR requirement. In certain cases, we have refined the relevant provisions to clarify these under the new regime.

5.26 The provisions we propose to carry forward are broadly those relating to:

- instruments for which no treatment is specified in the UK CRR
- standardised approach for options
- netting of a convertible
- offsetting derivative instruments
- excluding overshootings when determining multiplication factor addends
- determining notional positions for standardised approaches when using various products
- seeking permission to use internal models
- capturing risk when using internal models
- what we expect for the use of internal models

5.27 The UK CRR contains several provisions, eg articles 329 and 331 about options delta and interest rate sensitivity models respectively, where permission is required. We will address permissions and applications, including our proposals for existing permissions for market risk, in a subsequent consultation.

Use of K-NPR where an investment firm has permission to use K-CMG

5.28 FCA investment firms do not generally have to calculate K-NPR for portfolios for which they have been given permission to use the alternative K-factor requirement of clearing margin given or K-CMG (see section below).

5.29 However, an FCA investment firm that has been granted permission to use K-CMG (even for every portfolio in its trading book) may still need to calculate K-NPR for any positions it holds outside of its trading book that give rise to foreign exchange or commodities risk. This is because we consider it unlikely that such positions would be eligible for a K-CMG permission.

5.30 Further, if an FCA investment firm has settled trades in a portfolio subject to K-CMG which represent its own proprietary positions, they are unlikely to give rise to a margin requirement on any given day when using K-CMG. (See section on K-CMG below). We have therefore proposed that settled proprietary trades of the firm should be subject to the standard K-NPR calculation provided:

- the clearing member has not applied a 'haircut' for collateral purposes
- they are not included in the calculation of the margin requirement

5.31 Even if a firm uses K-CMG for all its trading book portfolios, K-NPR is still used to calculate K-CON for all portfolios. See Chapter 7 for more information on calculating K-CON.

Future developments

5.32 Our proposals for the K-NPR carry forward the current approaches to calculating market risk used in the UK CRR. We are also aware of developments to amend international standards on market risk for banks. Therefore, in future we will have regard to the UK CRR2 regime when reviewing our rules on K-NPR.

Clearing margin given K-factor requirement (K-CMG)

5.33 An FCA investment firm may apply to the FCA for permission to use K-CMG, instead of K-NPR, to calculate its market risk requirement for specified portfolios.

5.34 We will define a portfolio as including either all the positions attributable to a trading desk, or a subset of the positions of a trading desk where those positions share common characteristics and risks. This is to accommodate the different ways in which investment firms' trading desks are structured. The definition should not incentivise an investment firm to divide trading desks artificially, which could otherwise undermine the proper management of the risks arising from the activities of such desks. However, if the FCA investment firm has applied for permission to use flexibility, it must justify the choice of portfolio by referring to the common characteristics and risks of the positions it contains. Further, it must show it has not chosen the portfolio with a view to regulatory arbitrage.

5.35 The K-CMG requirement is calculated using the following formula:

K-CMG requirement = TM * 1.3

where TM is the third highest amount of total margin required from the investment firm, measured each day, over the preceding three months.

5.36 We propose that for each trading day during the relevant calculation period, the FCA investment firm must calculate the total combined margin provided to all clearing members in aggregate for the relevant portfolios. The K-CMG requirement is then calculated using the third highest daily aggregate amount.

5.37 In arriving at TM, an FCA investment firm shall use the sum of:

- the amount of margin required by the margin model of the relevant clearing member or central counterparty, plus
- the value of any 'haircut' applied by the clearing member or authorised central counterparty to positions included in the portfolio that represent settled trades and which the clearing member or central counterparty is treating as collateral to secure the present or future obligations of the FCA investment firm.

5.38 The relevant amount of margin is the margin required under the margin model and not necessarily the amount of margin subsequently transferred by the investment firm. This ensures that the firm's K-CMG requirement is not artificially reduced by subsequent commercial negotiations that may result in the clearing member or authorised central counterparty accepting a lower amount of margin than the model requires on any given day.

5.39 If a firm has settled trades in a portfolio which represent its own proprietary positions, those positions are unlikely to give rise to a margin requirement on any given day. In some cases, the clearing member or central counterparty may nonetheless take such positions into account by treating them as collateral to secure the other obligations of the trading firm. We understand that it is common to apply a 'haircut' to the value of such collateral which effectively reflects the risk that it will reduce in value due to market movements. That 'haircut' can therefore be used as a proxy for the market risk for the settled part of the portfolio.

5.40 The K-NPR requirement will apply to the position instead if it:

- has not been taken as collateral or no 'haircut' is applied
- is not included in the margin model

5.41 We propose to permit an FCA investment firm which is a clearing member of a central counterparty – where authorised or recognised under the on-shored EMIR regime – to apply for permission to use K-CMG when it self-clears the relevant portfolio(s). If the FCA investment firm is self-clearing, to determine the margin requirement it must use the authorised CCP's model, not that of the firm itself. And the FCA investment firm must meet all the other necessary criteria for permission (see below).

5.42 We also propose that FCA investment firms that are not direct clients of clearing members should be able to apply to use K-CMG. We may grant a K-CMG permission for a portfolio that is subject to indirect clearing if:

- all the standard conditions for a K-CMG permission are met, and
- the FCA is satisfied that the indirect clearing arrangement does not otherwise result in undue risk

5.43 Ultimately, the margin requirement would still be determined by reference to the margin model of the relevant clearing member of the authorised CCP.

Permission to use K-CMG

5.44 To obtain a K-CMG permission for a portfolio, an FCA investment firm must demonstrate to our satisfaction that all the following conditions are met:

- The firm is not part of a group containing a credit institution.
- The clearing and settlement of the transactions in the relevant portfolio take place under the responsibility of a clearing member of an authorised or recognised central counterparty.
- The clearing member is the investment firm itself, a UK credit institution or a designated investment firm.
- Transactions in the relevant portfolio are either centrally cleared in an authorised or recognised central counterparty or settled on a delivery-versus-payment basis under the responsibility of the clearing member.
- The investment firm is required to provide total margin calculated on the basis of a margin model that:
  - satisfies the necessary criteria (see below), and
  - is operated by the relevant clearing member or, for an investment firm that is a self-clearing firm, the authorised or recognised central counterparty

- The rationale for the firm's choice of calculating a K-CMG requirement for the portfolio has been clearly documented and has been approved by the firm's management body or risk management function.
- The choice of the portfolio to be subject to a K-CMG requirement has not been made with a view to engaging in regulatory arbitrage between the K-NPR requirement and the K-CMG requirement in a disproportionate or prudentially unsound manner.

5.45 The necessary criteria for the margin model are that:

- the margin requirements are sufficient to cover losses that may result from at least 99% of the exposures movements over an appropriate time horizon with at least a two-business days' holding period and
- the margin model used by the clearing member or authorised or recognised central counterparty to call the margin is always designed to achieve a level of prudence similar to that required in the provisions on margin requirements in article 41 of EMIR

5.46 If the parameters of a margin model operated by a clearing member or authorised or recognised central counterparty do not meet the criteria, those criteria will be considered to be met if an adjustment mechanism is applied to produce an alternative margin requirement. For this the alternative requirement must be at least equivalent to the margin requirement that would be produced by a margin model that meets the criteria. However, the FCA investment firm that has been granted the K-CMG permission must be able to give us, on request, a reasonable explanation of the adjustment it has applied. And it must continue to monitor and review the effectiveness of the adjustment mechanism.

5.47 If the margin model of a clearing member uses parameters that are more conservative than the minimum criteria, the output of the margin model may also be adjusted downwards to produce margin requirements that are consistent with the minimum criteria. This is to remove a regulatory incentive for clearing members or central counterparties to otherwise reduce the robustness of their risk management and margin models on behalf of their investment firm clients.

5.48 An FCA investment firm relying on a K-CMG permission must ensure that:

- the relevant individuals in the investment firm responsible for its risk management function, or for the oversight of that function, have a reasonable understanding of the operation of the margin model
- it integrates such understanding of the relevant margin model into its internal risk assessment process to consider whether:
  - the resulting K-CMG requirement is sufficient to cover the relevant risks to which it is exposed
  - the K-CMG permission remains appropriate to the portfolio(s) for which it was granted

5.49 If an FCA investment firm uses suitable advice or analysis provided by an appropriate third party, it will retain ultimate responsibility for ensuring that the relevant individuals in the investment firm have the necessary knowledge and understanding of the margin model.

5.50 Once an FCA investment firm has been granted permission to use K-CMG for a given portfolio, it must normally continue to do so for that portfolio for at least 2 years before reverting to using the K-NPR instead.

5.51 If an FCA investment firm identifies that any of the conditions for a K-CMG permission are no longer met, it must notify us immediately. In this case, we may revoke permission to use K-CMG for those portfolios that no longer meet the conditions. We also expect to review the use of K-CMG as part of any supervisory review process on the FCA investment firm. We will include our proposals for using f the supervisory review process in our next consultation.

Where firms with K-CMG permission will still need to use K-NPR

5.52 Where the trade has been settled and the proprietary position of the FCA investment firm is no longer included in the calculation of its margin requirement for that portfolio, it should be included in K-NPR to take account of any market risk. However, this is not required for positions that result from client servicing.

5.53 An FCA investment firm that has been granted permission to use K-CMG (even for every portfolio in its trading book) may still need to calculate K-NPR for any positions it holds outside its trading book that give rise to foreign exchange or commodities risk. This is because we consider it unlikely that such positions would be eligible for a K-CMG permission.

5.54 An FCA investment firm will still need to calculate K-NPR as part of any K-CON calculation, even for those portfolios that have been granted permission to use K-CMG (see Chapter 7 on concentration risk).

Trading counterparty default K-factor requirement (K-TCD)

5.55 The trading counterparty default K-factor requirement or K-TCD is designed to capture the risk of an FCA investment firm's exposure to the default of its trading counterparties. This component of the KFR is also used to calculate K-CON, the K-factor for concentration risk (see Chapter 7 for information on K-CON).

5.56 We are proposing that this requirement will apply to the following types of transactions that are recorded in the trading book of an FCA investment firm that trades in its own name, irrespective of whether this is on behalf of itself or on behalf of a client:

- derivative contracts listed in Annex II to the UK CRR, except:
  - derivative contracts directly or indirectly cleared through a central counterparty (provided various conditions are met)
  - exchange-traded derivative contracts
  - derivative contracts held for hedging a position of the firm resulting from an activity outside the trading book
- long settlement transactions
- repurchase transactions
- securities or commodities lending or borrowing transactions
- margin lending transactions
- any other types of securities financing transactions

5.57 In addition, it will include the following type of transaction if carried out by an FCA investment firm that has permission to trade in its own name (even though the firm may not be transacting in its own name when carrying out the particular transaction):

- Granting credits or loans to an investor so that they can carry out a transaction in one of more financial instruments where the FCA investment firm granting the credit or loan is involved in the transaction by:
  - executing the trade in the name of the investor, or
  - receiving and transmitting the order without executing it

5.58 We propose that transactions with the following types of counterparties do not need to be included when calculating K-TCD:

- central government and central banks, where the underlying exposures would receive a 0% risk weight under article 114 of the UK CRR
- multilateral development banks listed in article 117(2) of the UK CRR
- international organisations listed in article 118 of the UK CRR

5.59 We also propose that an FCA investment firm can apply to exclude certain intra-group transactions with other UK entities provided that various conditions are met. These include that the counterparty is part of the same group as the investment firm and both are subject to either prudential consolidation or the group capital test.

Calculating K-TCD

5.60 The own funds requirement for TCD = α x EV x RF x CVA

where:

α = 1.2

EV = the exposure value

RF = the risk factor that applies to the counterparty type

CVA = the credit valuation adjustment

Exposure value (EV)

5.61 The exposure value will be determined according to the formula:

EV = Max (0; RC + PFE – C)

where:

RC = replacement cost

PFE = potential future exposure (this only applies to derivative contracts)

C = collateral

Replacement Cost (RC)

5.62 We propose that the replacement cost is arrived at as follows:

- for derivative contracts, the current market value (CMV)
- for long settlement transactions, the settlement amount of cash to be paid or to be received by the firm upon settlement. A receivable should be treated as a positive amount and a payment as a negative amount
- for repurchase transactions and securities or commodities lending or borrowing transactions, the amount of cash lent or borrowed. Cash lent by the firm should be treated as a positive amount and cash borrowed by the firm as a negative amount. (However, this treatment does not apply to securities financing transactions, where both legs of the transaction are securities)
- for securities financing transactions, where both legs of the transaction are securities, the CMV of the security lent by the firm, increased by the corresponding volatility adjustment (see under 'value of collateral' below)
- for margin lending transactions, the book value of the asset in accordance with the applicable accounting framework
- for credits and loans to an investor so that they can carry out a transaction in one of more financial instruments (where the investment firm is executing the trade in the name of the investor, or receiving and transmitting the order without executing it), the book value of the asset in accordance with the applicable accounting framework

Potential future exposure (PFE)

5.63 The requirement to calculate potential future exposure (PFE) only applies to derivative contracts.

5.64 We propose that an FCA investment firm must calculate the PFE for derivative contracts in a netting set using one of two approaches:

- the hedging approach, or
- the derivative netting ratio approach

5.65 Where a single derivative contract cannot be allocated to a netting set with other derivative contracts, it must be treated as a separate netting set.

5.66 By making such proposals we will provide certainty to FCA investment firms, including for commodity derivative firms that currently calculate counterparty risk according to Chapter 3 of our Interim Prudential sourcebook for Investment Firms (IPRU-INV).

5.67 Both approaches require what is known as the 'effective notional amount', calculated using the following formula:

The effective notional amount = N * D * SD, where:

N = the notional amount

D = the duration

SD = the supervisory delta

5.68 Both approaches also require use of a supervisory factor, according to the relevant asset class. We propose that the supervisory factor for each asset class is as set out in **Table 4**.

Table 4: Supervisory factor for each asset class

Asset class	Supervisory factor
Interest rate	0.5%
Foreign exchange	4%
Credit	1%
Equity single name	32%
Equity index	20%
Commodity and emission allowance	18%
Other	32%

5.69 We propose that transactions relating to gold or gold derivatives must be allocated to the foreign exchange asset class.

5.70 The detailed rules for calculating PFE under each approach, including how to determine the notional amount, the duration and the supervisory delta, are set out in MIFIDPRU 4.

Value of collateral (C)

5.71 For transactions involving derivatives, margin lending, and credits and loans to an investor so that they can carry out a transaction in one of more financial instruments, the value of collateral, C, is the notional amount of collateral received by the FCA investment firm, decreased in accordance with the relevant volatility adjustment (see below).

5.72 For long settlement, repurchase, securities or commodities lending or borrowing, and any other types of securities financing transactions, the value of the C is the sum of the CMV of the security leg and the net amount of collateral posted or received by the FCA investment firm. If a contractual netting agreement satisfying a series of detailed requirements covers different types of transactions, the applicable volatility adjustments will be applied to the respective amounts calculated under both the security leg and the collateral leg on an issuer basis within each asset class. See Table 5 column C for the applicable volatility adjustments (volatility adjustment other transactions).

5.73 However, for securities financing transactions where both legs of the transaction are securities, the value of the C is the CMV of the security borrowed by the FCA investment firm.

5.74 If the FCA investment firm is purchasing or has lent the security, the CMV of the security will be treated as a negative amount and be decreased to a larger negative amount, using the relevant volatility adjustment below.

5.75 If the FCA investment firm is selling or has borrowed the security, the CMV of the security will be treated as a positive amount and be decreased by the relevant volatility adjustment below.

5.76 If there is a currency mismatch between the transaction and the collateral received or posted, an additional currency mismatch volatility adjustment of 8% will apply.

5.77 All collateral for both bilateral and cleared transactions will be subject to the volatility adjustments set out in **Table 5**.

Table 5: Volatility adjustment for different types of transaction

(A)		(B)	(C)
Asset class		**Volatility adjustment: repurchase transactions and securities lending and borrowing transactions**	**Volatility adjustment: other transactions**
Debt securities issued by central governments or central banks	≤ 1 year	0.707%	1%
	> 1 year ≤ 5 years	2.121%	3%
	> 5 years	4.243%	6%
Debt securities issued by other entities	≤ 1 year	1.414%	2%
	> 1 year ≤ 5 years	4.243%	6%
	> 5 years	8.485%	12%
Securitisation positions (excluding re-securitisation positions)	≤ 1 year	2.828%	4%
	> 1 year ≤ 5 years	8.485%	12%
	> 5 years	16.970%	24%
Listed equities and convertibles		14.143%	20%
Other financial instruments (including re-securitisation positions) and commodities		17.678%	25%
Gold		10.607%	15%
Cash		0%	0%

5.78 The references to years in column A of the above table are references to the remaining maturity of the relevant security or position.

5.79 As an example of how the volatility adjustment applies in practice, take an FCA investment firm that enters into an OTC derivative contract and receives collateral in the form of a debt security issued by a central bank with a maturity of 6 years. The notional value of the debt security is 100. The notional value of the collateral is required to be decreased by the applicable volatility adjustment. Applying the table above, the relevant volatility adjustment is 6%. The resulting value of C after the volatility adjustment has been applied is therefore 94.

Netting

5.80 For the purposes of calculating its K-TCD requirement, we propose that an FCA investment firm may, **in the following order**:

1. treat perfectly matching contracts included in a netting agreement as if they were a single contract with a notional principal equivalent to the net receipts

2. net other transactions subject to novation under which all obligations between the investment firm and its counterparty are automatically amalgamated so that the novation legally substitutes one set single net amount for the previous gross obligations, and
3. net other transactions where the FCA investment firm ensures that the following conditions have been met:

   a. those transactions are covered by netting contract with the counterparty, or by another agreement that creates a single legal obligation. That obligation would mean that the investment firm would have either a claim to receive, or obligation to pay, only the net sum of the positive and negative marK-to-market values of the individual transactions if a counterparty fails to perform due to any of the following:

      i. default
      ii. bankruptcy
      iii. liquidation, or
      iv. similar circumstances

   b. the netting contract does not contain any clause that, in the event of default of a counterparty, permits a non-defaulting counterparty to make limited payments only, or no payments at all, to the estate of the defaulting party even if the defaulting party is a net creditor
   c. the FCA investment firm has obtained an independent, written and reasoned legal opinion that, in the event of a legal challenge to the netting agreement, the investment firm's claims and obligations would be equivalent to those referred to in (a) above under each of the following legal regimes:

      i. the law of the jurisdiction in which the counterparty is incorporated
      ii. if a foreign branch of a counterparty is involved, the law of the jurisdiction in which the branch is located
      iii. the law that governs the individual transactions included in the netting agreement, or
      iv. the law that governs any contract or agreement necessary to effect the netting

Risk factor (RF)

5.81 The proposed risk factor for a counterparty is as set out in the following table:

Counterparty type	Risk factor
Central governments, central banks and public sector entities	1.6%
Credit institutions and investment firms	1.6%
Other counterparties	8%

Credit valuation adjustment (CVA)

5.82 The credit valuation adjustment (CVA) makes an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty to reflect the CMV of the credit risk of the counterparty to the FCA investment firm. It does not reflect the CMV of the credit risk of the investment firm to the counterparty.

5.83 The CVA for the following transactions is 1:

- transactions with certain non-financial counterparties, if they do not exceed the clearing threshold specified in article 10(3) and (4) of EMIR
- intra-group transactions as provided for in article 3 of EMIR
- long settlement transactions
- securities financing transactions
- credits and loans to an investor so that they can carry out a transaction in one or more financial instruments where the FCA investment firm granting the credit or loan is involved in the transaction by:
  - executing the trade in the name of the investor, or
  - receiving and transmitting the order without executing it

5.84 The CVA for all other transactions is 1.5.

5.85 The CVA is also 1.5 for securities financing transactions where we have notified an FCA investment firm that its CVA exposures from those transactions is material.

Daily trading flow K-factor requirement (K-DTF)

5.86 The K-factor capital requirement for daily trading flow or K-DTF is designed to capture the operational risks relating to the value of trading activity an FCA investment firm conducts throughout each business day. This could be from systems, processes, people and external events.

5.87 DTF measures the daily value of transactions an FCA investment firm carries out in its own name, including on behalf of clients. It does not include the value of orders handled for clients in the name of clients that are captured within the scope of K-COH – client orders handled. We will provide more information on the scope and how to calculate K-COH in a subsequent consultation.

5.88 DTF has 2 components that are to be measured separately – cash trades and derivatives trades. The FCA investment firm will then apply the following factor to calculate its own funds requirement:

- the cash trade component of DTF should be multiplied by 0.1%
- the derivatives trades component of DTF should be multiplied by 0.01%

5.89 The K-DTF will be the sum of the two components. It must be calculated on the first business day of each month.

5.90 DTF will be measured as a rolling average (using the arithmetic mean) of an FCA investment firm's daily trading flow measured over the previous 9 months, but excluding the 3 most recent months. It will be the sum of the absolute values of each buy and sell order.

5.91 We propose that a cash trade is an order that relates to the sale or purchase of any of the following:

- transferable securities
- money market instruments

- units in collective investment undertakings
- exchange-traded options

5.92 A derivatives trade is an order that relates to the sale or purchase of any financial instrument other than those listed above.

5.93 For cash trades, the value of an order is the amount paid or received on the trade. For cash trades relating to exchange traded options, the value of an order is the premium paid for the option.

5.94 For derivatives trades that **are not** related to interest rates, the value of an order is the notional amount of the contract calculated using the same method used to calculate the notional amount for the purposes of K-TCD.

5.95 For derivatives trades that **are** related to interest rates, the value of an order is the notional amount of the contract calculated using the same method used to calculate the notional amount for the purposes of K-TCD multiplied by the duration. The duration is the time to maturity in years, divided by 10.

Q10: **Are our proposals for the PMR sufficiently clear, including how it interacts with the ICR? If not, please explain what else could help.**

Q11: **Do you agree with our approach to K-NPR, which carries forward the current approaches to calculating market risk used in the UK CRR, including relevant rules and guidance from our current prudential sourcebooks?**

Q12: **Are the requirements relating to the application and calculation of K-CMG sufficient, or do you have any specific suggestions for improving them?**

Q13: **Do you have any specific comments on our detailed proposals for calculating the K-TCD, including the approach to potential future exposure?**

Q14: **Are our proposals for how to calculate K-DTF sufficiently clear? And should there be the possibility of an adjustment to calculating the coefficients for K-DTF in periods of extreme market stress and volatility? What specific suggestions do you have, and how could any adjustment operate effectively in the proposed framework for calculating K-DTF?**

6 Own funds requirements – transitional provisions

6.1 We are proposing several transitional provisions (TPs) to help FCA investment firms adjust to the proposed new minimum capital requirements of the IFPR. The majority of these apply in circumstances where there might otherwise be a relatively large increase for an individual firm compared to existing regulatory capital requirements. We also propose a TP for firms that are only authorised as FCA investment firms after the IFPR is introduced to ensure that they are not at a competitive disadvantage relative to existing firms that can rely on the other transitional arrangements.

6.2 These TPs apply to the PMR, the FOR or the K-factor requirement (KFR); it is possible to use more than one TP. Our intention is that the TPs will remain available for up to 5 years after the IFPR takes effect (except where stated otherwise). They are set out in MIFIDPRU TP2.

6.3 In addition, we propose a TP for where an investment firm group is subject to prudential consolidation and any FCA investment firm in that group is relying on any of the above TPs for its individual minimum own funds requirements. This is also set out in MIFIDPRU TP2.

6.4 We also propose a TP for calculating the K-factor requirement metrics given that their application uses historical observations of data points (and so would otherwise stretch back for considerable periods of time before the implementation date of the IFPR). This is set out in MIFIDPRU TP 4.

6.5 To ensure that both FCA investment firms, and parent undertakings of an FCA investment firm group where prudential consolidation applies, are able to calculate a K-factor requirement from the first day that the IFPR takes effect, we propose a further transitional as set out in TP 5. FCA investment firms should note that this TP imposes obligations that apply in the month immediately **before** the IFPR begins to apply.

Transitional provisions for the fixed overheads requirement and the K-factor requirement

Transitional provision for fixed overheads requirement and K-factor requirement for current IFPRU and BIPRU firms

6.6 This TP effectively caps the FOR or KFR as calculated using MIFIDPRU at twice the current own funds requirement of a current IFPRU or BIPRU firm (as is applied under the UK CRR or GENPRU, as appropriate). FCA investment firms will have to recalculate the alternative requirement regularly. Our proposal is that this recalculation should be done at least quarterly to fit in with regulatory reporting requirements.

6.7 The FCA investment firms to which this TP applies will still have to calculate their PMR. The PMR will be the firm's operative requirement, where it is higher than the above transitional requirement.

6.8 This TP does not apply to exempt-IFPRU and exempt-BIPRU commodities firms.

Transitional provision for fixed overheads requirement and K-factor requirement for current exempt CAD firms

6.9 Our proposal aims to ensure that larger exempt CAD firms (for whom the FOR or the KFR might bite) will have a smooth transition to the IFPR own funds requirements.

6.10 This TP caps the FOR and the KFR components of the own funds requirement of this current type of FCA investment firm to:

- its transitional PMR (see paragraph 6.15 below) for the first year
- 10% of its FOR or KFR (whichever is higher) for the second year
- 25% of its FOR or KFR (whichever is higher) for the third year
- 45% of its or KFR (whichever is higher) for the fourth year
- 70% of its FOR or KFR (whichever is higher) for the fifth year

6.11 The full requirement will then apply at the end of the fifth year.

6.12 For the avoidance of doubt, where the transitional PMR is higher than the capped FOR or KFR, the PMR will continue to be the operative requirement.

Transitional provision for KFR for firms that were not MiFID investment firms in the UK before the IFPR takes effect

6.13 We are proposing that an FCA investment firm, that was not a MiFID investment firm in the UK immediately before the IFPR takes effect, may cap its KFR at twice its FOR. The FOR should be recalculated during the transition period.

Transitional provisions for the permanent minimum capital requirement

6.14 The following TPs (paragraphs 6.16 to 6.20) do not affect an FCA investment firm's FOR or KFR. Where the FOR or KFR (modified by any relevant TP) is higher than the transitional PMR, an FCA investment firm's own funds requirement will still be the higher of its FOR or, if it applies, its KFR.

6.15 In addition, an FCA investment firm that applies to vary its permissions and, as a result has a higher PMR, will no longer be able to use the transitional provisions in paragraphs 6.16 and 6.17.

Transitional provision for the PMR for current exempt CAD firms

6.16 This TP allows firms that are exempt CAD firms immediately before the IFPR takes effect to gradually increase their PMR, up to £75,000.

Period from start of IFPR	Transitional PMR
TP year 1	£50,000
TP year 2	£55,000
TP year 3	£60,000
TP year 4	£65,000
TP year 5	£70,000
End of year 5 onwards	£75,000

Transitional provisions for the PMR for current IFPRU and BIPRU investment firms (except those that are currently 'matched principal')

6.17 These two TPs allow firms that will be IFPRU or BIPRU firms (except those that use the matched principal exemption) immediately before the IFPR takes effect to gradually increase their PMR own funds requirement from its existing level up the full applicable requirement under the IFPR.

Current base capital requirement	BIPRU	IFPRU 50k	IFPRU 125k	IFPRU 730k
TP year 1	£50,000	£50,000	£125,000	£730,000
TP year 2	£55,000	£55,000	£130,000	£735,000
TP year 3	£60,000	£60,000	£135,000	£740,000
TP year 4	£65,000	£65,000	£140,000	£745,000
TP year 5	£70,000	£70,000	£145,000	£750,000
End of year 5 onwards	£75,000	£75,000	£150,000	£750,000

Transitional provisions for the PMR for 'matched principal' firms

6.18 The matched principal exemption will no longer exist under the IFPR. This means that the PMR for FCA investment firms that deal on a matched principal basis will be £750,000. Our proposed TP applies to all IFPRU and BIPRU firms that currently use the matched principal exemption (under IFPRU 1.1.12R or BIPRU 1.1.23R).

6.19 We feel that this TP is more prudent than allowing such FCA investment firms to rely on the general PMR TPs as these do not provide a path to meeting the full £750,000 requirement. It would allow a gradual increase in the PMR up to £750,000 in the following stages:

- Year 1 – current base capital requirement
- Year 2 – £190,000
- Year 3 – £330,000
- Year 4 – £470,000
- Year 5 – £610,000

6.20 The full PMR of £750,000 applies from the end of year 5 onwards.

Transitional provision for the own funds requirement for 'local firms'

6.21 This TP will apply to firms that were UK MiFID investment firms before 25 December 2019 and will be 'local firms' immediately before the IFPR takes effect. Our proposal is to allow these firms to limit their minimum own funds requirement, gradually increasing it to £750,000 in the following stages:

- Year 1 – £250,000
- Year 2 – £350,000
- Year 3 – £450,000
- Year 4 – £550,000
- Year 5 – £650,000

6.22 From the end of year 5 onwards, the full own funds requirements of the IFPR apply – ie the highest of the PMR, the FOR, and the KFR.

Transitional provisions for the fixed overheads requirement and the K-factor requirement for exempt commodities firms

6.23 Our proposal aims to allow exempt (IFPRU and BIPRU) commodities firms to move from their current capital requirements to their own funds requirements under the IFPR (other than their PMR) over a period of 5 years. Instead of applying the FOR and the KFR as calculated using MIFIDPRU, the TP caps those elements of the own funds requirement under the IFPR to:

- its PMR for the first year
- 10% of its FOR or KFR (whichever is higher) for the second year
- 25% of its FOR or KFR (whichever is higher) for the third year
- 45% of its FOR or KFR (whichever is higher) for the fourth year
- 70% of its FOR or KFR (whichever is higher) for the fifth year

6.24 The full amount of its FOR or KFR (whichever is higher) will apply at the end of the fifth year

6.25 For the avoidance of doubt, where the PMR is higher than the capped FOR or KFR, the PMR will continue to be the operative requirement.

6.26 Where an exempt commodities firm is currently subject to IPRU-INV, its own funds should never drop below the amount of its financial resources requirement as if it continued to be subject to IPRU-INV as it stands on the day before the IFPR takes effect.

Transitional provision for calculating the consolidated own funds requirement

6.27 Our view is that an FCA investment firm group subject to prudential consolidation should not be prevented from taking account of any TPs used by an individual FCA investment firm within that group, for the purposes of determining its consolidated own funds requirement. We propose to do this by allowing consolidation groups to use a transitional 'credit' against their consolidated own funds requirement. This credit is based on the difference between the full MIFIDPRU requirement for each FCA investment firm that is part of the consolidated situation (ie the requirement that would apply if there was no transitional relief), and its transitional requirement on an individual basis. (See Chapter 3 for details on prudential consolidation).

Consolidated FOR

6.28 To calculate the transitional provision for the consolidated FOR ('A'):

- calculate the consolidated FOR in line with MIFIDPRU 2 ('B')
- deduct the transitional credit ('C')

6.29 To calculate C for the consolidation group, first calculate the credit available for each FCA investment firm individually:

- calculate its FOR as it would be under the IFPR without using any TPs that would otherwise apply ('D')
- calculate the alternative requirement that applies in place of its individual FOR using the relevant TP ('E')
- the credit available for that FCA investment firm is D – E

6.30 This step should be repeated for each FCA investment firm in the consolidation group. The credit available for the consolidation group FOR is the sum of the individual credits.

6.31 If an FCA investment firm does not have a TP for its FOR, there is no credit available.

6.32 'A' can never be lower than the sum of:

- the individual transitional FOR for each FCA investment firm for which there is an individual TP, and
- the individual FOR for each FCA investment firm for which there is no individual TP

Consolidated KFR

6.33 To calculate the transitional provision for the consolidated KFR ('F')

- calculate the consolidated KFR in line with MIFIDPRU 2 ('G')
- deduct the transitional credit ('H')

6.34 To calculate H for the consolidation group, first calculate the credit available for each FCA investment firm individually:

- calculate its KFR as it would be under the IFPR without using any TPs that would otherwise apply ('J')
- calculate the alternative requirement that applies in place of its individual KFR using the relevant TP ('K')
- the credit available for that FCA investment firm is J – K

6.35 This step should be repeated for each FCA investment firm in the consolidation group. The credit available for the consolidation group KFR is the sum of the individual credits.

6.36 'F' can never be lower than the sum of:

- the individual transitional KFR for each FCA investment firm for which there is an individual TP, and
- the individual KFR for each FCA investment firm for which there is no individual TP

K-factor metric calculations – transitional provisions

6.37 These TPs are set out in MIFIDPRU TP 4 and apply to individual FCA investment firms.

6.38 We recognise that the calculations behind some of the K-factor requirements require varying periods of historical observations of underlying metrics. These proposed TPs are therefore intended to aid the calculation of the K-factor requirements for existing FCA investment firms that are undertaking the relevant activities immediately before the IFPR takes effect. They are not relevant to FCA investment firms that need to calculate KFRs for new activities that they start after the IFPR is in place, as MIFIDPRU 4 specifies the use of business projections in this situation until historical data is available.

6.39 The duration of these transitional arrangements depends on the relevant K-factor metric. The transitional arrangements will cease to apply once a firm has (or should have) collected sufficient historical information to perform the necessary calculations in accordance with the standard calculation rules for the relevant K-factor metric in MIFIDPRU 4.

6.40 These TPs only apply to collecting the metrics relevant to calculating K-AUM, K-CMH, K-ASA, K-COH, K-DTF and K-CMG requirements. It is not relevant to its K-NPR, K-TCD or K-CON requirements as they do not use historical data.

6.41 These TPs only apply until the FCA investment firm has, or should have, collected enough historical data to be able to calculate the KFR in accordance with MIFIDPRU 4. The precise time these TPs remain available will depend on the precise KFR the FCA investment firm is calculating. For the avoidance of doubt, if a firm has suitable observed data for certain months, it must use those data points. The TPs can only be used for addressing missing historical data points.

6.42 We propose that an FCA investment firm may use reasonable estimates to fill any missing historical data points when calculating a particular KFR. On request, it must provide us with a reasonable explanation of how it has reached those estimates.

6.43 Alternatively, it can use the calculations set out in MIFIDPRU TP4. It should use this method where the FCA investment firm considers that it cannot reasonably estimate the missing historical data points.

6.44 The FCA investment firm should continue to use the same method for a specific KFR until it has enough historical data to calculate the KFR in accordance with MIFIDPRU 4.

6.45 This means that an FCA investment firm cannot, for example, use the calculations in TP 4 to calculate K-AUM for a few months, and then move to using estimates. The FCA investment firm can use different methods for different KFRs. For example, it might use reasonable estimates for AUM and the MIFIDPRU TP 4 method for COH.

6.46 Due to the requirement in MIFIDPRU TP 5 for firms to begin collecting relevant KFR data one month before MIFIDPRU begins to apply in full, all existing FCA investment firms will have at least one month's observed data by the time the new regime begins to apply. This will ensure that where necessary, they have a basis on which to apply the MIFIDPRU TP 4 calculation.

Applying the TP to KFR calculations

6.47 This section does not apply to K-CMG.

6.48 An FCA investment firm must first calculate the relevant average value for the K-factor. This is the monthly value for AUM, daily for the remaining K-factors.

6.49 This should be calculated over the number of months since the IFPR came into force (n) excluding the most recent months (y), where (y) is the greater of:

- zero, or
- (n) minus 12 when calculating AUM
- (n) minus 6 when calculating CMH, ASA or DTF
- (n) minus 3 when calculating COH

6.50 The first month during which IFPR begins to apply is treated as month 1 for these purposes (rather than month zero). During the first month, this calculation therefore uses the one month's worth of advance data the firm has collected to comply with MIFIDPRU TP 5.

Applying the TP to K-CMG calculations

6.51 An FCA investment firm must calculate the third highest amount of total margin according to MIFIDPRU 4 over the number of months since the IFPR came into force. Again, the first month during which IFPR begins to apply is treated as month 1 for these purposes.

K-factor metric calculations – transitional provisions for prudential consolidation

6.52 MIFIDPRU TP 4 also sets out a transitional provision on using the K-factor metrics if a UK parent of an FCA investment firm group applies MIFIDPRU 4 to its consolidated situation and the consolidation group includes:

a. an FCA investment firm to which MIFIDPRU TP 4 applies, or
b. a third-country firm to which MIFIDPRU TP 4 would apply, if it were established in the UK

6.53 A UK parent may use reasonable estimates to fill any missing historical data points when calculating a particular KFR. It should, on request, give us a reasonable explanation of how it has reached those estimates.

6.54 Alternatively, it can use the calculations set out in MIFIDPRU TP 4. It should use this method where it considers that it cannot reasonably estimate the missing historical data points.

6.55 All FCA investment firms in the investment firm group must use the same TP for the K-factor metrics when calculating a specific KFR. The UK parent must then apply the same approach to calculating a specific KFR on a consolidated basis as the FCA investment firms have applied on an individual basis.

Applying the TP to KFR calculations for prudential consolidation

6.56 This section does not apply to K-CMG.

6.57 A UK parent to which consolidation applies must first calculate the relevant average value for the K-factor (according to MIFIDPRU 4) on the basis of its consolidated situation. This is the monthly value for AUM, daily for the remaining K-factors.

6.58 This should be calculated over the number of months since the IFPR came into force (n) excluding the most recent months (y), where (y) is the greater of:

- zero, or
- (n) minus 12 when calculating AUM
- (n) minus 6 when calculating CMH, ASA or DTF
- (n) minus 3 when calculating COH

6.59 The first month during which IFPR begins to apply is treated as month 1 for these purposes (rather than month zero). During the first month, this calculation therefore uses the month's worth of advance data collected by the UK parent to comply with MIFIDPRU TP 5.

Applying the TP to K-CMG calculations for prudential consolidation

6.60 A UK parent to which consolidation applies must calculate the third highest amount of total margin (according to MIFIDPRU 4) on the basis of its consolidated situation over the number of months since the IFPR came into force. Again, the first month during which IFPR begins to apply is treated as month 1 for these purposes.

Advance data collection – transitional provision on collecting K-factor metrics

6.61 We propose a transitional provision, set out in MIFIDPRU TP 5, to ensure that both FCA investment firms, and the ultimate UK parent undertaking of an FCA investment firm group where prudential consolidation applies, are able to calculate a K-factor requirement from the first day that the IFPR takes effect.

6.62 MIFIDPRU TP 5 will require FCA investment firms and UK parents to begin collecting data on the K-factor metrics one month before the MIFIDPRU sourcebook begins to apply in full. It requires an FCA investment firm to only collect data on K-factor metrics that are relevant to the investment services/and or activities that it undertakes, or in the case of a UK parent, that relevant entities within its investment firm group undertake.

6.63 UK parents should note that where the FCA investment firm group includes third-country entities carrying on activities that would be relevant MiFID activities if they were carried on in the UK, they will need to collect data on K-factor metrics relevant to those entities.

Q15: **Do you agree with our proposals for the various transitional provisions relating to own funds requirements? Do you agree that they cover all relevant situations? If not, what specific suggestions do you have?**

Q16: **Are our suggestions for the transitional provisions for the initial collection and use of K-factor metrics practical? Do you have any specific suggestions for improvement?**

Q17: **If we did not introduce our proposed transitional provisions on advanced data collection of the K-factor metrics, what alternative solution would you propose?**

7 Concentration risk monitoring and K-CON

7.1 In this chapter, we explain how we propose concentration risk will work in relation to the IFPR. We set out our proposals for monitoring requirements for general concentration risk that will apply to all FCA investment firms. There are also reporting requirements on concentration risk for all non-SNI investment firms.

7.2 We also provide an overview of the various requirements that we propose will apply to the trading book exposures of FCA investment firms that deal on own account. This includes an additional K-factor requirement for concentration risk, known as the K-CON.

7.3 Finally, we describe when and how the requirements of this chapter will not apply to commodities and emissions allowance dealers.

7.4 Our proposed rules for concentration risk are set out in MIFIDPRU 5.

Monitoring and control of concentration risk

7.5 Harm can arise from more than just a concentrated trading book exposure to a client. To mitigate the potential for harm that can arise from different types of concentrated exposures or relationships, we propose that all FCA investment firms should monitor and control all their sources of concentration risk, including:

- exposures in a trading book
- assets (for example, trade debts) not recorded in a trading book
- off-balance sheet items
- the location of client money
- the location of client assets
- the location of its own cash deposits
- the sources of its earnings

7.6 When we refer to the location of client money/assets/cash, we mean that FCA investment firms should monitor and control the extent to which these assets are concentrated at particular banks, investment firms and other entities.

7.7 We propose to require FCA investment firms to identify not just individual clients but also groups of connected clients who may constitute a single risk because of their interconnectedness. Our proposed rules offer a detailed definition of what a group of connected clients means, based on the definition used in the UK CRR.

Reporting of concentration risk

7.8 Chapter 8 on reporting sets out in more detail the information on concentration risk that we are proposing to collect from non-SNI FCA investment firms. This includes, where applicable, information about the FCA investment firm's exposures or positions with its 5 largest counterparties. We propose that SNI investment firms will not be subject to the reporting requirement for concentration risk, although they must still monitor and control concentration risk.

Overview of concentration risk requirements for investment firms that deal on own account

7.9 The concentration risk requirements described in the following sections will only apply to the trading book exposures of an FCA investment firm that is dealing on own account. This includes:

- FCA investment firms that trade in their own name but on behalf of a client
- FCA investment firms that trade in their own name on a matched principal basis
- OTF operators that deal on own account on a matched principal basis or in illiquid sovereign debt

7.10 Our proposed rules cover:

- how to calculate the value of exposure to each client or group of connected clients, referred to as the exposure value or EV
- how to calculate the concentration risk 'soft limit' for exposure to a client or group of connected clients
- how to calculate the value by which exposure to each client or group of connected clients exceeds the concentration risk soft limit, referred to as the exposure value excess or EVE
- an obligation to notify the FCA if the value of exposure to a client or group of connected clients exceeds the concentration risk soft limit
- how to calculate a concentration risk capital requirement, the K-CON on the amount of the EVE
- preventing avoidance of the K-CON
- 'hard' concentration risk limits on the size of any individual exposure and the total level of concentrated exposures
- excluding certain types of exposures from the concentration risk requirements

Calculation of exposure value (EV)

7.11 Our proposals require FCA investment firms to calculate an exposure value or EV for each client or group of connected clients. Here 'client' means any counterparty of the FCA investment firm.

7.12 The EV is calculated by adding together the following items:

- the positive excess of long positions over short positions in all the trading book financial instruments issued by the client in question, using the approach for K-NPR to calculate the net position for each instrument
- the exposure value of contracts and transactions with the client in question, calculated using the approach for K-TCD

7.13 K-NPR and K-TCD are the K-factor requirements for net position risk and trading counterparty default – see Chapter 5 of this CP for details of how to calculate these.

7.14 FCA investment firms that have permission to use K-CMG (the K-factor requirement for clearing margin given) for any of their portfolios will still need to use the rules for the K-NPR to calculate their net position for the exposures in those portfolios, for the purpose of calculating any K-CON requirement.

7.15 The exposure to a group of connected clients must be calculated by adding together the exposures to the clients in the group.

Concentration risk 'soft limit'

7.16 Our proposed rules specify a concentration risk soft limit for trading book exposures to a client or group of connected clients. If the EV to a client or group of connected clients exceeds this limit, a further capital requirement, the K-CON, will then apply.

7.17 The concentration risk soft limit will generally be 25% of an FCA investment firm's own funds. However, where the client is, or the group of connected clients contains, one or more banks or investment firms, we propose that the soft limit should increase to the lower of £150 million or 100% of the FCA investment firm's own funds.

7.18 This is provided that, for the sum of EVs to connected clients that are not banks or investment firms, the concentration risk soft limit remains at 25% of the FCA investment firm's own funds.

Calculating exposure value excess (EVE)

7.19 A firm that exceeds the concentration risk soft limit for a client or group of connected clients will then be required to calculate the exposure value excess (EVE). The EVE will be used to calculate the K-CON.

7.20 The EVE for an individual client or group of connected clients is to be calculated using the following formula:

EVE = EV – L

where EV = the exposure value, and L = the concentration risk soft limit.

Calculating the concentration risk capital requirement – K-CON

7.21 For as long as a firm exceeds the concentration risk soft limit for one or more clients or groups of connected clients, it must calculate the concentration risk capital requirement or K-CON. The key elements needed to calculate K-CON on any concentrated exposure to a client or to a group of connected clients are the EV, EVE, the own funds requirement (OFR) relating to that exposure, and the number of days that the excess has persisted.

7.22 K-CON involves a 2-step calculation. The first step is an exposure-based calculation, known as the own funds requirement for the excess (OFRE). The second involves applying a multiplying factor to the OFRE (or applying different multiplying factors to tranches of the OFRE) based on the length of time for which the exposure has persisted and by how much (as a percentage of own funds) the EV exceeds the 'soft' limit.

7.23 For the purposes of the first step:

- the OFRE is determined by applying the following formula:

  OFRE = OFR/EV*EVE

- the OFR is the total amount calculated for K-TCD and of the specific-risk requirements for K-NPR for the relevant exposure (see Chapter 5 of this CP on K-factor requirements). FCA investment firms should ignore any requirement for general risk calculated as part of K-NPR, as it is only the specific risk that is relevant in terms of concentration to the client (or issuer) in question.
- if an FCA investment calculates a K-CMG requirement for a portfolio, it must calculate the OFR using the approach specified for K-NPR instead.
- the OFR for a group of connected clients is calculated by adding together the exposures to individual clients in the group.

7.24 For the purposes of the second step:

- the OFRE has a multiplying factor applied to it, determined by the length of time the exposure has exceeded the 'soft' limit and by how much (as a percentage of own funds) the EV exceeds the 'soft' limit
- in measuring the length of time the exposure has exceeded the soft limits, we propose to only include business days

7.25 Our proposed rules set out in detail how to calculate the K-CON. Below we provide two simplified worked examples to help explain how to do this. The first example covers where an excess has existed for 10 business days or less. The second is for where an excess continues to exist after 10 business days, and where extra steps are involved.

Worked example 1: How to calculate the K-CON own funds requirement for an exposure to a client that has existed for 10 business days or less

1	An FCA investment firm has:	
	a	own funds of 1,000
	b	its concentration risk soft limit (L) is 25% of own funds 1,000 x 25% = 250
	c	an exposure value (EV) of 262
	d	its exposure value excess (EVE) is its EV minus its soft limit (L) EVE = 262 – 250 EVE = 12

2	In this example, the exposure is all due to debt securities with a specific risk of 8%. This specific risk is taken from Table 1 in Article 336 of the UK CRR. (Note that in practice it is possible that an exposure could be made up of different types of positions to a client or group of connected clients, with different specific risk requirements.) There is zero K-TCD to this client. In this example, the OFR is therefore = 262 x 8% = 20.96
3	To calculate the own funds requirement excess (OFRE) $\text{OFRE} = \frac{\text{OFR}}{\text{EV}} * \text{EVE}$ $\text{OFRE} = \frac{20.96}{262} * 12$ $\text{OFRE} = 0.96$
4	This exposure has persisted for less than 10 business days. This means that to calculate the CON own funds requirement, the OFRE needs to be multiplied by 200% **K-CON own funds requirement** = 0.96 x 200% **= 1.92**

Worked example 2: How to calculate the K-CON own funds requirement for an exposure to a client that has existed for more than 10 business days

1	An FCA investment firm has:	
	a	own funds of 1,000
	b	its concentration risk soft limit (L) is 25% of own funds 1,000 x 25% = 250
	c	an exposure value (EV) of 780
	d	its exposure value excess (EVE) is its EV minus its soft limit (L) EVE = 780 – 250 EVE = 530
2	In this example, the exposure is all due to debt securities with a specific risk of 8%. This specific risk is taken from Table 1 in Article 336 of the UK CRR. (Note that in practice it is possible that an exposure could be made up of different types of positions to a client or group of connected clients, with different specific risk requirements.) There is zero K-TCD to this client. In this example, the OFR is therefore = 780 x 8% = 62.4	
3	To calculate the own funds requirement excess (OFRE) $\text{OFRE} = \frac{\text{OFR}}{\text{EV}} * \text{EVE}$ $\text{OFRE} = \frac{62.4}{780} * 530$ $\text{OFRE} = 42.4$	

<table>
<tr><td>4</td><td>This exposure has persisted for more than 10 days.
The OFRE should be allocated to the appropriate EVE band in the following table:
<table><tr><th>EVE as a percentage of own funds</th><th>Factor</th></tr><tr><td>Up to 40%</td><td>200%</td></tr><tr><td>From 40% to 60%</td><td>300%</td></tr><tr><td>From 60% to 80%</td><td>400%</td></tr><tr><td>From 80% to 100%</td><td>500%</td></tr><tr><td>From 100% to 250%</td><td>600%</td></tr><tr><td>Over 250%</td><td>900%</td></tr></table>Each allocation is then multiplied by the applicable band factor.</td></tr>
<tr><td></td><td>In this example, 40% of own funds is 400, and 60% of own funds is 600.
The FCA investment firm's EVE is 530.</td></tr>
<tr><td>5</td><td>The proportion of the OFRE that relates to the first 400 of the EVE needs to be multiplied by 200%
The proportion of the OFRE that relates to the remaining 130 of the EVE needs to be multiplied by 300%
<table><tr><th></th><th>EVE split by bands</th><th>allocating the OFRE across the bands</th><th>CON own funds requrement (OFRE x factor for that band)</th></tr><tr><td>a</td><td>400 (200% band)</td><td>$\frac{400}{530} * 42.4 = 32$</td><td>32 x 200% = 64</td></tr><tr><td>b</td><td>130 (300% band)</td><td>$\frac{130}{530} * 42.4 = 10.4$</td><td>10.4 x 300% = 31.2</td></tr></table></td></tr>
<tr><td>6</td><td>The total K-CON requirement for this exposure is the sum of the CON requirement for a and b.
K-CON = 64 + 31.2 = 95.2</td></tr>
</table>

Anti-avoidance procedures

7.26 Our proposals include rules to prevent FCA investment firms from deliberately avoiding the K-CON own funds requirement.

7.27 A firm must not undertake artificial transactions to close out the exposure and create a new exposure, or temporarily transfer the exposure to another undertaking, whether within the same group or not.

7.28 There is also a requirement to maintain systems which ensure that any closing out or transfer in breach of the above is immediately reported to the FCA.

Concentration risk 'hard' limits

7.29 It is prudent to set a maximum level of concentration risk that the trading book exposures of an FCA investment firms should not exceed. We are proposing that these 'hard' limits be set at:

- 500% of the FCA investment firm's own funds for an EV to an individual client or group of connected clients that has exceeded the soft limit for 10 business days or less
- 600% of the FCA investment firm's own funds for the total of all its exposure value excesses or EVEs that have existed for more than 10 business days

7.30 An exposure exceeding the concentration risk soft limit persists for as long as the overall exposure exceeds the concentration risk soft limit, irrespective of whether the constituent parts that make up that total exposure change over the duration of that total exposure.

7.31 The 600% limit applies to the aggregate of all individual EVEs for excesses that have persisted for more than 10 business days, irrespective of whether the individual concentrated exposures are connected to one another.

Notification requirements

7.32 If an FCA investment firm exceeds the concentration risk soft limit for a client or group of connected clients, it must notify us of the amount of the EVE, the name of the individual client or the group of connected clients concerned, without delay.

7.33 If an FCA investment firm exceeds either of the two hard limits, it will also be required to notify us without delay. This notification would include:

- the amount of the exposure or exposures that have led to the breach
- the name or names of the clients concerned
- any steps the FCA investment firm has taken or intends to take to deal with the breach and to prevent any future occurrence

Exclusions

7.34 Our proposals provide for some specific types of exposures to be excluded from the concentration risk requirements for dealing on own account. These are exposures:

- that have been deducted from own funds
- that are incurred during the ordinary course of settlement of:
  - payment services
  - foreign currency transactions
  - securities transactions
- that are incurred in the provision of money transmission

- to, or guaranteed by, the following (where they have a 0% risk weight in the UK CRR):
  - central governments
  - central banks
  - public sector entities
  - international organisations
  - multilateral development banks

7.35 We are also proposing to exclude exposures incurred by an FCA investment firm to its parent, to other subsidiaries or connected undertakings of that parent or to its own subsidiaries or connected undertakings. This is provided that those undertakings are supervised:

- on a consolidated basis in accordance with the IFPR or with UK CRR
- for compliance with the group capital test in accordance with IFPR, or
- in accordance with comparable standards in force in a third country

7.36 Two further conditions must also be met to use the above exclusion for intra-group exposures:

- there is no current or foreseen material practical or legal impediment to the prompt transfer of capital or repayment of liabilities
- the risk evaluation, measurement and control procedures of the parent include the relevant group entity

7.37 Currently, an FCA investment firm to which the existing large exposures regime applies is required to seek our permission to exempt certain intra-group exposures from the limits to large exposures in the UK CRR (under article 400(2)). The conditions for this permission are very similar to the proposed conditions for the exclusion under the IFPR. However, firms will no longer need to apply to us for permission before they can apply the new exclusion. We therefore expect that firms which exclude intra-group exposures under the UK CRR will continue to be able to exclude these exposures under the new regime, without needing to take any further action.

Exemption for commodities and emissions allowance dealers

7.38 Given the specific nature of trading in specialised commodities derivatives markets, we propose that the concentration risk requirements (including monitoring, reporting and limits and K-CON for trading book exposures) will not apply to commodity and emission allowance dealers where all the following conditions are met:

- the other counterparty is a non-financial counterparty
- both counterparties have appropriate centralised risk evaluation, measurement and control procedures
- the transaction can be assessed as reducing risks directly relating to the commercial activity or treasury financing activity of the non-financial counterparty or of that group

7.39 Commodity and emission allowance dealers will have to notify us in advance that they that wish to use this exemption and set out how their activity will meet these conditions. They will need to update this notification annually. If there is a material change to the information provided, the commodity and emission allowance dealer will have to notify us without delay.

Q18: **Do you have any comments on the proposal for monitoring and control of concentration risk? Please provide suggestions for any specific clarifications that you feel may be helpful.**

Q19: **Are the proposed concentration risk requirements for investment firms that deal on own account sufficiently clear? For example, how to determine the soft limit for exposures to a group of clients involving a mixture of banks and investment firms and corporates? If not, what improvements would you suggest?**

Q20: **Would you suggest any specific changes to our proposals for commodity and emission allowance dealers?**

8 Reporting requirements

8.1 In this chapter, we set out the changes we propose to make to regulatory reporting by introducing the IFPR. Our intention is to collect an appropriate amount of data that will let us supervise FCA investment firms against the requirements of the IFPR. The proposed reporting templates and instructions on how to complete them are available on www.fca.org.uk/publication/consultation/ifpr-reporting-forms.pdf and www.fca.org.uk/publication/consultation/ifpr-reporting-instructions.pdf.

8.2 Our proposals for calculating the values that should be reported are in:

- Chapter 4 of this CP for calculating own funds
- Chapter 5 of this CP for calculating PMR, K-NPR, K-CMG, K-DTF, and K-TCD
- Chapter 7 of this CP for calculating K-CON

8.3 Our next consultation will include:

- how we propose the FOR, the liquidity requirement and the remaining K-factors are calculated
- remuneration reporting requirements
- any additional reporting that may be required for ICARA purposes

Single suite of reporting forms for all FCA investment firms

8.4 We intend to introduce a single suite of IFPR reporting forms for all FCA investment firms. Currently, FCA investment firms complete different sets of regulatory returns depending on which prudential sourcebook they fall under and if they are subject to COREP or FINREP. This is complex for FCA investment firms as a change in permissions can result in a completely new set of regulatory returns. It is also complex for the FCA and makes comparing FCA investment firms with similar business models more difficult.

8.5 We are proposing to take a proportional and risk-based approach to IFPR reporting requirements. We will expect FCA investment firms to be able to produce additional detail on how they have calculated the information they have provided to us if we ask them to do so.

8.6 We are proposing that all FCA investment firms should report this information to us quarterly. The relevant reporting reference dates will be the last business day in March, June, September and December.

8.7 We propose to continue to require FCA investment firms to submit balance-sheet and income statement returns. However, all FCA investment firms will use FSA029 and FSA030 reports in the existing format for these purposes. These returns will also be required quarterly, but reporting reference dates will be determined by referring to the firm's accounting reference date.

8.8 We will retire FCA001, FSA002 and COREP returns for FCA investment firms.

8.9 Firms that are structures as partnerships or sole traders will also need to provide annual solvency statements, as under the current regime.

Reporting for SNI investment firms

8.10 We are proposing that SNI FCA investment firms will generally report in accordance with our proposals above, but with 2 exceptions:

- SNI firms are not required to submit reports relating to general concentration risk or the K-CON requirement (ie MIF004 and MIF005)
- If, exceptionally, the FCA has exempted an SNI firm from complying with the liquidity requirements under the IFPR, that firm is not required to submit the liquidity report (ie MIF002). We will set out our proposals on the IFPR liquidity regime, including any relevant exemptions, in our next consultation.

Reporting on fixed overheads

8.11 We will include additional information on calculating fixed overheads and the FOR in our next consultation. At that point, we will determine what additional detail we propose firms to report to us on the make-up of and deductions from a firm's fixed overheads. That consultation will highlight any changes to the reporting form.

Additional information from firms for K-factor calculations

8.12 At this stage, we are not proposing to routinely collect additional information showing how FCA investment firms have calculated individual K-factors. We do expect that FCA investment firms will be able to give us this information on request.

8.13 We may also ask firms with specific business models or those over a particular size to report some additional detail regularly. Additional information required for this, or in support of ICARA requirements, will be included in a later consultation.

Rationale for the data we are proposing to collect

8.14 To enable us to deliver our Mission and objectives, we must ensure that FCA investment firms have adequate financial resources to allow them to wind down in an orderly way, and to be able to put right any harm that they might cause to others. To support this, through regulatory reporting we need to:

- know that the capital an FCA investment firm holds is of sufficient quality that it can generally absorb losses, from whatever cause, without having an adverse effect on customers and markets. The same applies for holding liquid assets and being able to meet debts as they fall due
- know where an FCA investment firm is using a transitional capital requirement and which transitional capital requirement it is
- be able to monitor changes in an FCA investment firm's activities and size over time as these are likely to affect other requirements
- see what concentration risks an FCA investment firm might face from its counterparties – including with entities with which it has its own cash and where it places client money and assets

Consolidated and group reporting

8.15 If an FCA investment firm is part of a prudential consolidation group, we need to be satisfied that the group as a whole meets the requirements. Where the group capital test (GCT) is used, we need to be satisfied that investments in FCA investment firms are backed by enough capital of the right quality at the holding or parent company.

8.16 If an FCA investment firm group is subject to prudential consolidation (rather than the GCT), we are proposing that the UK parent entity for that group should submit reports on a consolidated basis. The reports that are required will depend on whether the UK parent entity is treated as an SNI or a non-SNI firm on a consolidated basis. We set out the criteria to determine this in Chapter 2 of this CP. A UK parent entity that is classified as an SNI firm on a consolidated basis will submit the same reports required from an SNI firm on an individual basis, but those reports will cover the consolidated situation of the group. The same approach will apply to a UK parent entity that is classified as a non-SNI firm on a consolidated basis.

8.17 If the GCT applies to an FCA investment firm group, each parent undertaking in the UK that is subject to the GCT must submit a separate return explaining how it complies with the relevant requirements. The reporting requirement for a responsible UK parent will depend on whether that parent undertaking has decided to:

a. hold own funds instruments to meet the requirement that would apply to its third-country subsidiary, or
b. ensure that the third-country subsidiary holds sufficient own funds instruments to satisfy the GCT at the third-country level

8.18 In point a above, the responsible UK parent will submit a single GCT return, but will include details of the holdings of the third-country subsidiary, as well as its own holdings.

8.19 In point b above, the responsible UK parent will submit 2 returns – one explaining how it complies with the GCT and another explaining how its third-country subsidiary does so.

8.20 We propose that investment firm groups may nominate a single FCA investment firm or UK parent entity to submit all reports required from the individual members of that group. This option is provided for administrative convenience, but does not relieve individual firms in that group of their ultimate responsibility for ensuring that they submit any reports relating to their individual position in an accurate and timely way.

Q21: Do you agree that all FCA investment firms should have the same basic regulatory reporting forms? If not, what changes to the regulatory reporting form do you suggest, and to which types of investment firm should they apply?

Q22: Do you agree with the frequency of the reporting? If not, please state what the frequency should be and explain why.

Q23: Do you think that the instructions for completing the regulatory forms are clear? If not, please specify where additional detail is required and what level of additional detail would be helpful.

9 Our approach to the FS Bill and compatibility with our duties and principles

9.1 When we consult on new rules, the FCA must meet certain requirements under Financial Services and Markets Act 2000 (FSMA). This CP also follows the Government's introduction of its FS Bill on 20 October 2020. As currently drafted, the FS Bill introduces a new Part 9C into FSMA. Part 9C includes provisions relating to the prudential regulation of FCA investment firms.

9.2 The FCA intends to meet the new obligations set out in the FS Bill ahead of the Bill coming into force. The current draft of the FS Bill permits this, to enable the FCA to consult stakeholders well in advance of implementing the new prudential requirements.

9.3 The drafting of new Part 9C may change over the course of the FS Bill's passage through Parliament. Nonetheless we believe consulting now is preferable to waiting until the Bill comes into force. This ensures the timely introduction of the IFPR while giving firms sufficient time to prepare for it. We will monitor the FS Bill's passage through Parliament, and consider whether any changes to its provisions require us to take any further steps before we introduce the new regime.

9.4 The scope of the secondary legislation that HM Treasury makes using the proposed regulation-making powers in the Bill will affect our powers to introduce the IFPR. Again, we will closely monitor the content of those regulations and reflect these in subsequent consultations if needed.

9.5 In this chapter, we set out:

1. the effect of the new provisions in the FS Bill, including the duties and public accountability requirements it sets out for us
2. how we intend to fulfil those duties through the draft rules set out in this CP
3. how our 'have regard to' considerations have affected our draft rules, with a specific focus on the new considerations set out in the FS Bill and reflecting our wider FSMA duties

FS Bill provisions

9.6 In the FS Bill, as introduced to Parliament in October 2020, provisions will dis-apply the CRR for FCA investment firms. It will give the FCA additional rule-making, information-gathering and enforcement powers over unauthorised holding companies of FCA investment firms. These are necessary to allow us to introduce the IFPR.

9.7 The FS Bill also sets out the duties, new 'have regard to' considerations and public accountability requirements that we must apply in our rule-making for the IFPR.

9.8 The FS Bill places a duty on the FCA to make rules for FCA investment firms, using our existing rule-making powers, to impose the following prudential requirements:

- the types and amounts of capital and liquid assets they must hold
- the management of risks arising from the strength of firms' relationships with, or exposure to, clients
- regulatory reporting
- public disclosure
- governance arrangements
- remuneration policies and practices

9.9 In doing so, we should look to address the risks to:

- consumers arising from investment firms
- the integrity of the UK financial system arising from investment firms
- which FCA investment firms are exposed

9.10 The FS Bill also imposes similar obligations to make prudential rules for authorised parent undertakings of FCA investment firms, and (if we think such rules are necessary or expedient to advance one of our operational objectives) for unauthorised parent undertakings of FCA investment firms.

9.11 The rules the FCA makes to meet these new duties under the FS Bill for the IFPR are referred to in the Bill as 'Part 9C Rules'.

9.12 The FS Bill sets out that when making or amending any Part 9C rules we must have regard to:

- any relevant standards set by an international body
- the likely effect of the rules on the relative standing of the United Kingdom as a place for internationally active investment firms to be based or to carry on activities
- any other matter specified by HM Treasury regulations

9.13 These new considerations are in addition to the FCA's existing statutory objectives, its duty to have regard to the regulatory principles in FSMA, and to the importance of taking action to minimise the extent to which it is possible for a business to be used for a purpose connected with financial crime. All of which are considered in the context of the matters set out in Chancellor's Recommendations for the Financial Conduct Authority letter of 4th November 2019. Unlike these existing obligations, the new considerations in the FS Bill only apply to Part 9C rules.

9.14 The FS Bill would also require us to consider, and consult HM Treasury on, the likely effect of the rules on relevant equivalence decisions. HM Treasury is responsible for determining what is considered a relevant equivalence decision and must notify the FCA of these in writing. This requirement also only applies to Part 9C rules.

9.15 The FS Bill also sets out new public accountability requirements. When we consult on our draft IFPR rules, we are required to explain:

- the provisions included to address the risks set out above
- the ways in which having regard to the above new considerations has affected the rules

This is in addition to our existing consultation requirements under section 138I of FSMA.

9.16 When we make our proposed rules to introduce the IFPR, we must also publish a summary of the purpose of the rules and explanations and a statement on the points above. We are also required to publish a list of the rules we consider to be Part 9C rules.

How we intend to fulfil our duties

9.17 In this section, we set out how we propose to make prudential rules to address in part the risks and fulfil our duties, as set out above.

9.18 As set out in the Chapter 1, we want to provide industry with sufficient time to prepare for the introduction of this new regime. We have therefore adopted a staggered approach to consultation where we set out now our draft rules on those areas where we believe industry needs more time to prepare, rather than waiting until later in 2021 to release a single consultation.

9.19 A consequence is that – as with our CBA – we will set out in this CP how we have fulfilled our duties and addressed the risks as required by the FS Bill provisions. But we will do this only in the context of the chapters for the new prudential sourcebook MIFIDPRU that we are consulting on in this CP. We will explain in later consultations how other elements of our proposals further address our duties and the risks set out.

9.20 Our intention is that our final consultation will bring together the elements covered in the preceding consultations.

9.21 In this CP we set out our draft rules to introduce the following chapters, or elements of them, of the new prudential sourcebook for MIFID investment firms:

- MIFIDPRU 1 – Application
- MIFIDPRU 2 – Prudential consolidation and the group capital test
- MIFIDPRU 3 – Own funds resources
- MIFIDPRU 4 – Own funds requirements
- MIFIDPRU 5 – Concentration risk
- MIFIDPRU 9 – Regulatory reporting

9.22 Below we set out how we believe our proposed rules in these chapters help us fulfil our duties and address the risks.

MIFIDPRU 1 – Application

9.23 Our current prudential regime for FCA investment firms encompasses a wide range of categories of firms. This is the result of our base regime being amended by various iterations of, and exemptions from, EU prudential legislation which has culminated in the CRR. Two notable consequences of this are that:

- the regime can be complex to understand, leading to the risk that firms inadvertently mis-apply the rules and expose themselves and others to harm
- it is harder for the FCA to be proportionate through the application of its rules.

9.24 Our proposals look to address this by simplifying the new regime by replacing all the existing categories of FCA investment firms with just two: SNIs, and non-SNIs. SNIs are not permitted to trade in their own name or hold client money or assets, and typically include smaller asset managers and advisers. We have proposed that these SNI firms benefit from a proportionate implementation of the regime in key areas such as calculating capital requirements, reporting, disclosure and remuneration requirements. The non-SNI category comprises all other FCA investment firms.

9.25 We consider that our proposals more clearly delineate between those firms that pose a wider risk of harm to markets and clients, and apply our supervisory focus accordingly. This allows us to better mitigate such harms.

MIFIDPRU 2 – Prudential consolidation and the group capital test

9.26 The level at which a firm holds financial resources, assesses its risks and governance, and at which we focus our supervisory oversight, is important in determining an individual firm or group's financial resilience. For solo-regulated firms that are part of a group the risk is that liabilities, losses or events arising from another entity in that group adversely affect the solo-regulated entity.

9.27 The CRR regime we currently apply to FCA investment firms looks to address these risks through consolidated supervision requirements, meaning that at a consolidated or group-wide level, adequate financial resources are held to cover risks across the group. However, prudential consolidation can be complicated to apply in practice, and it may be possible to address the risks arising from simpler group structures in a more proportionate way.

9.28 Under the CRR regime, groups which contain exclusively limited licence firms and/or limited activity firms may be eligible for a consolidation waiver. In practice, this has sometimes been used to avoid a capital deficit that would otherwise occur if the relevant group had to deduct goodwill from its consolidated financial resources. In extremis, this can mean that the capital of regulated firms is financed by significant amounts of debt at parent level. In turn, this can result in pressure on the regulated entity to transfer financial resources to the parent to service that debt, with implications for the financial resilience of the regulated firm and the wider group.

9.29 Our proposals look to address issues around group risk and consolidation, and so the risks FCA investment firms are exposed to by virtue of their relationship with their parent undertaking, by:

- clarifying the types of relationships that will result in an investment firm group for prudential purposes so as to capture the types of entities that might give rise to harm to consumers and to markets
- providing for a group capital test to ensure that an investment firm group has a stable financial structure, but as a less complex alternative to prudential consolidation for groups that have a sufficiently simple structure
- for groups that are subject to consolidation, providing more practical detail on how to capture the relevant potential risks arising across the group
- removing the existing investment firm consolidation waiver, which can lead to financially unstable group structures. We consider it will no longer be appropriate under the new regime, particularly due to the availability of the group capital test as a more proportionate alternative to prudential consolidation.

MIFIDPRU 3 – Own funds resources

9.30 The composition of capital or own funds resources used by firms to meet their capital requirements is of critical importance to their financial resilience. A key failure of the regime in place pre-2007/8 financial crisis was that not only did financial institutions hold inadequate levels of capital, but that the capital held did not have adequate loss absorbing capacity.

9.31 The Basel Committee on Banking Supervision (BCBS) subsequently set out new standards for the quality of capital banks should hold. These standards were largely adopted in the CRR and so applied to investment firms subject to that regime.

9.32 Our proposals in MIFIDPRU 3 look to build on the UK CRR by making changes for FCA investment firms to reflect their business models, and reflect changes to how capital requirements will apply under our proposed rules. The new rules also include some simplifications as to how a firm calculates its available capital. We are also proposing to extend the definitions of capital from the UK CRR to all types of FCA investment firms, including former BIPRU Firms and Exempt-CAD firms. These firms will no longer be able to use existing definitions of capital such as Tier 3 to meet their own funds requirements under IFPR.

9.33 As a result, the effect of our proposed rules for own funds resources will be to:

- make them more appropriate for FCA investment firms already subject to the UK CRR before the IFPR
- improve the financial resilience of other FCA investment firms currently not subject to the same quality of capital requirements.

This will better address risks to consumers and the integrity of the financial system. It will also ensure consistency across the population of FCA investment firms.

MIFIDPRU 4 – Own funds requirements

9.34 As noted above, the absence of sufficient own funds, both in absolute terms and the quality of capital required, was a key driver of firm failure during the 2007/8 financial crisis. In response, the CRR raised the quantum of capital held, including for the FCA investment firms to which it applied.

9.35 However, the BCBS regime is designed to address the risks faced by deposit-taking institutions. So, while the CRR raised the quantum of capital, how this is calculated does not reflect the business models of investment firms.

9.36 Furthermore, other aspects of the own funds requirements for FCA investment firms were not updated in the various legislative changes that followed the financial crisis. Most notably, the initial capital required for authorisation has not been updated for FCA investment firms since 1993, despite inflation and significant changes to the affected firms in terms of size and business model.

9.37 We are proposing changes that address both these issues. By updating the initial capital for the authorisation for FCA investment firms we are looking to ensure that the baseline for authorisations more accurately reflects the changing nature of the risks posed. We then propose to ensure that at least this basic minimum amount is maintained at all times through applying a 'permanent minimum' capital requirement.

9.38 In addition, all FCA investment firms will now be subject to a fixed overheads requirement. Its aim is that any exit from the market takes place in a more orderly manner.

9.39 Further, by introducing the K-Factors methodology, larger FCA investment firms to which it applies will also assess risks and hold capital that better reflects (than the BCBS regime) their business model and the potential harm posed to consumers and markets. This should help better align capital requirements to harm.

9.40 The overall effect of these various own funds requirement rules is intended to be that in future all FCA investment firms hold, at all times, an adequate minimum level of financial resources.

MIFIDPRU 5 – Concentration risk

9.41 Having excessive exposure to, or relationships with, a single or limited number of counterparties or connected counterparties can put financial institutions at risk if those counterparties run into difficulties. Sources of concentration risk for FCA investment firms can arise in different ways, including from a trading book, off balance sheet items, the location of client money, assets and deposits, and sources of earnings.

9.42 Diversification of counterparties is a key risk-mitigation strategy firms should apply. To encourage this, and to help build up financial resilience among FCA investment firms that have a concentration of counterparties, we are proposing rules that require FCA investment firms to monitor and control concentration risks. To ensure that we are proportionate to the risk posed, regulatory reporting on concentration risk will not apply to those FCA investment firms that are SNIs.

9.43 To further address the requirement set out in the FS Bill on managing risks arising from the strength of firms' exposure to clients, we are also proposing a further set of requirements for FCA investment firms with a trading book: the introduction of the K-CON K-factor. This calculates a minimum amount of own funds an FCA investment firm is required to hold based on its exposure to individual or connected counterparties. And we are proposing a limit on the maximum concentration risk an FCA investment firm can have to a counterparty or group of connected counterparties, independent of the K-CON charge they receive for it.

9.44 With the proposed concentration risk rules, we believe we are addressing risks to individual FCA investment firms, and by better correlating capital with concentration in the system, the wider integrity of the financial system.

MIFIDPRU 9 – Regulatory reporting

9.45 Without access to relevant and timely data on the risk profile of FCA investment firms, the FCA may not be able to identify trends in individual firms or groups of firms that point to potential risks to their financial resilience. FCA supervisors may also be unable to identify outliers among a cohort of firms that can be a prompt for further supervisory investigation.

9.46 For FCA investment firms, having to produce and process excessive volumes of data that does not typically relate to their business model can distract both them and FCA supervisors from being able to focus on core relevant data.

9.47 The collation of appropriate regulatory reporting data helps firms get a better understanding of their regulatory risk profile, allowing them to identify potential risks to their resilience and take steps to address this. The ability of an FCA investment firm to consistently and accurate provide regulatory data can often indicate the effectiveness of its wider data gathering, IT and operational or governance.

9.48 We are proposing a move to more targeted and business-model-specific reporting requirements. This will remove the need for FCA investment firms to report COREP data and substantially reduce the number of data points a firm is expected to provide.

9.49 In our view, this will improve prudential outcomes as it will:

- allow both firms and supervisors to focus on the core business model indicators of financial resilience relevant to FCA investment firms
- reduce the unnecessary burden of reporting and analysing data of little value in identifying and mitigating against potential harm

Our proposals will also ensure greater consistency across the FCA investment firm population. This will facilitate greater comparability between firms.

Summary

9.50 We consider the impact of the proposals that we have set out in this CP will be to reduce the risks to consumers, to which FCA investment firms are exposed (including by virtue of their relationship with their parent undertaking), and to support the integrity of the financial system.

9.51 In so doing, these proposals are part of the fulfilment of our duties under the FS Bill to impose the following requirements on FCA investment firms and their parent undertakings:

- the types and amounts of capital they must hold
- the management of risks arising from the strength of firms' relationships with, or exposure to, clients
- regulatory reporting

9.52 We will set out in later consultations how we will complete the fulfilment of these duties, and our proposals to impose the other requirements on FCA investment firms and their parent undertakings as set out in the FS Bill.

Advancing our objectives

9.53 When proposing changes to our rules, our approach is guided by advancing our operational objectives. The proposals set out in this CP are primarily intended to advance our objectives to enhance the integrity of the UK financial system and promote effective competition in the interests of consumers.

9.54 We consider these proposals compatible with the FCA's strategic objective of ensuring that the relevant markets function well. They are intended to reduce the potential harm that an investment firm may cause to its clients or markets by better aligning standards with their business model and source of harm. More appropriate standards should prevent a firm's disorderly failure, protecting consumers and improving the stability of the financial sector overall.

9.55 The regime will also support our competition objective by treating all investment firms in a more consistent and simpler manner. This allows for better competition between investment firms which operate within consistent regulatory standards. A more resilient and fairer competitive landscape should benefit consumers, particularly FCA investment firms' clients, as they can be confident that the market operates efficiently and that smaller firms, which may offer services more appropriate to their needs, are financially resilient.

How we have taken account of our 'have regard to' considerations in developing the draft rules

9.56 When proposing changes to our rules, we are required to have regard to factors set out in FSMA, and the recommendations in the Chancellor's Recommendations for the Financial Conduct Authority letter. The FS Bill proposes two further considerations we must apply for the purposes of our IFPR rule-making:

- having regard to any relevant standards set by an international body
- having regard to the likely effect of the rules on the relative standing of the United Kingdom as a place for internationally active investment firms to be based or to carry on activities

Relevant standards set by an international body (as proposed by the FS Bill)

9.57 For the purposes of the MIFIDPRU chapters included in this CP we have only identified one relevant standard for investment firms: IOSCO's 'Core Principle 30'. This sets out that: 'there should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake'.

9.58 We consider that the proposals set out in this CP are consistent with the standard. Our proposed rules ensure that the prudential requirements set out in IFPR meet the risks and reflect the business models of FCA investment firms. These include elements of the rules for setting initial and ongoing capital requirements, the remainder of which we will be set out in our next consultation.

9.59 In our next consultation, when we set out our proposed rules on remuneration and governance, we will explain how we have had regard to the relevant international standards that apply in these areas.

The relative standing of the UK (as proposed by the FS Bill)

9.60 The Chancellor's letter with Recommendations for the FCA (received on 4 November 2019) requires us to consider the impact of our rule-making on the UK's attractiveness for internationally active financial institutions when developing any policy intervention.

9.61 The new 'have regard to' duty set out in the FS Bill addresses a similar issue, but places a wider framework by requiring us to consider our 'relative standing'.

9.62 When considering this, it is first necessary for us to establish a baseline of where the UK stands before the proposed rules come into force.

9.63 The UK is the world's largest or second largest financial centre by most measures, and has the highest number of domestic and international investment firms operating in Europe. As such, we believe the UK has a strong relative standing as a place for international investment firms to establish and conduct business. This is confirmed in discussions we have with firms and industry bodies. They state that the deep pool of skilled labour, deep capital markets, time zone, and strong, informed and consistent regulatory approach are all positive drivers in this regard.

9.64 For the purposes of our IFPR rule-making, the most relevant other country or territory where in our opinion internationally active investment firms could choose to be based or carry on activities jurisdiction is the EU. It is the other major jurisdiction currently introducing a prudential regime for investment firms, shares broadly the same time zone, has deep capital markets, and a labour pool with the relevant financial services skill set.

9.65 The EU's IFR/IFD is the baseline for the UK's IFPR. Our intention is to achieve the same outcomes with IFPR as that of the IFR/IFD. This, in part, reflects the level of input we had on the design of the EU's regime. This approach, we believe, will positively impact the relative standing of the UK in the eyes of internationally active investment firms.

9.66 As we have considered aspects of the EU's regime (at least those published to date), and the impact of its introduction in the UK, we have had regard to the specifics of the UK market and the business models of investment firms located here. We agree with the outcome the EU regime is looking to achieve. But we have identified areas of the EU's regime that – if introduced on a line-by-line basis in the UK – could lead to less optimal outcomes, both prudentially and on FCA investment firms' business models.

9.67 There are three areas in particular, where having regard to the UK's relative international standing – both as a jurisdiction that places a high emphasis on maintaining market integrity, and in terms of ease of doing business – has been our consideration for our proposed rules.

The application of the K-CMG K-factor

- The EU's rules take a single view on the structure of trading desks and the clearing arrangements that investment firms operate. This may be appropriate for many markets. But in our view it does not reflect the reality of how the trading desks of UK-based investment firms operate.
- Introducing the EU's rules could require firms to change their business models and how they approach risk management beyond that which we consider necessary or appropriate to achieve the desired outcomes. Our approach, taking this impact into consideration, is to propose a set of rules in MIFIDPRU 4 on the application of K-CMG that achieve the same prudential outcomes, but in a risk-based and proportionate way to reflect the business models of UK firms.

Our new regulatory reporting requirements

- The EBA is still consulting on its proposals for the EU's IFR reporting requirements. Its draft proposals envisage over 30 different types of data collection forms, and retaining COREP.
- As we have considered the appropriateness of the EU's approach, we have had regard to the value implications for FCA investment firms of maintaining such an

approach to reporting versus the supervisory benefits to us of obtaining such quantities of data. The EBA may adopt a different approach, and we may iterate our approach at a later stage. But in this CP we are proposing more proportionate regulatory reporting requirements that are bespoke to the UK. We are also proposing to stop collecting COREP data and to reduce duplication of other data compared to current CRR requirements.

Our proposed treatment of intangible assets deducted from own funds

- The EU's rules allow for the carve-out of certain eligible software from CET1 deductions. This reflects the EU's approach to the CRR2. However, in our draft MIFIDPRU 3 rules we are proposing that all intangible assets must be deducted in full, with no carve-out for software.
- We have considered the impact our proposed approach would have on the UK's international standing. Taken in isolation, international firms for whom this carve-out was substantial may view this negatively in terms of the UK's relative standing. However, on balance, and considering our wider objectives and desire to raise prudential standards, we do not believe the carve-out is appropriate.

Likely effect on equivalence decisions (as proposed by the FS Bill)

9.68 As part of the process of drafting the rules in this CP we have discussed with HM Treasury the rules' likely effect on relevant equivalence decisions. We are not expected under our new public accountability requirements to provide further detail on this.

The need to use our resources in the most efficient and economical way

9.69 We have designed our proposals to be proportionate and ensure FCA investment firms are clear about our expectations.

9.70 For example, our new data-gathering proposals are more targeted and business-model specific. They remove the need for FCA investment firms to report COREP data and substantially reduce the number of data points they are required to provide.

9.71 In our view, our proposals should allow both FCA investment firms and supervisors to focus on the core business model indicators of financial resilience relevant to each firm, and result in a more efficient and economic allocation of resources for both.

The principle that a burden or restriction should be proportionate to the benefits

9.72 As we have noted throughout this CP, a key driver for our proposed rules is to address the issue that the burden and focus of the existing regime is not fully aligned with the harm that FCA investment firms present. This means that some groups of FCA investment firms do not hold sufficient financial resources to mitigate their potential for harm; others hold too much, or are subject to other burdens such as reporting costs, that do not align with the risks they pose. This is particularly the case for smaller, non-interconnected firms.

9.73 Through our proposed rules, and in keeping with the above principle, all FCA investment firms will benefit from a bespoke regime that reflects their business models. Smaller firms will also benefit from the built-in proportionality for calculating capital requirements and reporting requirements that we propose in this CP; and from disclosure and remuneration requirements that we cover in later consultations.

9.74 We have included a full analysis of the costs and benefits of our proposals in Annex 2.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

9.75 Given the importance of FCA investment firms to the functioning of the UK and global economy, it is in everyone's interest that they are held to prudential standards that are proportionate to the risks they pose to clients, other firms and the wider market.

9.76 The current prudential regime was designed for globally active systemically important banks. This means that the current requirements are not designed to address the specific harms that investment firms may pose, based on the different activities they carry out.

9.77 By contrast, under the IFPR, FCA investment firms will be required to hold financial resources proportionate to the scale and nature of the risks they pose. This should ensure that, if an investment firm has to wind down, it can do so in an orderly manner.

9.78 Introducing a regime that supports orderly wind-down will avoid wider disruption to the UK economy during periods of financial stress, thereby helping to drive sustainable long-term growth.

9.79 We consider that our more targeted approach to requirements should lead to better prudential outcomes, greater stability and overall confidence in the industry, and therefore bring benefits to the wider economy.

The general principle that consumers should take responsibility for their decisions

9.80 The proposals are primarily prudential and about reducing the potential that an investment firm may cause to its clients and markets. Consumers do not typically have any influence over these.

The responsibilities of senior management

9.81 Senior managers should understand the proposals and the impacts they may have on their firm. We expect senior management to take responsibility for their firms' compliance with the new reporting requirements consistent with their responsibilities under the Senior Managers & Certification Regime.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation

9.82 Our proposals are designed to ensure greater proportionality and alignment of standards with firms' business models, size and the relevant risks they pose.

9.83 For example, our new differentiation between SNI and non-SNI FCA investment firms should ensure that smaller firms are not subject to requirements that are disproportionate to their size and the risks they pose.

The desirability of publishing information relating to persons subject to requirements imposed under FSMA, or requiring them to publish information

9.84 Our proposals in this CP do not require firms to publish, or make publicly available, confidential or commercially sensitive information.

9.85 We support public disclosure as a way to allow third parties – whether investors in the firm, counterparties or clients – to monitor and compare the risks that investment firms take. We believe this promotes good governance and allows investors and counterparties to make more accurate decisions. We will consult on disclosure of prudential data for investment firms in a later consultation.

The principle that we should exercise our functions as transparently as possible

9.86 Our consultation processes are intended to transparently set out the thinking behind our proposals and clearly explain what we expect to achieve. We will continue to engage with industry and other stakeholders to obtain feedback during the consultation process to ensure transparency and clarity in our approach.

9.87 In formulating these proposals, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s. 1B(5)(b) FSMA). We do not consider this relevant to our proposals.

Annex 1
Questions in this paper

Q1: Do you agree that FCA investment firms with permission to deal on own account and/or underwrite or place financial instruments on a firm commitment basis (as indicated by a permission to deal as principal in financial instruments) should not be considered an SNI? If not, please include in your response what you consider to be a suitable quantitative threshold for these activities.

Q2: Do you agree with the quantitative thresholds, as set out in Figure 1, that we are proposing? If not, please include in your response what you consider to be suitable quantitative thresholds.

Q3: Do you think that any other criteria should be considered for determining if an FCA investment firm can be an SNI? Please provide examples and thresholds as appropriate.

Q4: Do you have any specific comments on our proposals for the scope and methods of prudential consolidation? Please provide evidence to support any changes? Is there anything relevant to consolidation that is not covered in our rule proposals?

Q5: Are our proposals for how to calculate the consolidated own fund requirements (including the consolidated fixed overheads requirement, the consolidated permanent minimum requirement and the consolidated K-factor requirement) clear and sufficient? If not, do you have any specific suggestions for how to improve this?

Q6: Do you agree with our approach towards the use of the group capital test (as an alternative to prudential consolidation), including our proposal for a transitional provision to allow its use as part of our initial implementation of the IFPR?

Q7: Do you agree with the proposals for the definitions and types of, and deductions from, regulatory capital that investment firms should use to calculate their own funds? Do you think that any additional simplification is needed? If yes, please provide suggestions.

Q8: **Do you agree with our proposals for trigger events for the conversion or write-down of AT1 instruments, including setting the minimum the same as under the UK CRR but expressed in a different way to reflect the structure of capital under the IFPR? If not, please let us know why and what trigger events you think there should be instead?**

Q9: **Do you agree with our proposed transitional provisions for existing permissions in respect of own funds instruments (under UK CRR)? Do you think that any additional transitional provisions are necessary and if so, please identify what they should be and why?**

Q10: **Are our proposals for the PMR sufficiently clear, including how it interacts with the ICR? If not, please explain what else could help.**

Q11: **Do you agree with our approach to K-NPR, which carries forward the current approaches to calculating market risk used in the UK CRR, including relevant rules and guidance from our current prudential sourcebooks?**

Q12: **Are the requirements relating to the application and calculation of K-CMG sufficient, or do you have any specific suggestions for improvement?**

Q13: **Do you have any specific comments on our detailed proposals for calculating the K-TCD, including the approach to potential future exposure?**

Q14: **Are our proposals for how to calculate K-DTF sufficiently clear? And should there be the possibility of an adjustment to calculating the coefficients for K-DTF in periods of extreme market stress and volatility? What specific suggestions do you have, and how could any adjustment operate effectively within the proposed framework for calculating K-DTF?**

Q15: **Do you agree with our proposals for the various transitional provisions relating to own funds requirements and that they cover all relevant situations? If not, what specific suggestions do you have?**

Q16: **Are our suggestions for the transitional provisions for the initial collection and use of K-factor metrics practical? Do you have any specific suggestions for improvement?**

Q17: **If we did not introduce our proposed transitional provisions on advanced data collection of the K-factor metrics, what alternative solution would you propose?**

Q18: **Do you have any comments on the proposal for monitoring and control of concentration risk? Please provide suggestions for any specific clarifications that you feel may be helpful.**

Q19: **Are the proposed concentration risk requirements for investment firms that deal on own account sufficiently clear? For example, how to determine the soft limit for exposures to a group of clients involving a mixture of banks and investment firms and corporates? If not, what improvements would you suggest?**

Q20: **Would you suggest any specific changes to our proposals for commodity and emission allowance dealers?**

Q21: **Do you agree that all FCA investment firms should have the same basic regulatory reporting forms? If not, what changes to the regulatory reporting form do you suggest, and to which types of investment firm should they apply?**

Q22: **Do you agree with the frequency of the reporting? If not, please state what the frequency should be and explain why.**

Q23: **Do you think that the instructions for completing the regulatory forms are clear? If not, please specify where additional detail is required and what level of additional detail would be helpful.**

Annex 2
Cost benefit analysis

Introduction

1. FSMA, as amended by the Financial Services Act 2012, requires us to publish a CBA of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'.

2. This analysis presents estimates of the impacts of our proposal discussed in this consultation. We provide monetary values for the impacts where we believe it is reasonably practicable to do so. For others, we provide estimates of outcomes in other dimensions.

3. The scope of this CP and corresponding CBA focus on own funds, a subset of own funds requirements both at a solo and consolidated level, and reporting. Subsequent consultations will cover the remaining elements of the Investment Firm Prudential Regime, and will include the relevant CBAs.[1]

4. This CBA has the following structure:

a. Section 1 outlines the problem and rationale for our proposed intervention.
b. Section 2 presents our baseline and key assumptions.
c. Section 3 lays out our estimates and analysis of the costs and benefits.

Problem and rationale for our proposed intervention

5. FCA investment firms are an important element of a well-functioning economy. They help ensure capital is allocated efficiently and appropriately and help individuals make the most of their savings and investments. If FCA investment firms are not financially resilient, their failure, if it occurs in a disorderly manner, could bring disruption to clients or the markets in which they operate. This means it is necessary for such to be held to appropriate prudential standards.

6. Furthermore, decisions and choices of individual market participants can lead to negative externalities. These are side effects on third parties, such as consumers, other firms, the taxpayer, or the wider economy, that are not necessarily taken into account by these market participants. This can lead to a suboptimal (low) level of capital held. Where FCA investment firms fail, this can have knock-on effects on the markets or the economy. However, if the prudential requirements are set too high, this

1 Additional capital requirements due to firm-specific risks may be identified by firms themselves or through the supervisory review process. These are not addressed through our proposed methodologies as set out in our rules and are therefore not in scope. As a result, we have not produced an estimate of the costs and benefits of any such firm-specific requirements.

could lead to inefficient allocation of capital based on measures such return on capital employed.

7. Our proposed intervention aims to achieve a better balance between avoiding the excessive social cost from firm failure and ensuring the efficient allocation of capital. The proposed regime is expected to generate benefits to FCA investment firms and the market. We expect that firms subject to the proposed regime would find the new prudential framework more appropriate and proportionate to their business model and less burdensome than the current requirements. Prudential requirements that better align with an FCA investment firm's business model should also help improve the financial stability in the sector overall. This should have positive implications for consumer protection and particularly for clients of these firms, either because it reduces the potential for firm failure itself, or because it reduces the potential for disorderly failure in the event that a firm does fail including restoring consumers back into the position they should have been in. The proposed changes should help reduce economic losses in drawn-out insolvency proceedings or reliance on investor compensation schemes, avoiding consequent impacts on other firms to top-up these schemes to handle pay-outs. Overall confidence, investor sentiment and market stability should also benefit.[2]

8. The proposed regime will be closely aligned with the new EU regime – the IFD/IFR, while taking into consideration the specifics of the UK market. The details of the EU's new prudential regime for investment firms can be found in our June 2021 Discussion Paper- DP20/2.

Baseline and key assumptions

Baseline – current regulatory regime

9. It is necessary to establish a baseline against which to assess the costs and benefits of an intervention to ensure that only those attributable to the intervention are considered.

10. The EU's proposed rules introducing a new regime for investment firms were published last year. As the UK is no longer a member of the EU, we are not obliged to implement the EU's rules. We have discretion to decide whether to implement a UK domestic regime that reflects the new EU regime for investment firms or certain parts of it. We consider that the existing levels of regulatory requirements and the current market conditions are an appropriate baseline, because absent our proposed rules, those existing requirements would continue.

11. We will compare our proposals against the current prudential framework that either specifies direct requirements for UK investment firms or defines the scope of the FCA's discretion to apply other prudential requirements i.e. the on-shored CRD IV and the CRR regimes.[3] Where an IFPR requirement impacts a firm in a materially different way to these regimes, this will be set out in this analysis. Some of our proposals will be aligned with the EU, so we will also consider the case made by the EU in making its proposals.

2 Also see EU Impact Assessment of the Review of the appropriate prudential treatment for investment firms for the rationale and expected benefits from the proposed changes (available here: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/1307-Review-of-the-appropriate-prudential-treatment-for-investment-firms).

3 References to the "CRR" in this CBA are to the onshored version of the CRR as it is expected to apply in UK domestic law by virtue of the European Union (Withdrawal) Act 2018 (as amended) and any related subordinate legislation.

Scope

12. This CBA will only assess costs and direct benefits of proposals covered by this consultation. The scope of this CP covers elements of the IFPR where the proposed changes are either neutral or beneficial. In this case, the proposed rules either closely resemble the current regime, or are not expected to require firms to make changes to business models or incur substantial costs.

Affected firms

13. The IFPR will apply to around 3,200 investment firms regulated by the FCA. This is based on the number of firms with relevant permissions on the Financial Services Register.

14. We have defined three categories of investment firms: Small, Medium and Large (note that this differs from the proposed approach to categorisation set out in Chapter 2 of this CP and MIFIDPRU 1, and is purely for the purpose of this CBA). Two of these ((a) and (b) below) are FCA investment firms and are covered by the IFPR:

a. Small firms – non-systemic investment firms that are either SNI (small and non-interconnected) firms or small non-SNI firms, of which there are in total around 3,000. These firms are subject to the IFPR and capital will be driven by either the permanent minimum capital (PMC) or fixed overhead requirement (FOR). The K-factors[4] though applicable for small non-SNI firms is not expected to be greater than the PMC or FOR. This is because some small firms will be categorised as non-SNI investment firms, due only to breaching one or more of the following zero calibrated thresholds for ASA, CMH, DTF, TCD, NPR or CMG by the smallest amount

b. Medium firms – non-systemic investment firms that are non-SNI firms of which there are around 200. These firms are subject to the IFPR and their own funds requirement will be the higher of permanent minimum capital (PMC), fixed overhead requirement (FOR), and K-factor methods. For these firms, it is expected that it will be the K-factors that drive the capital requirements.

c. Large firms – systemic investment firms of which there are 8. These firms are not subject to the IFPR but will remain subject to the CRR/CRDIV and prudentially regulated by the PRA. These firms, since they are not subject to the IFPR, are not part of the CBA.

Data

15. We conducted this analysis of the costs and benefits of the consultation proposals using data held by the FCA. These data include information provided through firms' regulatory returns and the application of the FCA's standardised costs model to estimate compliance costs as a result of the proposed intervention.[5] We have separately issued a data request to collect data from firms to support later consultations.

4 'K-factor' concept is a capital calculation based on the activities that an investment firm undertakes. See paragraph [1.30-1.31] of the consultation.

5 Standardised Cost Model: https://www.fca.org.uk/publication/corporate/how-analyse-costs-benefits-policies.pdf#page=40

Costs and Benefits

Summary of costs and benefits

16. In the sections below, we have assessed the implementation costs, the costs arising from the proposed prudential rules and the expected benefits.

17. The following table sets out a summary of the estimated implementation costs, which are one-off costs:

Type of cost	One-off costs
Familiarisation costs and gap analysis	£9.5m
Costs of changes to the firms' methodology for capital calculations	£4m
Costs of making changes to the IT systems	£4.5m
Costs of providing staff training/disseminating information about the new rules	£1.6m
Total implementation cost	£19.6m

18. The estimated total one-off implementation costs imply average costs of around £26k and £5k per medium and small firms respectively (as defined in paragraph 14). The per-firm average estimated values do not represent the costs we expect each firm of a given size to incur as a result of the proposals in this CP. Rather, these are averages published for the purposes of transparency for our calculations of the cost of these interventions. The size categories we have used are broad, and each encompasses a range of firm sizes, which in turn would have a range of compliance costs above or below the averages we have included.

19. In the table below we assess how FCA investment firms will be impacted by the proposed changes to the prudential regime:

Item	Impact on firms	Small (circa. 3,000 firms)	Medium (circa. 200 firms)
Prudential consolidation and the group capital test *Rules: draft MIFIDPRU 2*	Neutral-to-beneficial impact as scope and methodology match the current regime, with a new optional derogation, the Group Capital Test, added. Removal of Investment Firm consolidation waiver is expected to have an immaterial impact on firms, in aggregate.	Yes	Yes
Definition and composition of own funds *Rules: draft MIFIDPRU 3*	Neutral-to-beneficial impact as definition and composition of own funds is based on a simplified three-tiered structure using current CRR requirements.	Yes	Yes
K-NPR (net position risk) *Rules: draft MIFIDPRU 4.12*	Neutral impact as the proposed rule carries across CRR market risk requirements, and position risk applies primarily to IFPRU firms.	No	Yes
K-CMG (clearing margin given *Rules: draft MIFIDPRU 4.13*	New optional approach that will be beneficial to firms that choose to implement it.	No	Yes

Item	Impact on firms	Small (circa. 3,000 firms)	Medium (circa. 200 firms)
K-TCD (trading counterparty default *Rules: draft MIFIDPRU 4.14*	Beneficial due to significant simplification of requirements and reduction in scope.	No	Yes
Concentration risk including K-CON *Rules: draft MIFIDPRU 5*	Neutral-to-beneficial overall impact, due to simplification and clarification of existing relevant trading book CRR requirements.	No	Yes
Reporting requirements *Rules: draft MIFIDPRU 9 and connected amendments to SUP16.12*	Beneficial due to significant reduction in the number of data items to be reported.	Yes, quarterly	Yes, quarterly

20. In addition, FCA investment firms might be eligible to opt in for a transitional arrangement (contained in the draft MIFIDPRU transitional provision annexes), or a phase-in period, which mostly last for five years. These are designed to reduce the immediate impact of the new prudential requirements for (potentially smaller) firms that might find transition challenging, and should thus help to mitigate some costs in the short term.

21. In summary, the benefits of the proposed rules assessed in this CBA are:

- Reducing the scope of application to make the regime more proportionate and tailored to business models of FCA investment firms.
- Promoting consistency, transparency and market liquidity in FCA investment firm capital instruments so maintaining or increasing the quality of capital in the system and maintaining or potentially reducing firms' cost of capital.
- Improving financial stability and consumer protection by reducing the potential for firm failure itself or reducing the potential for disorderly failure in the event that a firm does fail.
- Reducing the social cost of firm failure by reducing the reliance on investor compensation schemes, avoiding consequent impacts on other firms to top-up these schemes to handle pay-outs.

22. We do not consider it reasonably practicably to quantify these benefits.

23. Taking all the costs and benefits in the round, we believe that our proposals in this CP will be net-beneficial in the short to medium term. Most of the costs are one-off implementation costs, while the benefits are ongoing and will likely build over time.

Implementation, IT and training costs

24. Implementation costs include the time and resources spent by firms familiarising themselves with the proposals and performing a gap analysis to identify necessary changes as a result. Firms may also incur training and IT costs. These costs will be one-off in nature to prepare for the introduction of the IFPR.

25. We use standard assumptions to estimate firm compliance costs based on the standardised costs model, of which further details can be found in the FCA publication "How we analyse the costs and benefits of our policies".[6]

26. To familiarise themselves with our proposals, we expect that all firms will read the consultation, which contains 104 pages some of which will not be relevant to all firms. We assume that the number of compliance staff who would need to read the consultation will on average be 5 people at a medium firm and 2 at a small firm. We use an average salary of a compliance function and apply these estimates to circa. 200 medium firms and circa. 3,000 small firms.

27. To meet the proposed requirements, firms are expected to conduct a gap analysis of the amount of capital required, among other things, and compare it against the current regime. Firms will be required to assess the actions they may need to take to eliminate any gaps. The standardised cost model assumes it will take 2 and 1 legal or compliance professionals at a medium and a small firm respectively to review legal text, which contains 235 pages, and assess our proposals.

28. We estimate the total cost of familiarisation and gap analysis to be around £9.5m. This would amount to an average cost of £14k for a medium firm and an average cost of £2k for a small firm.

29. In addition to the costs set out above, we expect firms to incur some training costs, although these are likely to be relatively small given the nature of the proposed changes in this CP. For this consultation, we expect firms to disseminate information about the new requirements to their staff, without a need for a formal training. Training will include information given to relevant staff, ranging from informal memos and updates via email through to oral updates. We assume that a medium firm will brief 10 employees and a small firm will brief 2 employees, comprising of compliance staff and investment advisors. We assume that reading the briefing and acting on the information will take a half-day for each affected employee. This would result in the cost of £1.6m.

30. We expect that firms will need to make some changes to own funds calculations methodologies, which would require a small project management team. The main costs relate to the opportunity cost of staff time. Our model assumes that a medium firm will spend 14 person days to implement this change, while a small firm will spend 3 person days. We also assume that this change will need to be reviewed by Senior Managers at each firm. The total cost of this change is expected to be around £4.4m.

31. Finally, we expect firms will need to make some changes to their IT systems to reflect changes to own funds calculations methodologies, even if only for simplification purposes. Firms would also need to update their systems to comply with updated reporting requirements. Our estimates assume that medium firms have an in-house IT capability and will spend 8 person days to implement this change, while small firms are likely to rely on external consultants, and spend the equivalent of 4 person days to implement the IT change. We expect the total cost of this change to be around £4m.

32. In summary, we estimate the total one-off implementation costs to be around £19.6m. This would amount to an average cost of £27k for a medium firm and £5k for a small firm.

6 https://www.fca.org.uk/publication/corporate/how-analyse-costs-benefits-policies.pdf#page=40

Rule-specific net costs to firms

33. This section covers costs and benefits that firms would incur from each of the rules proposed in this consultation:

a. Prudential consolidation and the group capital test
b. Definition and composition of own funds
c. K-NPR (net position risk)
d. K-CMG (clearing margin given)
e. K-TCD (trading counterparty default)
f. K-CON (concentration risk)
g. Transitional arrangements for own funds requirements
h. Reporting requirements
i. Permanent minimum capital

Prudential consolidation and exemptions for an investment firm group

34. Unlike the CRR, the proposed obligations under a prudential consolidation in IFPR would fall directly upon parent undertakings (including an investment firm where it is a parent undertaking), rather than the authorised entity. This means parent undertakings, which may otherwise be unregulated, will have to meet regulatory obligations.[7]

35. The methods of prudential consolidation match those in the CRR, including full consolidation and, proportional consolidation. Investment firm groups will be required to do a full consolidation unless the FCA permits the group to do a proportional consolidation. This CBA assumes that, where proportional consolidation is currently used this is on the basis it is risk-based and proportionate and will continue to be case under the IFPR.

36. There are currently 224 FCA investment firm groups and we expect there could be more groups when the IFPR applies to all types of investment firms. All groups will have parent entities that are either regulated or unregulated, and any unregulated UK parent entities will now fall within the scope of the IFPR. Since groups typically require there to be a parent entity that, in practice, is normally at least indirectly required to meet consolidated requirements under the CRR, this change essentially formalises current arrangements. Consequently, the impact on how groups are organised and consolidated for the purpose of determining group capital should be neutral.

37. In addition, the IFPR introduces a new derogation – the Group Capital Test (GCT). The purpose of the GCT is to ensure that an investment firm in a group is not exposed to unnecessary financial strain due to its membership of that group. The GCT is an optional alternative to prudential consolidation subject to our permission for its use. Since this approach is optional, it follows that a firm would only apply to use it if beneficial.

38. The proposed regime removes the existing investment firm consolidation waiver (IFCW) for IFPRU and BIPRU firms. IFCWs have been used to facilitate business combinations through acquisitions funded by capital ineligible to be included in own funds. This resulted in consolidation deficits due to the deduction of goodwill. Since the FCA applied conditional IFCWs in 2013, the aggregate deficit across all

7 Prudential consolidation for investment firms will apply to an investment firm group, which must include at least one investment firm subject to IFPR. The entities that must be consolidated include investment firms, financial institutions, ancillary services undertakings and tied agents. Insurance undertakings are not included within scope.

FCA investment firm groups has over time been reduced to zero. Consequently, the removal of the IFCWs will have no impact on firms.

Definition and composition of own funds (capital)

39. Own funds is the amount and type of capital a firm must hold at both an entity and consolidated group level. Eligible capital includes share capital and distributable reserves (or their equivalent for non-joint stock entities), hybrid instruments that are either convertible into share capital or written-down, and subordinated debt that must be amortised over the last five years of its maturity.

40. Our proposals define[8] the amount and type of capital using the current CRR definitions with one modification – to where hybrid capital instruments are convertible into share capital (referred to as additional tier 1 capital or AT1), then in the event more share capital is required, the entire amount should be converted. This then increases the minimum amount of the highest quality of capital to absorb losses.

41. Since FCA investment firms issue little or no AT1, a modification to AT1 conversion, a feature designed to typically mitigate extreme market events, is not a material change so will have little or no impact on investment firms.

42. For other regimes, including BIPRU and IPRU-INV Chapter 3, 5, 9 and 13, the definition and composition of capital is substantively the same ie share capital and distributable reserves and long-term debt capital.

43. FCA investment firms that are not joint-stock companies funded by LLP member capital, partnership capital and sole trader capital, can continue to treat this as eligible capital, so there will be no change as a result of our proposal.

Prudential filters and deductions

44. Prudential filters and deductions reduce the amount of capital that is eligible to be treated as own funds. These have been carried over under our proposals from the CRR, with the following exceptions or simplifications.

45. Significant financial sector entities (FSE) holdings below the current 10% threshold will now have to be deducted instead of risk-weighted 250%. This increase in capital requirements is expected to be more than offset by not requiring firms to deduct FSE positions were these are held for the purposes of market making.

46. If defined benefit pension assets are on the firm's balance sheet and the value exceeds the pension obligation, that amount will now be deducted. Due to very few firms operating defined benefit schemes (having switched to money purchase defined contribution schemes), and based on the information readily available at the FCA, the amount of defined benefit assets held on investment firm's balance sheet is immaterial, so we expect that for FCA investment firms, deduction rather than risk-weighting will have little or no impact on firm's costs.

47. Deferred tax assets that rely on future profitability and arise out of temporary differences which are below the current 10% threshold will now have to be deducted instead of risk weighted 250%. Based on information readily available to the FCA, such balances are immaterial for most investment firms.

8 See MIFIDPRU 3 draft rules on the composition of own funds.

48. Subject to meeting the relevant requirements, under our proposals FCA investment firms may now reduce own funds without the need for our permission in certain specified circumstances (such as certain changes in the regulatory or tax treatment of additional tier 1 or tier 2 instruments). This is a benefit to firms as it speeds up the process and reduces the administrative burden, although we do not consider it reasonably practicable to give an estimate of this benefit since it partly depends upon future circumstances which are not reasonably foreseeable.

49. FCA investment firms currently have the option to either deduct qualifying holdings or apply a 1250% risk-weight. Under our draft rules, firms will no longer have the option to risk-weight this exposure so will have to deduct the amount from share capital and reserves. The consequence is that it reduces the amount of CET1 that counts towards own funds and, due to how the own funds limits operate, will reduce the amount of AT1 and T2 that can be treated as eligible capital. This will mean that those FCA investment firms that have qualifying holdings and also rely on lower quality capital will need to increase share capital or retain more distributable reserves. This is not expected to be a material cost for firms.

K-NPR (net position risk)

50. The K-NPR provisions in MIFIDPRU 4 cross-refer to the current approaches for market risk set out in the CRR and carry forward some of our existing rules and guidance supporting that. Consequently, there is no change from the current position for IFPRU firms.

K-CMG (clearing margin given)

51. K-CMG is an alternative approach to K-NPR for cleared trading book positions. Firms are required to meet certain conditions and gain our permission prior to using this approach. Since firms have the option to seek permission to use K-CMG, we expect that this will generally be exercised if beneficial to the firm.

K-TCD (trading counterparty default)

52. Our IFPR proposals simplify the current requirements for counterparty risk by implementing a single standardised regime, drawing on the key features of the current standardised approaches in the CRR.

53. K-TCD will continue to include CRR Annex II derivative contracts, long settlement transactions, repurchase transactions, securities or commodities lending or borrowing transactions, margin lending transactions and any other type of securities financing transactions (SFT).

54. In addition, and to the extent not already caught by other types of SFT, the K-TCD specifically includes within the scope of application the following ancillary service: "credits and loans in the event the investment firm is executing the trade in the name of the client or receiving and transmitting the order without executing it".[9]

55. We consider that our proposed rules will be beneficial to firms for the following reasons:

a. The scope of application is reduced by exempting derivative contracts cleared through a CCP, exchange-traded derivative contracts and, to the extent not in a trading book, any derivative hedges.

9 As set out in MiFID II, Annex I, Section B, point (2).

b. Firms can exclude certain intragroup counterparty exposures from the solo K-TCD capital calculation, subject to our approval.
c. Exposures currently 0% risk-weighted under the CRR are excluded.

K-CON (concentration risk including)

56. The concentration risk regime covers capital requirements and monitoring obligations.

57. Our proposals for K-CON, the capital requirements for concentration risk, are based on CRR large exposure (LE) regime for trading book position risk and counterparty risk. Non-trading book requirements have not been carried across as FCA investment firms are not expected to have material positions that are not in the trading book so helping to simplify these requirements.

58. The exposure value used for concentration risk is based on the aggregation of K-NPR (specific risk only) and K-TCD. Firms using K-CMG for position risk will need to calculate K-NPR for these positions for the purposes of K-CON. Since K-CMG is optional, firms will be expected to take this into account when assessing the benefits of using K-CMG.

59. Commodity and emission allowance dealers are exempt from the current large exposures regime in the CRR. We propose that they can continue to benefit from an exemption, but are now subject to conditions limiting the exemption to non-financial entities, and that we are notified before an FCA investment firms makes use of it. This is not expected to prevent most if not all firms currently using the exemption in CRR from continuing to exempt much of their trading business. Being required to notify the FCA is not considered unduly burdensome and expected to be a minimal cost to firms.

60. Those CRR Article 95(1) firms that currently benefit from the matched-principal concession, and Article 96(1) or limited activity firms, will now be included within the scope of K-CON.

61. Other CRR Article 95(1) firms are not permitted to deal on own account or underwrite financial instruments and/or place financial instruments on a firm commitment basis. Consequently, even if exceeding one of the other K-Factor thresholds and being deemed a non-SNI, there would still be no capital required for K-CON as there are no trading book positions.

62. Article 96(1)(a) firms are permitted to run trading book positions for the purposes of executing or fulfilling client orders, so will be subject to K-TCD and K-NPR. These firms will be non-SNI investment firms and subject to K-CON. Since their trading book positions arise only for the purposes of fulfilling the firm's obligation to the client, the amount of position risk will be very low, consequently the amount of K-CON capital required will be zero. Firms that use extended delivery versus payment settlement, free deliveries or run long dated derivative positions with no margining or netting, could result in risking more than 25% of own funds against a single counterparty or group of connected counterparties. Given this, few if any firms are expected to hold capital for concentration risk.

63. Article 96(1)(b) firms are permitted to undertake only dealing on own account, must have no customers and must not safeguard client money and assets. The firms can have directional trading book positions and counterparty risk so will be subject to K-CON. These firms would need to risk more than 25% of own funds on a single exposure or group of connected risk exposures in order to be required to hold capital against concentration risk. Given this, few firms are expected to need to hold capital for concentration risk.

64. The scope of our proposals for concentration risk monitoring extends beyond reporting requirements and applies to all FCA investment firms.[10] Examples of this are set out in the DP20/2 (paragraph 9.8) e.g. location of client money, location of custody assets, firm's own cash deposits and earnings. Since firms are already required to have adequate systems and controls, it could be argued that these monitoring requirements already exist. However, it remains that the IFPR has referenced these specific monitoring requirements so for firms that do not already have this monitoring in place there will be some extra costs. However, this is not expected to be material.

65. Overall, we expect the proposed K-CON requirement not to have a material cost impact as most FCA investment firms are already subject to very similar concentration risk requirements. Some firms may need to improve their systems and controls to comply with the new monitoring requirements, but this not expected to unduly costly. Some CRR 96(1)(a) firms may be required to hold capital for the first time for concentration risk, but this can be mitigated by having more diverse counterparties and using credit risk mitigation techniques such as netting and or margining. For 96(1)(b) firms the same applies for counterparty risk, but there could also be significant amount of position risk, so arguably there is a greater possibility of having to hold capital for concentration risk. The threshold above which K-CON applies to an exposure is though set quite high at 25% of own funds on a single exposure or group of connected exposures.

Reporting requirements

66. We are proposing to introduce a more proportionate and risk-based reporting regime for FCA investment firms.

67. This will be achieved by:

a. Having a single suite of IFPR reporting forms. Currently, there are different sets of regulatory returns depending on which prudential sourcebook firms fall under and if they are subject to COREP or FINREP. This has proven to be unduly complex for firms to navigate, especially if there is a change on permissions.
b. Reducing the number of data items reported, while maintaining sufficient information to adequately supervise firms.
c. Requiring firms to report information to us quarterly.

68. The following reports will be consulted on in future consultations:

a. Remuneration reporting.
b. Internal capital and risk assessment (ICARA) reporting.
c. Fixed overhead reporting

69. Under our proposals FSA029 balance sheet and FSA030 income statement will be retained and applied to all FCA investment firms. FSA001 balance sheet and FSA002 income statement and the corresponding COREP forms will no longer need to be completed.

10 See MIFIDPRU 5

70. SNI firms will not be required to submit general concentration risk report MIF004 and K-CON report MIF005.

71. SNI firms which have obtained an exemption from liquidity requirements will not be required to submit liquidity report MIF002. The FCA will consult on the IFPR liquidity regime, including any relevant exemptions, in a future consultation.

72. Unless the group is subject to the group capital test (GCT) the ultimate UK parent undertaking will continue to submit consolidated returns. The GCT however, requires that each parent undertaking i.e. intermediate parent undertakings as well as the ultimate UK parent undertaking, must report separately. Since the GCT is optional, subject to FCA granting permission, it follows that firms will only request to apply the GCT if it is beneficial.

73. To enable the FCA to effectively supervise firms, we will continue to reserve the right to require firms to provide additional information if required.

74. In summary, the reporting requirements that we are consulting on will be a scaled down version of existing reporting requirements, with the added benefit that there will be a dedicated single suite of reporting forms making navigating the requirements far easier. Notwithstanding some initial one-off cost in becoming acquainted with what reporting requirements have been removed or clarified, this should be overall beneficial to firms.

Transitional arrangements for own funds requirements

75. IFPR transitional arrangements (or a phase-in period) are designed to reduce the immediate impact of the new prudential requirements for (potentially smaller) firms that might find transition challenging. These arrangements would give FCA investment firms up to five years to comply after the IFPR's introduction, and so provide a potential benefit. However, we do consider it not reasonably practicable to give an estimate of the reduction in costs. There is uncertainty about how many firms will make use of this transitional arrangement given it will ultimately depend upon the specific situation of each investment firm.

Permanent minimum capital (PMC)

76. At present, it is not reasonably practicable to prepare a meaningful estimate of the costs or benefits arising from the proposals relating to the PMC. This is because the PMC will not necessarily determine the overall capital requirements of an FCA investment firm. Instead, we propose that the PMC will become the operative requirement only where it is higher than the fixed overheads requirement (FOR) and (for firms that are non-SNI investment firms) the K-factor requirement (KFR) of the relevant firm. We expect to publish proposals which will complete the outstanding elements of the overall KFR calculation and will specify the calculation of the FOR in our next consultation. Until those proposals are finalised, it is not generally possible to determine the overall impact of the proposed PMC on the population of FCA investment firms. We will incorporate the impact of the PMC into our next CBA, when we will have complete proposed frameworks for the FOR and KFR.

Benefits

77. We believe that the benefits of our proposals will be delivered in the form of improved consumer protection and particularly for clients of FCA investment firms, either because it reduces the potential for firm failure itself, or because it reduces the

potential for disorderly failure in the event that a firm does fail. The proposed changes should help reduce economic losses in drawn-out insolvency proceedings or reliance on investor compensation schemes, avoiding consequent impacts on other firms to top-up these schemes to handle pay-outs. Overall confidence, investor sentiment and market stability should also benefit.

78. FCA investment firms are also likely to benefit from a more proportionate and risk-based reporting regime, and thus a less costly regime overall.

79. In addition, there will be benefits to the stability of the financial system and wider economy that we have not been able to quantify, but which will be a part of the overall package of benefits that we expect this new prudential regime to deliver.

80. We will provide a further analysis of benefits in the forthcoming consultations, covering the rest of the new prudential regime for FCA investment firms.

Annex 3
Other legal duties

Expected effect on mutual societies

1. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies.

Equality and diversity

2. We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, to and foster good relations between people who share a protected characteristic and those who do not.

3. As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. The outcome of our consideration in relation to these matters in this case is stated in paragraphs 1.15-1.17 of this CP.

Legislative and Regulatory Reform Act 2006 (LRRA)

4. We have had regard to the principles in the LRRA for the parts of the proposals that consist of general policies, principles or guidance and consider that they will help firms understand and meet the regulatory requirements associated with our new capital requirements framework, leading to better prudential outcomes for firms and their clients. We also think our proposals are proportionate and take into consideration the variety of firms in scope.

5. We have had regard to the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance and consider the proposals do not create an unnecessary burden on firms, or adversely affect competition.

Annex 4
Abbreviations used in this paper

AIFMD	Alternative Investment Fund Management Directive
AT1	Additional Tier 1 capital
BCBS	Basel Committee on Banking Supervision
BIPRU	Prudential sourcebook for banks, building societies and investment firms
BRRD	Bank Recovery and Resolution Directive
CBA	Cost benefit analysis
CCP	Central counter party
CET1	Common Equity Tier 1 capital
CMV	Current market value
CP	Consultation Paper
CPMI	Collective Portfolio Management Investment firm
COREP	Common reporting
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CU	Connected Undertaking
EBA	European Banking Authority
EMP	Energy market participant
ESG	Environmental, Social and Governance
EU	European Union
FCA	Financial Conduct Authority
FICOD	Financial Conglomerates Directive
FINREP	Financial reporting

FOR	Fixed overheads requirement
FS Bill	Financial Services Bill
FSE	financial sector entities
FSMA	Financial Services and Markets Act
GENPRU	General Prudential sourcebook
GCT	Group capital test
ICARA	Internal Capital Adequacy and Risk Assessment
IFCW	Investment Firm Consolidation Waiver
IFD	Investment Firm Directive
IFPR	Investment firm prudential regime
IFPRU	Prudential sourcebook for investment firms
IPRU-INV	Interim prudential sourcebook for investment business
IFR	Investment Firm Regulation
KFR	K-factor requirement
LRRA	Legislative Regulatory Reform Act
MiFID	Markets in Financial Instruments Directive
MIFIDPRU	New Prudential sourcebook for solo regulated MiFID investment firms
OFR	Own funds requirement
OFRE	Own funds requirement for the excess
OMP	Oil market participant
OTC	Over the counter
OTF	Organised trading facility
PMC	Permanent minimum capital
PMR	Permanent minimum requirement
PRA	Prudential Regulation Authority

PS	Policy Statement
RC	Replacement cost
SFTs	Securities financing transactions
SNI	Small and non-interconnected investment firm
T2	Tier 2 capital
TOFR	Total own funds requirement
UCITS	Undertakings for Collective Investment in Transferable Securities Directive
VaR	Value at risk

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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Appendix 1
Draft Handbook text

INVESTMENT FIRMS PRUDENTIAL REGIME INSTRUMENT 2021

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137A (The FCA's general rules);
(2) section 137T (General supplementary powers);
(3) section 138D (Actions for damages);
(4) section 139A (Power of the FCA to give guidance);
(5) section 143D (Duty to make rules applying to parent undertakings);
(6) section 143E (Powers to make rules applying to parent undertakings);[1] and
(7) paragraph 23 of Schedule 1ZA (Fees).

B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. The following parts of this instrument come into force on [*Editor's note*: insert date one month before the application date specified in paragraph D]:

(1) Part 2 of Annex A to the instrument; and
(2) solely for the purpose of enabling a person to comply with the rules in Part 2 of Annex A to this instrument, the provisions in Part 1 of Annex A and in Annex B to this instrument.

D. This instrument comes into force for all remaining purposes on [*date*].

Making the Prudential sourcebook for MiFID Investment Firms (MIFIDPRU)

E. The Financial Conduct Authority makes the rules and gives the guidance in Annex A to this instrument.

Amendments to the Handbook

F. The Glossary of definitions is amended in accordance with Annex B to this instrument.

G. The Supervision manual (SUP) is amended in accordance with Annex C to this instrument.

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[1] *Editor's note:* The references to sections 143D and 143E of the Financial Services and Markets Act 2000 are to those provisions as they appear in the Financial Services Bill introduced in the House of Commons on 20 October 2020. The reference to the statutory powers and related provisions in this instrument may need to be reviewed and updated if the Bill is amended during the parliamentary process.

Notes

H. In the annexes to this instrument, the "notes" (indicated by "**Note:**" or "*Editor's note*:") are included for the convenience of readers, but do not form part of the legislative text.

Citation

I. This instrument may be cited as the Investment Firms Prudential Regime Instrument 2021.

J. The sourcebook in Annex A to this instrument may be cited as the Prudential sourcebook for MiFID Investment Firms (or MIFIDPRU).

By order of the Board
[*date*]

[*Editor's note*:

The text of the *EU CRR* is amended at the EU level by the EU texts of the Investment Firms Regulation (Regulation (EU) 2019/2033) ("IFR") and Regulation (EU) 2019/876 amending the *EU CRR* ("CRR2"). All references to the *UK CRR* in this instrument are references to the onshored *UK CRR* in the form in which it would appear if it contained equivalent amendments, unless expressly stated otherwise. The FCA expects that such amendments will largely be made to the *UK CRR* by UK primary and secondary legislation. This is consistent with HM Treasury's stated legislative approach in its 'Prudential standards in the Financial Services Bill' policy statement published in June 2020. However, the FCA may replace cross-references to the *UK CRR* in this consultation text with final rules that copy out provisions of the *UK CRR* in full (reflecting the necessary amendments) to the extent that it is necessary or desirable to do so to make the rules easier for firms to use.

Notes marked "**Note:**" in this instrument contain references to provisions of the EU IFR or EU Investment Firms Directive (Directive (EU) 2019/2034) ("IFD"). As the IFR and IFD will not apply in the UK, these references will not appear in the final Handbook text. They are provided in this draft instrument solely to assist firms in identifying EU provisions which have a broadly similar effect to the Handbook provision to which they relate. These references may assist firms and groups that operate on an international basis in understanding how the UK prudential regime for investment firms will achieve similar outcomes to the EU IFR and IFD and therefore may be useful for implementation purposes.

References to the "*Act*" (i.e. the Financial Services and Markets Act 2000) are references to provisions of the *Act* as they are expected to appear following the enactment of the Financial Services Bill 2020-21.

Amendments to the Glossary of definitions in this instrument assume that the FCA will be repealing the related parts of the BIPRU and IFPRU sourcebooks. The FCA will consult on the repeal of existing sourcebooks in a subsequent consultation.]

Annex A

Prudential sourcebook for MiFID Investment Firms (MIFIDPRU)

In this Annex, all the text is new and is not underlined.

Insert the following new sourcebook, the Prudential sourcebook for MiFID Investment Firms (MIFIDPRU) after the Prudential sourcebook for Insurers (INSPRU).

Part 1: Comes into force on [*date*]

1 Application

1.1 Application and purpose

[*Editor's note*: This section will be published in a subsequent consultation paper.]

1.2 SNI MIFIDPRU investment firms

Basic conditions to be classified as an SNI MIFIDPRU investment firm

1.2.1 R A *MIFIDPRU investment firm* is an *SNI MIFIDPRU investment firm* if it satisfies the following conditions:

(1) its *AUM*, as calculated in accordance with *MIFIDPRU* [*Editor's note*: insert the appropriate cross-reference to the calculation methodology for AUM in *MIFIDPRU* 4.7] is less than £1.2 billion;

(2) its *COH*, as calculated in accordance with *MIFIDPRU* [*Editor's note*: insert the appropriate cross-reference to the calculation methodology for COH in *MIFIDPRU* 4.10] is less than:

(a) £100 million per *day* for *cash trades*; and

(b) £1 billion per *day* for *derivatives trades*;

(3) its *ASA*, as calculated in accordance with *MIFIDPRU* [*Editor's note*: insert the appropriate cross-reference to the calculation methodology for ASA in *MIFIDPRU* 4.9] is zero;

(4) its *CMH*, as calculated in accordance with *MIFIDPRU* [*Editor's note*: insert the appropriate cross-reference to the calculation methodology for CMH in *MIFIDPRU* 4.8] is zero;

(5) it does not have *permission* to *deal on own account*;

(6) the on- and off-balance sheet total of the *firm* is less than £100 million; and

(7) the total annual gross revenue from *investment services and/or activities* of the *firm* is less than £30 million, calculated as an average on the basis of the annual figures from the two-year period immediately preceding the given financial year.

[**Note:** article 12(1), first paragraph of the *IFR*.]

1.2.2 G The definitions of *ASA* and *CMH* relate to client assets and *client money* that are held in the course of *MiFID business*. As a result, a *firm* may hold client assets or *client money* in the course of business other than *MiFID business* (provided that it has the necessary *permissions* to do so) and still meet the conditions to be classified as an *SNI MIFIDPRU investment firm*. When determining whether client assets or *client money* are to be treated as held in the course of *MiFID business* for these purposes, *MIFIDPRU investment firms* should refer to the *rules* and *guidance* in *MIFIDPRU* [4.8] and [4.9].[2]

Additional provisions relating to the calculation of conditions to be classified as an SNI MIFIDPRU investment firm

1.2.3 R Notwithstanding the calculation methodologies in *MIFIDPRU* 4, the *firm* shall use the following for the purposes of the criteria in *MIFIDPRU* 1.2.1R:

(1) end-of-day values to assess each of the following conditions:

(a) its *AUM* under *MIFIDPRU* 1.2.1R(1);

(b) its *COH* under *MIFIDPRU* 1.2.1R(2);

(c) its *ASA* under *MIFIDPRU* 1.2.1R(3);

(2) intra-day values to assess its *CMH* under *MIFIDPRU* 1.2.1R(4).

[**Note:** article 12(1), second to fourth subparagraphs of the *IFR*.]

1.2.4 R (1) By way of derogation from *MIFIDPRU* 1.2.1R, a *firm* may use the alternative approach in (2) to measure:

(a) its *AUM* for the purposes of *MIFIDPRU* 1.2.1R(1); and/or

(b) its *COH* for the purposes of *MIFIDPRU* 1.2.1R(2).

(2) The alternative approach is to apply the methodologies in *MIFIDPRU* 4 for measuring *AUM* and *COH*, but with the following modifications:

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[2] *Editor's note*: It is currently anticipated that these rules and guidance will be published as part of the rules for calculating *CMH* and *ASA* in a subsequent consultation paper.

(a) the measurement must be performed over the immediately preceding 12 *months*; and

(b) the exclusion of the three most recently monthly values does not apply.

(3) A *firm* that chooses to apply the derogation in (1) must:

(a) notify the *FCA* by [*Editor's note*: notification and contact details to be inserted] before applying the alternative approach in (2); and

(b) apply the alternative approach for a continuous period of at least 12 *months* from the date specified in the *firm's* notice in (a).

[**Note:** article 12(1), sixth subparagraph.]

1.2.5 G Where a *firm* relies on the derogation in *MIFIDPRU* 1.2.4R, the alternative approach applies only for the purpose of determining whether the *firm* meets the requirements to be classified as an *SNI MIFIDPRU investment firm*. It does not apply for the purpose of a *MIFIDPRU investment firm's* calculation of its *K-factor requirement* under *MIFIDPRU* 4.

1.2.6 R (1) A *firm* must use the values recorded at the end of the last financial year for which accounts have been finalised and approved by its *management body* to assess each of the following conditions:

(a) its on- and off-balance sheet total under *MIFIDPRU* 1.2.1R(6); and

(b) its total annual gross revenue under *MIFIDPRU* 1.2.1R(7).

(2) By way of derogation from (1), where a *firm's* accounts have not been finalised and approved after six *months* from the end of the last financial year, the *firm* must use provisional accounts for the purposes of this *rule*.

[**Note:** article 12(1), fifth subparagraph.]

1.2.7 R (1) A *firm* may use the end-of-day value for *CMH* instead of the intra-day value under *MIFIDPRU* 1.2.3R(2) if:

(a) there has been an error in record-keeping or in the reconciliation of accounts that incorrectly indicated that the *firm* had breached the zero threshold in *MIFIDPRU* 1.2.1R(4); and

(b) the error is resolved before the end of the *business day* to which it relates.

(2) Where a *firm* relies on (1) to use an end-of-day value, it must notify the *FCA* by [*Editor's note*: notification and contact details to be inserted] immediately of:

(a) the error;

(b) the reasons that the error occurred; and

(c) how the error has been corrected.

[**Note:** article 12(1), fourth subparagraph of the *IFR*.]

1.2.8 G (1) *MIFIDPRU* 1.2.7R applies to a situation where a *firm* has incorrectly recorded an amount of *client money* as *CMH*. This could occur, for example, where there has been an error in data entry, or where a *firm* incorrectly records *client money* as meeting the *CMH* definition and identifies the mistake before the end of the same *business day*.

(2) *MIFIDPRU* 1.2.7R does not apply where a *firm* mistakenly accepts an amount that meets the *CMH* definition and subsequently returns that amount to the relevant *client*. In that case, the *firm* will have breached the zero threshold in *MIFIDPRU* 1.2.1R(4) and the situation has not arisen merely due to an error in record-keeping or reconciliation. A *firm* that wishes to be classified as an *SNI investment firm* should therefore operate effective systems and controls that prevent it from mistakenly accepting *money* or assets that constitute *CMH* or *ASA*.

1.2.9 R A *MIFIDPRU investment firm* must assess the following conditions on the basis of the *firm's* individual situation:

(1) *ASA* under *MIFIDPRU* 1.2.1R(3);

(2) *CMH* under *MIFIDPRU* 1.2.1R(4); and

(3) whether the *firm* has *permission* to *deal on own account*.

[**Note:** article 12(2), second subparagraph of the *IFR*.]

1.2.10 R (1) A *MIFIDPRU investment firm* must assess the conditions in (2) on the basis of the combined position of each of the following entities that form part of the same *group* as that *MIFIDPRU investment firm*:

(a) *MIFIDPRU investment firms*;

(b) *designated investment firms*;

(c) *collective portfolio management investment firms*; and

(d) *third country investment firms* that carry on *investment services and/or activities* in the *UK*.

(2) The relevant conditions are:

(a) *AUM* under *MIFIDPRU* 1.2.1R(1);

(b) *COH* under *MIFIDPRU* 1.2.1R(2);

(c) the on- and off-balance sheet total under *MIFIDPRU* 1.2.1R(6); and

(d) total annual gross revenue under *MIFIDPRU* 1.2.1R(7).

(3) When measuring the combined total annual gross revenue under (2)(d), the *firm* may exclude any double counting that may arise in respect of gross revenues generated within the *group*.

(4) For the purposes of this *rule*, when calculating the contribution to the combined position of the *group* of:

(a) a *collective portfolio management investment firm*, a *MIFIDPRU investment firm* is required to include only amounts that are attributable to the *investment services and/or activities* that fall within *COLL* 6.9.9R (4) to (6) or *FUND* 1.4.3R (3) to (6); and

(b) a *third country investment firm*, a *MIFIDPRU investment firm* is required to include only amounts that are attributable to the *investment services and/or activities* that are carried on by the *third country investment firm* in the *UK*.

[**Note:** article 12(2), first subparagraph of the *IFR*.]

1.2.11 G (1) *MIFIDPRU* 1.2.10R applies to each individual *MIFIDPRU investment firm* by reference to the relevant entities that form part of that *firm's group*. The purpose of that *rule* is to prevent a *MIFIDPRU investment firm* from dividing its business between multiple separate *group* entities that may each carry-on *investment services and/or activities* in the *UK* in order to avoid being classified as a *non-SNI MIFIDPRU investment firm*. Where two or more *MIFIDPRU investment firms* exceed one or more of the relevant thresholds in *MIFIDPRU* 1.2.10R on a combined basis, each of those *firms* will be treated as a *non-SNI MIFIDPRU investment firm* as a result.

(2) Where a *MIFIDPRU investment firm* forms part of an *investment firm group* to which consolidation applies under *MIFIDPRU* 2.5, *MIFIDPRU* 2.5.21R explains how *MIFIDPRU* 1.2 applies to the *consolidated situation* of the relevant *UK parent entity*.

Summary of conditions to be classified as an SNI MIFIDPRU investment firm and associated calculation requirements

1.2.12 G The following table summarises the effect of *MIFIDPRU* 1.2.1R to 1.2.10R.

Measure	**Measurement of relevant values**	**Threshold to be classified as an SNI MIFIDPRU investment firm**	**Application of threshold on an individual basis or combined basis of investment firms within a group (see MIFIDPRU 1.2.8R)**	
AUM	End-of-day	Less than £1.2 billion	Combined	See Note 1
COH (cash trades)	End-of-day	Less than £100 million per day	Combined	See Note 1
COH (derivatives)	End-of-day	Less than £1 billion per day	Combined	See Note 1
ASA	End-of-day	Zero	Individual	
CMH	Intra-day	Zero	Individual	See Note 2
DTF	*Firm* must not have *permission* to *deal on own account*, so these measures must always be zero		Individual	
NPR			Individual	
CMG			Individual	
TCD			Individual	

On- and off-balance sheet total	End of last financial year for which accounts finalised by *management body*	Less than £100 million	Combined	See Note 3
Total annual gross revenue from *investment services and/or activities*	End of last financial year for which accounts finalised by *management body*	Less than £30 million, based on an average of annual figures for the two-year period immediately preceding the current financial year	Combined	See Notes 3 and 4
Notes				
Note 1:	The *firm* may calculate the relevant values for these measures by applying the applicable methodologies in *MIFIDPRU* 4, but over a period of the most recent 12 *months* and without excluding the three most recent monthly values, in accordance with *MIFIDPRU* 1.2.4R.			
Note 2:	If there has been an error in record keeping or in reconciliation of accounts that incorrectly indicated the *firm* has breached the zero threshold for *CMH* and the error is corrected before the end of the *business day* to which it relates, the *firm* may use the end-of-day value in accordance with *MIFIDPRU* 1.2.7R.			
Note 3:	Where the relevant accounts have not been finalised and approved after six *months* from the end of the last financial year, the *firm* must use provisional accounts for these purposes, in accordance with *MIFIDPRU* 1.2.6R.			
Note 4:	The *firm* may exclude any double counting that may arise in respect of gross revenues generated within the *group*, in accordance with *MIFIDPRU* 1.2.10R.			

Non-SNI MIFIDPRU investment firms that subsequently meet the conditions to be an SNI MIFIDPRU investment firm

1.2.13 R (1) This *rule* applies to a *firm* that is originally a *non-SNI MIFIDPRU investment firm* and subsequently satisfies all the conditions in *MIFIDPRU* 1.2.1R.

(2) The *firm* in (1) shall be reclassified as an *SNI MIFIDPRU investment firm* only:

(a) after a period of six *months* from the date on which the *firm* met all the relevant conditions; and

(b) where the *firm* also meets the requirements in (3).

(3) The relevant requirements are that the *firm*:

(a) must not subsequently breach one or more of the conditions in *MIFIDPRU* 1.2.1R during the six-*month* period in (2)(a); and

(b) has promptly notified the *FCA* by [*Editor's note*: contact details to be inserted] that it has met all of the conditions in *MIFIDPRU* 1.2.1R for the six-*month* period in (2)(a).

[**Note:** article 12(4) of the *IFR*.]

Ceasing to meet the conditions to be an SNI MIFIDPRU investment firm

1.2.14 R Where a *MIFIDPRU investment firm* no longer meets all the conditions set out in *MIFIDPRU* 1.2.1R, it shall cease to be an *SNI MIFIDPRU investment firm* with immediate effect, except where *MIFIDPRU* 1.2.15R applies.

[**Note:** article 12(3), first subparagraph of the *IFR*.]

1.2.15 R (1) Where a *MIFIDPRU investment firm* no longer meets one or more of the thresholds in (2), but continues to meet all other conditions in *MIFIDPRU* 1.2.1R, it shall cease to be an *SNI MIFIDPRU investment firm* three *months* after the date on which the relevant threshold was first exceeded.

(2) The relevant conditions are:

(a) the *AUM* threshold in *MIFIDPRU* 1.2.1R(1);

(b) either or both of the *COH* thresholds in *MIFIDPRU* 1.2.1R(2);

(c) the on- and off-balance sheet total threshold in *MIFIDPRU* 1.2.1R(6); and

(d) the total annual gross revenue threshold in *MIFIDPRU* 1.2.1R(7).

[**Note:** article 12(3), second subparagraph of the *IFR*.]

1.2.16 R Where a *MIFIDPRU investment firm* ceases to meet one of the conditions in *MIFIDPRU* 1.2.1R, it must promptly notify the *FCA* by [*Editor's note*: contact details to be inserted].

[**Note:** article 12(3), second subparagraph of the *IFR*.]

1.2.17 G Where a *firm* ceases to meet one of the conditions in *MIFIDPRU* 1.2.11R, but subsequently begins to satisfy that condition again within the three-*month* period referred to in that *rule*, the *firm* will still be reclassified as a *non-SNI MIFIDPRU investment firm* three *months* after the date on which it first ceased to meet that condition. The *firm* will only be reclassified as an *SNI MIFIDPRU investment firm* where it meets the conditions in *MIFIDPRU* 1.2.13R.

Application of senior management, remuneration and systems and controls requirements to SNI MIFIDPRU investment firms

1.2.18 R (1) Subject to (2) and (3), the following provisions do not apply to an *SNI MIFIDPRU investment firm*:

(a) [*Editor's note*: any requirements which will be disapplied in relation to SNI MIFIDPRU investment firms and which should be referenced in this rule will be published as part of a future consultation paper.]

[(b)] [*Editor's note*: further provisions to be listed here will be published as part of a future consultation paper][3]

(2) If a *non-SNI MIFIDPRU investment firm* meets the conditions to be classified as an *SNI MIFIDPRU investment firm*, the provisions in (1) will cease to apply only:

(a) six *months* after the date on which the *firm* first met the conditions to be reclassified as an *SNI MIFIDPRU investment firm*; and

(b) provided that the *firm*:

[3] *Editor's note*: The FCA will consult in a subsequent consultation paper on the proposed approach to applying IFPR remuneration, governance and risk management requirements (including the internal capital and risk assessment (ICARA) process). That consultation will also explain the extent to which such requirements will apply to SNI MIFIDPRU investment firms. The relevant cross-references to any requirements that are disapplied for SNI MIFIDPRU investment firms will be populated in MIFIDPRU 1.2.18R at that time. The proposed structure of MIFIDPRU 1.2.18R in this instrument is without prejudice to the content of the FCA's proposals in the future consultation paper and may be amended as part of that future consultation.

(i) continued to meet the conditions to be classified as an *SNI MIFIDPRU investment firm* without interruption throughout that six-*month* period; and

(ii) has given the notification in *MIFIDPRU* 1.2.13R(3)(b) to the *FCA* promptly following the expiry of the relevant period.

(3) If an *SNI MIFIDPRU investment firm* no longer meets the conditions to be classified as such, it must:

(a) notify the *FCA* immediately of the date on which it ceased to be eligible to be classified as an *SNI MIFIDPRU investment firm*; and

(b) comply with the provisions in (1) within 12 *months* from the date on which the *firm* ceased to be eligible to be an *SNI MIFIDPRU investment firm*.

1.2.19 G *MIFIDPRU investment firms* are reminded that under the Capital Requirements (Country-by-Country Reporting) Regulations 2013 (SI 2013/3118) as amended[4], *non-SNI MIFIDPRU investment firms* may be required to disclose certain information relating to their branches or subsidiaries outside the *UK.* Those Regulations also set out how the country-by-country reporting obligations apply when a *MIFIDPRU investment firm* is reclassified as either an *SNI MIFIDPRU investment firm* or a *non-SNI MIFIDPRU investment firm*.

1.3 Actions for damages

1.3.1 R A contravention of the *rules* in *MIFIDPRU* does not give rise to a right of action by a *private person* under section 138D of the *Act* (and each of those *rules* is specified under section 138D(3) of the *Act* as a provision giving rise to no such right of action).

2 Level of application of requirements

2.1 Application and purpose

Application

2.1.1 R *MIFIDPRU* 2 applies to:

(1) a *MIFIDPRU investment firm*;

[4] *Editor's note*: The Financial Services Bill, as introduced in the House of Commons on 20 October 2020, amends SI 2013/3118 so that country-by-country reporting obligations will apply to FCA investment firms. This guidance provision may change if the Bill is amended during the parliamentary process.

(2) a *UK parent entity*;

(3) a *UK investment holding company*, *UK mixed financial holding company* or *UK mixed-activity holding company*; and

(4) a *parent undertaking* in the *UK* that is a *relevant financial undertaking* in an *investment firm group*.

Purpose

2.1.2 G This chapter contains:

(1) a *rule*, *MIFIDPRU* 2.2.1R, applying requirements in this sourcebook to *MIFIDPRU investment firms* on an individual basis;

(2) *rules* in *MIFIDPRU* 2.3 outlining the circumstances where a *MIFIDPRU investment firm* may apply to the *FCA* for an exemption from specific requirements in this sourcebook that apply on an individual basis;

(3) *rules* and *guidance* in *MIFIDPRU* 2.4 which contain:

(a) *guidance* on the basic definition of an *investment firm group*;

(b) *rules* and *guidance* relating to the *undertakings* that are included within an *investment firm group*; and

(c) *rules* and *guidance* on how an *investment firm group* may apply to the *FCA* for permission to use the *group capital test* as an alternative to the prudential consolidation requirements in *MIFIDPRU* 2.5, as well as the applicable criteria for such an application;

(4) *rules* and *guidance* in *MIFIDPRU* 2.5 which cover the following (note that a more detailed breakdown of the *rules* and *guidance* in *MIFIDPRU* 2.5 is contained in the table in *MIFIDPRU* 2.5.3G):

(a) the application of requirements in this sourcebook on a *consolidated basis*;

(b) the circumstances in which the *FCA* may permit an *investment firm group* to disapply certain prudential consolidation requirements; and

(c) how prudential consolidation would apply to an *investment firm group* in practice, in the context of different obligations contained in this sourcebook;

(5) *rules* and *guidance* in *MIFIDPRU* 2.6 in relation to the *group capital test*; and

(6) *rules* and *guidance* in *MIFIDPRU* 2.7 which cover the following:

(a) additional requirements and *FCA* supervisory powers that are relevant to a *UK parent entity*; and

(b) additional requirements that are relevant to a *MIFIDPRU investment firm* which is a *subsidiary* of a *UK mixed-activity holding company*.

2.2 General principle

2.2.1 R A *MIFIDPRU investment firm* must comply with the *rules* in *MIFIDPRU* 3 to *MIFIDPRU* 9 on an individual basis.

[**Note:** article 5 of the *IFR*.]

2.3 Exemptions

2.3.1 R A *MIFIDPRU investment firm* will be exempt from *MIFIDPRU* [8][5] (Disclosure by investment firms), as applied by *MIFIDPRU* 2.2.1R, where:

(1) the *firm* has applied to the *FCA* in accordance with *MIFIDPRU* 2.3.3R;

(2) the application in (1) has demonstrated the following to the satisfaction of the *FCA*:

(a) the *firm* is a *SNI MIFIDPRU investment firm*;

(b) the *firm* is a *subsidiary* and is included in the supervision on a *consolidated basis* of an *insurance undertaking* or *reinsurance undertaking* in accordance with Rule 10.5 of the *PRA Rulebook*: Solvency II firms: Group Supervision;

(c) both the *firm* and its *parent undertaking* are subject to *authorisation* and supervision in the *UK*;

(d) *own funds* are distributed adequately between the *firm* and its *parent undertaking* and:

(i) there is no current or foreseen material practical or legal impediment to the prompt transfer of capital

[5] *Editor's note:* The FCA intends to consult on the public disclosure requirements for investment firms in MIFIDPRU 8 in a future consultation paper.

or repayment of liabilities by the *parent undertaking*;

(ii) either the *parent undertaking* will guarantee the commitments entered into by the *firm*, or the risks in the *firm* are of negligible interest;

(iii) the risk evaluation, measurement and control procedures of the *parent undertaking* include the *firm*; and

(iv) the *parent undertaking* holds more than 50% of the voting rights attached to shares in the capital of the *firm* or has the right to appoint or remove a majority of the members of the *firm's management body*.

(3) the *PRA* does not object to the exemption.

[**Note:** article 6(2) of the *IFR*.]

2.3.2 R A *MIFIDPRU investment firm* will be exempt from *MIFIDPRU* [6][6] (Liquidity), as applied by *MIFIDPRU* 2.2.1R, where:

(1) the *firm* has applied to the *FCA* in accordance with *MIFIDPRU* 2.3.3R;

(2) the application in (1) has demonstrated the following to the satisfaction of the *FCA*:

(a) the *firm*:

(i) is supervised on a *consolidated basis* in accordance with Chapter 2 of Title II of Part One of *UK CRR*; or

(ii) is included in an *investment firm group* subject to *MIFIDPRU* 2.5.11R and has not obtained the exemption referred to in *MIFIDPRU* 2.5.19R;

(b) the *parent undertaking*, on a *consolidated basis*, monitors and has oversight at all times over the liquidity positions of all *institutions* and *MIFIDPRU investment firms* within the group or sub-group that are exempted from liquidity requirements on an individual basis, and ensures a sufficient level of liquidity for all of those *institutions* and *MIFIDPRU investment firms*;

[6] *Editor's note:* The FCA intends to consult on the liquidity requirements in MIFIDPRU 6 in a future consultation paper.

(c) the *parent undertaking* and the *firm* have entered into contracts that, to the satisfaction of the *appropriate regulator*, provide for the free movement of funds between the *parent undertaking* and the *firm* to enable them to meet their individual obligations and joint obligations as they become due;

(d) there is no current or foreseen material, practical or legal impediment to the fulfilment of the contracts referred to in (c); and

(3) the *PRA*, if consolidating supervisor of the group, does not object to the exemption.

[**Note:** article 6(3) of the *IFR*.]

2.3.3 R An application referred to in *MIFIDPRU* 2.3.1R(1) or *MIFIDPRU* 2.3.2R(1) must:

(1) be made using the form in *MIFIDPRU* 2 Annex 1R; and

(2) be submitted to the *FCA* according to the instructions in that form.

2.4 Investment firm groups: general

Application and purpose

2.4.1 R This section applies to:

(1) a *UK parent entity*; and

(2) a *MIFIDPRU investment firm*.

2.4.2 G (1) The basic definition of an *investment firm group* covers a *parent undertaking* and its *subsidiaries*, at least one of which must be a *MIFIDPRU investment firm*.

(2) The definition of an *investment firm group* also includes *connected undertakings*. These are *relevant financial undertakings* which are not *subsidiaries*, but which form part of the *investment firm group* due to one of the types of relationship listed in *MIFIDPRU* 2.4.6R.

(3) If the relevant *subsidiaries* of the *investment firm group* include a *UK credit institution*, the group will not be an *investment firm group*. However, if a *UK credit institution* is merely a *connected undertaking* in relation to an *investment firm group*, that group will still be an *investment firm group*.

2.4.3 G (1) When a *UK parent entity* or a *MIFIDPRU investment firm* is identifying whether it forms part of an *investment firm group*, it will need to identify all *relevant financial undertakings* that are either *subsidiaries* or *connected undertakings*.

(2) The *UK parent entity* or *MIFIDPRU investment firm* can use the analysis in (1) to determine whether the *investment firm group*:

(a) is likely to be subject to consolidation under *MIFIDPRU* 2.5; or

(b) has a sufficiently simple structure to justify submitting an application to the *FCA* to apply the *group capital test* under *MIFIDPRU* 2.6.

2.4.4 G (1) Where consolidation under *MIFIDPRU* 2.5 applies, the definition of an *investment firm group* and the resulting *consolidated situation* includes all *relevant financial undertakings* that are either *subsidiaries* or *connected undertakings*.

(2) Where *MIFIDPRU* 2.6 applies, the definition of an *investment firm group* means that the *group capital test* only applies to a *parent undertaking* in relation to *relevant financial undertakings* that are its *subsidiaries*. It does not apply in relation to *relevant financial undertakings* that are merely *connected undertakings* of the *parent undertaking*.

(3) However, as explained in *MIFIDPRU* 2.4.19G, where an *investment firm group* contains *connected undertakings*, the *FCA* considers that the underlying structure of the *investment firm group* is unlikely to be sufficiently simple to permit the application of the *group capital test*. As a result, it is likely that the *UK parent entity* of the relevant *investment firm group* will need to apply consolidation under *MIFIDPRU* 2.5 instead.

Subsidiaries

2.4.5 G (1) The definition of a *subsidiary* for the purposes of *MIFIDPRU* refers to any *undertaking* which is a “subsidiary undertaking” as defined in section 1162, read together with Schedule 7, of the Companies Act 2006.

(2) *UK parent entities* and *firms* are reminded that under section 1162(4) of the Companies Act 2006, this includes relationships where either of the following apply in relation to an *undertaking* (“A”) and another *undertaking* (“B”):

(a) A has the power to exercise, or actually exercises, dominant influence or control over B; or

(b) A and B are managed on a unified basis.

(3) *UK parent entities* and *firms* are also reminded that under section 1162(5) of the Companies Act 2006, if an *undertaking* ("A") has a *subsidiary undertaking* ("B") and B is a *parent undertaking* of another *undertaking* ("C"), then C is also a *subsidiary undertaking* of A. As a result, the definition of a *subsidiary* in *MIFIDPRU* includes *subsidiaries* of *subsidiaries*.

Connected undertakings: general

2.4.6 R An *undertaking* ("CU") is a *connected undertaking* of another *undertaking* ("P1") if:

(1) P1 is connected to CU by *majority common management* in accordance with *MIFIDPRU* 2.4.8R(1);

(2) P1 exercises significant influence over CU in accordance with *MIFIDPRU* 2.4.10R(1);

(3) P1 and CU have been placed under single management, other than pursuant to a contract, clauses in memoranda or articles of association, in accordance with *MIFIDPRU* 2.4.12R(1);

(4) CU is a *subsidiary* of another *undertaking* ("P2"), and P2:

(a) is connected to P1 by *majority common management* in accordance with *MIFIDPRU* 2.4.8R(1); or

(b) has been placed under single management with P1, other than pursuant to a contract, clauses in memoranda or articles of association, in accordance with *MIFIDPRU* 2.4.12R(1); or

(5) P1 holds a *participation* in CU in accordance with *MIFIDPRU* 2.4.15R.

2.4.7 G The criteria in *MIFIDPRU* 2.4.8R(2)-(5) and *MIFIDPRU* 2.4.12R(2)-(5) for determining the deemed *parent undertaking* in relation to a *connected undertaking* apply on the basis of the facts at the time at which the relevant relationship first arises. This means that subsequent changes in the *own funds requirement* of entities or *investment firm groups* referenced in those *rules* will not lead to a change in the deemed *parent undertaking* for such purposes.

Connected undertakings: majority common management

2.4.8 R (1) This *rule* applies where:

(a) a *MIFIDPRU investment firm* is connected to a *relevant financial undertaking* by *majority common management*; or

(b) a *relevant financial undertaking* that forms part of an *investment firm group* is connected to another *relevant financial undertaking* by *majority common management*.

(2) If only one of the *undertakings* connected by *majority common management* forms part of an existing *investment firm group*, that *undertaking* shall be deemed to be the *parent undertaking* of the other *undertaking* when applying the requirements in *MIFIDPRU* 2.5.

(3) If both *undertakings* connected by *majority common management* form part of separate existing *investment firm groups*, the *undertaking* that forms part of the *investment firm group* which has, or would have, the higher consolidated *own funds requirement* based on its *consolidated situation*, shall be deemed to be the *parent undertaking* of the other *undertaking* when applying the requirements in *MIFIDPRU* 2.5.

(4) If neither of the *undertakings* connected by *majority common management* forms part of an existing *investment firm group* and both *undertakings* are *MIFIDPRU investment firms*, the *MIFIDPRU investment firm* with the higher individual *own funds requirement* shall be deemed to be the *parent undertaking* of the other *MIFIDPRU investment firm* when applying the requirements in *MIFIDPRU* 2.5.

(5) If neither of the *undertakings* connected by *majority common management* forms part of an existing *investment firm group* and only one of those *undertakings* is a *MIFIDPRU investment firm*, the *MIFIDPRU investment firm* shall be deemed to be the *parent undertaking* of the other *undertaking* when applying the requirements in *MIFIDPRU* 2.5.

[**Note:** article 2(1) and (2) of the draft consolidation RTS.]

2.4.9 G A *MIFIDPRU investment firm* may wish to apply to the *FCA* under section 138A of the *Act* to modify the application of *MIFIDPRU* 2.4.8R(2)-(5), if it considers that a different *undertaking* should be deemed to be the *parent undertaking* for the purposes of *MIFIDPRU* 2.5 in the context of *majority common management*.

[**Note:** article 2(3) of the draft consolidation RTS.]

Connected undertakings: significant influence without participation or capital ties

2.4.10 R (1) This *rule* applies where:

(a) any of the following *undertakings* (“A”) exercises significant influence over a *relevant financial undertaking*:

(i) a *MIFIDPRU investment firm*;

(ii) an *investment holding company*; or

(iii) a *mixed financial holding company*; and

(b) the *relevant financial undertaking* is not:

(i) a *subsidiary* of A; or

(ii) connected to A by *majority common management*.

(2) Where this *rule* applies, A shall be deemed to be the *parent undertaking* of the *relevant financial undertaking* for the purposes of *MIFIDPRU* 2.5.

2.4.11 G For the purposes of *MIFIDPRU* 2.4.10R(1)(a), the following circumstances may be indicators that A is exercising significant influence over the *relevant financial undertaking*:

(1) A appoints or has the ability to appoint a representative in the *management body*, either in the executive or in the supervisory function, of the *relevant financial undertaking*;

(2) A participates in the policy-making processes of the *relevant financial undertaking*, including *participation* in decisions about dividends and other distributions;

(3) the existence of material transactions between the two *undertakings*;

(4) the interchange of managerial personnel between the two *undertakings*;

(5) the provision of essential technical information or critical services from one entity to the other;

(6) A enjoys additional rights in the *relevant financial undertaking*, by virtue of a contract or of a provision in the articles of association or other constitutional documents of that *undertaking*, that could affect the management or the decision-making of that *relevant financial undertaking*; and

(7) the existence of share warrants, share call options, debt instruments that are convertible into ordinary shares or other similar instruments that are currently exercisable or convertible and have the potential, if exercised or converted, to give voting power or to reduce another party’s voting power over the financial and operating policies of the *relevant financial undertaking*.

[**Note:** article 3(2) of the draft consolidation RTS.]

Connected undertakings: single management other than pursuant to a contract, clauses in memoranda or articles of association

2.4.12 R (1) This *rule* applies where:

(a) any of the following *undertakings* ("A") has been placed under single management, other than pursuant to a contract, clauses in memoranda or articles of association, with a *relevant financial undertaking*:

(i) a *MIFIDPRU investment firm*;

(ii) an *investment holding company*; or

(iii) a *mixed financial holding company*; and

(b) the *relevant financial undertaking* is not:

(i) a *subsidiary* of A;

(ii) connected to A by *majority common management*; or

(iii) an *undertaking* over which A exercises significant influence in accordance with *MIFIDPRU* 2.4.10R.

(2) If only one of the *undertakings* placed under single management already forms part of an existing *investment firm group*, that *undertaking* shall be deemed to be the *parent undertaking* of the other *undertaking* when applying the requirements in *MIFIDPRU* 2.5.

(3) If both *undertakings* placed under single management form part of separate existing *investment firm groups*, the *undertaking* that forms part of the *investment firm group* which has, or would have, the higher consolidated *own funds requirement* based on its *consolidated situation* shall be deemed to be the *parent undertaking* of the other *undertaking* when applying the requirements in *MIFIDPRU* 2.5.

(4) If neither of the *undertakings* placed under single management forms part of an existing *investment firm group* and both of those *undertakings* are *MIFIDPRU investment firms*, the *MIFIDPRU investment firm* with the higher individual *own funds requirement* shall be deemed to be the *parent undertaking* of the other *MIFIDPRU investment firm* when applying the requirements in *MIFIDPRU* 2.5.

(5) If neither of the *undertakings* placed under single management

forms part of an existing *investment firm group* and only one of those *undertakings* is a *MIFIDPRU investment firm*, the *MIFIDPRU investment firm* shall be deemed to be the *parent undertaking* of the other *undertaking* when applying the requirements in *MIFIDPRU* 2.5.

[**Note:** article 4(1) of the draft consolidation RTS.]

2.4.13 G For the purposes of *MIFIDPRU* 2.4.12R, the following circumstances are indicators that the type of single management in *MIFIDPRU* 2.4.12R(1)(a) may exist:

(1) A and the *relevant financial undertaking* are controlled by:

(a) the same natural *person*;

(b) the same group of natural *persons*;

(c) an *undertaking* or the same group of *undertakings* that do not otherwise belong to that *group*;

(d) an *undertaking* or the same group of *undertakings* that are not established in the *UK*; or

(2) the majority of the management body, either in its executive or in its supervisory function, of A and the *relevant financial undertaking* is composed of people appointed by the same *undertaking* or *undertakings*, by the same natural *person* or by the same group of natural *persons*, even if they do not necessarily consist of the same people.

2.4.14 G The indicators in *MIFIDPRU* 2.4.13G are not conclusive and the occurrence of a situation in which two or more *undertakings* are placed under single management for the purposes of *MIFIDPRU* 2.4.12R must in each case be assessed by reference to the individual facts, and in particular whether in practice there is effective coordination of the financial and operating policies of the relevant *undertakings*.

[**Note:** article 4(2) of the draft consolidation RTS.]

Connected undertakings: participations

2.4.15 R (1) This *rule* applies where the following conditions are met:

(a) one of the following ("A") holds, directly or indirectly, a *participation* in a *relevant financial undertaking*:

(i) a *MIFIDPRU investment firm*;

(ii) an *investment holding company*; or

(iii) a *mixed financial holding company*;

(b) the *relevant financial undertaking* is not:

(i) a *subsidiary* of A; or

(ii) connected to A by *majority common management*; or

(iii) an *undertaking* over which A exercises significant influence in accordance with *MIFIDPRU* 2.4.10R; or

(iv) an *undertaking* with which A has been placed under single management in accordance with *MIFIDPRU* 2.4.12R; and

(c) A forms part of an existing *investment firm group*.

(2) Where this *rule* applies, A shall be deemed to be the *parent undertaking* of the *relevant financial undertaking* when applying the requirements in *MIFIDPRU* 2.5.

2.4.16 G (1) By virtue of the definition of a *participation*, where an *undertaking* ("A") has direct or indirect ownership of 20% or more of the voting rights in, or capital of, a *relevant financial undertaking*, A will hold a *participation* in that *undertaking*.

(2) However, A may also hold a *participation* where, even though A does not have an ownership interest as described in (1), A nonetheless has rights in the capital of the *relevant financial undertaking* which create a durable link with that *undertaking* which is intended to contribute to its activities.

(3) For the purpose of assessing whether there is a *participation* of the type described in (2), it is relevant to consider the overall ownership structure of the *relevant financial undertaking*, having regard in particular to whether interests in the capital or voting rights of the *relevant financial undertaking* are distributed across a large number of shareholders, or whether A is the main investor.

Application to apply the group capital test to an investment firm group

2.4.17 R An *investment firm group* will be subject to the requirements in *MIFIDPRU* 2.6, rather than those in *MIFIDPRU* 2.5, where:

(1) the *UK parent entity* of that *investment firm group* or a *MIFIDPRU investment firm* within that *investment firm group* has applied to the *FCA* in accordance with *MIFIDPRU* 2.4.18R; and

(2) the *FCA* is satisfied on the basis of the application in (1) that:

(a) the group structure of the *investment firm group* is sufficiently simple to justify applying the *group capital test*; and

(b) there are no significant risks to *clients* or to the market stemming from the *investment firm group* as a whole that would otherwise require supervision on a *consolidated basis*.

[**Note:** article 8(1) of the *IFR*.]

2.4.18 R An application submitted under *MIFIDPRU* 2.4.17R(1):

(1) must be made using the form in *MIFIDPRU* 2 Annex 3R, and should be submitted to the *FCA* in accordance with the instructions in that form;

(2) must include:

(a) a group structure chart that:

(i) identifies each *undertaking* that forms part of the *investment firm group*;

(ii) explains the nature of the business or activities undertaken by each *undertaking*;

(iii) identifies whether each *undertaking* is a *relevant financial undertaking* and, if so, which type of *relevant financial undertaking* it is; and

(iv) explains the nature and degree of ownership or control that connects the *undertaking* to the *investment firm group* (including, where applicable, any relationship which has led the *undertaking* to be classified as a *connected undertaking* in relation to the *investment firm group*);

(b) an explanation of why the group structure is sufficiently simple to justify the application of the *group capital test*;

(c) an explanation of why there are no significant risks to *clients* or to the market stemming from the *investment firm group* that would require supervision on a *consolidated basis*;

(d) calculations which show how each *parent undertaking* within the *investment firm group* would satisfy the *group capital test*;

(e) evidence that the book value of each *parent undertaking's* investment in a *subsidiary*, whether that *subsidiary* forms part of the *investment firm group* or not, is a fair reflection of the consideration paid by the *parent undertaking* for that *subsidiary*;

(f) calculations which demonstrate the consolidated *own funds* and *liquid assets* requirements that would apply on the basis of the *consolidated situation* of the *investment firm group* if consolidation under *MIFIDPRU* 2.5 applied instead;

(g) an explanation of:

(i) how the *investment firm group* would comply with the consolidated requirements in (f) if the *FCA* did not grant permission to apply the *group capital test*; and

(ii) the timeframe in which the *investment firm group* would expect to achieve compliance with such consolidated requirements; and

(h) an explanation of how the *UK parent entity* of the *investment firm group* would comply with the systems requirement in *MIFIDPRU* 2.5.8R.

(3) may only be submitted by a *UK parent entity* or a *MIFIDPRU investment firm* if that *UK parent entity* or *MIFIDPRU investment firm* has the necessary authority to make the application on behalf of all *undertakings* within the *investment firm group* which would be subject to the *group capital test*.

2.4.19 G In the *FCA's* view, where an *investment firm group* includes one or more undertakings which are *connected undertakings*, it is unlikely that the *investment firm group* will be sufficiently simple for the purposes of *MIFIDPRU* 2.4.17R(2)(a). This is because the nature of the relationship between the relevant member of the *investment firm group* and the *connected undertaking* is likely to involve a more complex fact pattern and because the *group capital test* could not be applied to that relationship. Therefore, the *FCA* considers that it is likely to be more appropriate to apply prudential consolidation under *MIFIDPRU* 2.5 to the *investment firm group* in such circumstances.

2.5 Prudential consolidation

2.5.1 R (1) This section applies to a *UK parent entity* that is not subject to the *group capital test* under *MIFIDPRU* 2.6.

(2) This section also applies to a *MIFIDPRU investment firm* that forms part of the same *investment firm group* as the relevant *UK parent entity* in (1).

2.5.2 G Prudential consolidation under this section and the *group capital test* under *MIFIDPRU* 2.6 are mutually exclusive requirements that may apply to an *investment firm group*. If an *investment firm group* is not permitted to use the *group capital test* under *MIFIDPRU* 2.6, the consolidation requirements in this section will apply to that *investment firm group*, except to the extent that an exemption applies.

2.5.3 G The table below is a guide to the content of this section.

Provisions of *MIFIDPRU* 2.5	**Summary of content**
MIFIDPRU 2.5.4G	The interaction between prudential consolidation under *MIFIDPRU* 2.5 and prudential consolidation under the *UK CRR*
MIFIDPRU 2.5.5G	The meaning of the *consolidated situation*
MIFIDPRU 2.5.6G	The treatment of *tied agents* included within the *consolidated situation*
MIFIDPRU 2.5.7R to 2.5.12G	The main obligations in relation to prudential consolidation under *MIFIDPRU* 2.5
MIFIDPRU 2.5.13R to 2.5.16G	The default position requiring full consolidation and the availability of alternative methods of consolidation
MIFIDPRU 2.5.17R and 2.5.18G	Proportional consolidation
MIFIDPRU 2.5.19R and 2.5.20G	Exemption from consolidated liquidity requirements
MIFIDPRU 2.5.21R and 2.5.22G	Determining whether a *UK parent entity* should be treated as an *SNI MIFIDPRU investment firm* on a *consolidated basis*
MIFIDPRU 2.5.23G	Determining consolidated *own funds*
MIFIDPRU 2.5.24G to 2.5.46R	Determining the consolidated *own funds requirement*

MIFIDPRU 2.5.47R and 2.5.48G	Consolidated liquidity requirements
MIFIDPRU [2.5.49]	Consolidated disclosure requirements
MIFIDPRU 2.5.50G	Consolidated reporting requirements
MIFIDPRU [2.5.51]	Consolidated governance and remuneration requirements
MIFIDPRU [2.5.52]	Application of the *ICARA process* on a *consolidated basis*

Interaction between consolidation under MIFIDPRU and the UK CRR

2.5.4 G (1) Under this section, prudential consolidation applies where there is an *investment firm group*. The definition of an *investment firm group* excludes a *group* which contains a *UK credit institution*. Where a *group* includes a *UK credit institution*, prudential consolidation applies in accordance with the provisions of the *UK CRR* and the *PRA Rulebook*.

(2) However, a *group* may be an *investment firm group* where it contains both a *MIFIDPRU investment firm* and a *designated investment firm* subject to the *UK CRR*, but no *UK credit institution*. In that case, the *MIFIDPRU investment firm* would trigger prudential consolidation according to this section (and the *designated investment firm* would trigger consolidation according to the *UK CRR*). It is therefore possible for certain group structures to be subject to consolidation under both *MIFIDPRU* and the *UK CRR* simultaneously, with the same entities included within the scope of consolidation of each. In these situations, the relevant *group* must comply with both sets of consolidated requirements, which are aimed at addressing different types of risks.

[**Note:** article 4(1)(25) of the *IFR*.]

Meaning of "consolidated situation"

2.5.5 G (1) The application of prudential consolidation under this section is based on the *consolidated situation* of a *UK parent entity*.

(2) A *consolidated situation* is defined as the situation that results from applying relevant requirements in *MIFIDPRU* in accordance with *MIFIDPRU* 2.5.7R and *MIFIDPRU* 2.5.11R to a *UK parent entity*, as if that *undertaking* formed, together with all the *relevant financial undertakings* in the *investment firm group*, a single *MIFIDPRU investment firm*.

(3) For the purposes of the *consolidated situation*, the term "*relevant financial undertaking*" (and the underlying definitions of "*investment firm*", "*financial institution*", "*ancillary services undertaking*" and "*tied agent*") shall also apply to *undertakings* established outside the *UK*, which, were they established in the *UK*, would fulfil the definitions of those terms.

[**Note:** article 4(1)(11) of the *IFR*.]

Tied agents included within the consolidated situation

2.5.6 G (1) If a *tied agent* is included within the *consolidated situation*, all relevant activities and expenditure of that *tied agent* will be consolidated in full (or, where proportional consolidation applies, the relevant proportion of the activities of that *tied agent* will be consolidated) for the purpose of calculating the consolidated *fixed overheads requirement* and the consolidated *K-factor requirement*. This is the case irrespective of whether the *investment services and/or activities* carried on by the *tied agent* are undertaken, or the relevant expenses are incurred, on behalf of another entity included within the *consolidated situation* or on behalf of a third party that is not included within the *consolidated situation*.

(2) The *guidance* in (1) relates to a *tied agent* that is included within the *consolidated situation*. There are separate requirements in:

(a) *MIFIDPRU* [4.5.xR], which applies in relation to the individual *fixed overheads requirement* of a *MIFIDPRU investment firm* where a *tied agent* incurs expenses on behalf of that *firm*; and

(b) *MIFIDPRU* [4.7.xR], *MIFIDPRU* [4.8.x.R], *MIFIDPRU* [4.9.xR] or *MIFIDPRU* [4.10.xR][7], which apply in relation to the individual *K-factor requirement* of a *MIFIDPRU investment firm* where a *tied agent* carries on certain *investment services and/or activities* on behalf of that *firm*.

These requirements apply in relation to the calculation of the individual *fixed overheads requirement* and *K-factor requirement* of a *MIFIDPRU investment firm*, even if the *tied agent* is not part of the same *investment firm group* as that *MIFIDPRU investment firm*.

[7] *Editor's note:* The FCA will consult on the fixed overheads requirement in MIFIDPRU 4.5 and the remaining K-factor calculations in MIFIDPRU 4.7 to 4.10 in a subsequent consultation paper.

(3) Where the requirements in (2)(a) or (2)(b) apply in relation to a *MIFIDPRU investment firm* which is included within the *consolidated situation*, the relevant amounts that are added to the individual requirements of that *MIFIDPRU investment firm* due to the activities of the *tied agent* must be included in the *consolidated situation*, irrespective of whether the *tied agent* is itself included within the *consolidated situation*.

(4) An individual *tied agent* ("A") may both:

(a) be included within the *consolidated situation*; and

(b) incur expenses and/or carry on *investment services and/or activities* on behalf of a *MIFIDPRU investment firm* ("B") where B is also included in the *consolidated situation*.

In such a case, the contribution of A to the consolidated *fixed overheads requirement* and consolidated *K-factor requirement* may be adjusted to the extent necessary to prevent double-counting of any amounts which may already have been included due to B being included in the *consolidated situation* and a proportion of A's activities or expenses having already been attributed to B.

Prudential consolidation – main requirements

2.5.7 R A *UK parent entity* must comply with the *rules* in the following chapters of *MIFIDPRU* on the basis of its *consolidated situation*:

(1) *MIFIDPRU* 3 (Own funds);

(2) *MIFIDPRU* 4 (Own funds requirements);

(3) *MIFIDPRU* 5 (Concentration risk);

(4) [*MIFIDPRU* 8 (Disclosure)][8]; and

(5) *MIFIDPRU* 9 (Reporting).

[**Note:** article 7(1) of the *IFR*.]

2.5.8 R To ensure that the data required to comply with the consolidated requirements under *MIFIDPRU* 2.5.7R are duly processed and forwarded, a *UK parent entity* to which *MIFIDPRU* 2.5.7R applies and any *MIFIDPRU investment firms* in the same *investment firm group* must establish the following:

[8] *Editor's note:* The FCA will consult on the content of MIFIDPRU 8 and any outstanding content in MIFIDPRU 4 and 9 in a subsequent consultation.

(1) a proper organisational structure; and

(2) appropriate internal control mechanisms.

2.5.9 R A *UK parent entity* to which *MIFIDPRU* 2.5.7R applies and any *MIFIDPRU investment firms* in the same *investment firm group* are each responsible for ensuring that any of their *subsidiaries* that are not subject to *MIFIDPRU* implement such arrangements, processes and mechanisms as are necessary to ensure that the *UK parent entity* complies with the consolidated requirements under *MIFIDPRU* 2.5.7R.

[**Note:** article 7(1) of the *IFR*.]

2.5.10 R (1) For the purposes of *MIFIDPRU* 2.5.7R, when applying *MIFIDPRU* 3 on a *consolidated basis,* the requirements in Title II of Part Two of the *UK CRR* shall also apply.

(2) For the purposes of (1), when applying the provisions of article 84(1), article 85(1) and article 87(1) of the *UK CRR*:

(a) to the extent that those provisions refer to other provisions of the *UK CRR* that impose own funds requirements, only the references to article 92(1) of the *UK CRR* shall apply; and

(b) the references to article 92(1) of the *UK CRR* in those provisions shall be read as if they were references to the *own funds requirement* under *MIFIDPRU.*

[**Note:** article 7(2) of the *IFR*.]

2.5.11 R A *UK parent entity* must comply with [*MIFIDPRU* 6 (Liquidity)][9] on the basis of its *consolidated situation*.

[**Note:** article 7(3) of the *IFR*.]

2.5.12 G *MIFIDPRU* 2.5.7R to 2.5.11R require a *UK parent entity* to comply with other chapters of *MIFIDPRU* on the basis of its *consolidated situation*. Certain requirements in those chapters do not apply, or apply in a modified manner, to *SNI MIFIDPRU investment firms*. *MIFIDPRU* 2.5.21R explains how the *UK parent entity* should determine whether it should be treated as an *SNI MIFIDPRU investment firm* on the basis of its *consolidated situation*.

Default position: full consolidation of relevant entities

2.5.13 R (1) For the purposes of determining the *consolidated situation*

[9] *Editor’s note:* The FCA will consult on the content of MIFIDPRU 6 in a subsequent consultation.

under *MIFIDPRU* 2.5.7R and *MIFIDPRU* 2.5.11R, a *UK parent entity* must carry out a full consolidation of all *relevant financial undertakings* that form part of its *investment firm group,* unless (2) applies.

(2) A *UK parent entity* is not required to carry out a full consolidation of a *relevant financial undertaking* under (1) where:

(a) the *relevant financial undertaking* is a *connected undertaking* that forms part of the *investment firm group* by virtue of a *participation* in accordance with *MIFIDPRU* 2.4.15R; and

(b) the conditions for proportional consolidation under *MIFIDPRU* 2.5.17R are satisfied.

[**Note:** article 6(1) of the draft consolidation RTS.]

2.5.14 G A *UK parent entity* which is subject to *MIFIDPRU* 2.5.13R(1) may make an application to the *FCA* under section 138A of the *Act* to modify the application of *MIFIDPRU* 2.5.13R(1) so as to require an alternative method of consolidation.

2.5.15 G When determining an application of the type described in *MIFIDPRU* 2.5.14G the *FCA* will consider a range of factors, including whether full consolidation is appropriate because the *UK parent entity* or a *MIFIDPRU investment firm* within the same *investment firm group*:

(1) acts as sponsor by managing or advising the *relevant financial undertaking* or marketing its securities;

(2) provides liquidity or credit enhancements to the *relevant financial undertaking*;

(3) is an important investor in the equity or debt instruments of the *relevant financial undertaking*;

(4) by virtual of contractual or non-contractual relationships, is exposed to risks or equity-like returns that are derived from the assets of the *relevant financial undertaking* or that are dependent upon the performance of that *undertaking*;

(5) is effectively involved in the decision-making process of the *relevant financial undertaking* or exercises influence over that *undertaking*;

(6) receives critical operational services from the *relevant financial undertaking* which cannot be replaced in a timely fashion without excessive cost;

(7) has a credit rating upon which the credit rating of the *relevant financial undertaking* is based;

(8) has a close commercial relationship with other investors in the *relevant financial undertaking*;

(9) has a common customer base with the *relevant financial undertaking* or is involved in the commercialisation of its products;

(10) is part of the same brand as the *relevant financial undertaking*;

(11) has already provided financial support to the *relevant financial undertaking* in relation to financial difficulties; or

(12) incurs a disproportionate amount of the expenses connected with the business operations of the *relevant financial undertaking*.

[**Note:** article 6(4) of the draft consolidation RTS.]

2.5.16 G The *FCA* would generally expect that the alternative method of consolidation proposed in an application of the type described in *MIFIDPRU* 2.5.14G would involve either:

(1) proportional consolidation according to the share of the capital or voting rights held in the *relevant financial undertaking*, in which case the *FCA* will take into account factors equivalent to those set out in *MIFIDPRU* 2.5.17R(2) in addition to the factors in *MIFIDPRU* 2.5.15G; or

(2) consolidation of an appropriate alternative fixed percentage of the relevant metrics attributable to the *relevant financial undertaking*.

Proportional consolidation: participations

2.5.17 R (1) This *rule* applies where a *relevant financial undertaking* forms part of an *investment firm group* because it is a *connected undertaking* by virtue of a *participation* in accordance with *MIFIDPRU* 2.4.15R.

(2) For the purposes of determining the *consolidated situation* under *MIFIDPRU* 2.5.7R and *MIFIDPRU* 2.5.11R, a *UK parent entity* (“A”) may apply proportional consolidation in relation to the *relevant financial undertaking* in (1) (“B”) if the following conditions are met:

(a) A’s liability is limited to the share of capital that it holds in B;

(b) the liability of the other shareholders or members of B ("participating undertakings") is clearly established by means of a legally binding and enforceable contract between A and all participating undertakings which:

(i) limits the liability of the parties to the percentage of each shareholding;

(ii) clearly states that any potential losses arising from B will be borne by all shareholders or members proportionately to the share of capital held by each of them at such point in time;

(iii) clarifies that any changes in the share of capital of the shareholders or members are subject to the explicit consent of all the shareholders or members;

(iv) specifies that should B be recapitalised, A shall inform the *FCA* in a timely manner about the progress of the recapitalisation process and that each shareholder or member shall be liable to contribute to the recapitalisation no more than an amount that is proportionate to its current share of capital held in A;

(c) there are no other agreements or arrangements between any of the following that would override or undermine any of the conditions in (b);

(i) some or all of the participating undertakings; or

(ii) some or all of the participating undertakings and one or more third parties;

(d) any participating undertakings who do not form part of the same *investment firm group* as A either:

(i) are subject to prudential supervision; or

(ii) can reasonably be expected to have sufficient resources to fund any contribution for which they may be liable under (b)(iv);

(e) the solvency of the participating undertakings is satisfactory and can be expected to remain so; and

(f) before applying proportional consolidation in relation to the *relevant financial undertaking* in accordance with this *rule*, the *UK parent entity* has notified the *FCA* by email to [*Editor's note*: contact details to be inserted] that it intends to do so.

[**Note:** article 7(1) – (4) of the draft consolidation RTS]

2.5.18 G Proportional consolidation allows a *UK parent entity* to include within its *consolidated situation* only a proportion of the relevant metrics associated with the *relevant financial undertaking* to which it is connected by a *participation*. The relevant proportion is equal to the proportion of capital or voting rights that comprises that *participation*.

Exemption from consolidated liquidity requirements

2.5.19 R A *UK parent entity* will be exempt from *MIFIDPRU* 2.5.11R if:

(1) the *UK parent entity* has applied to the *FCA* in accordance with *MIFIDPRU* 2.5.20R; and

(2) the application in (1) has demonstrated the following to the satisfaction of the *FCA*:

(a) all *MIFIDPRU investment firms* in the *investment firm group* are subject to the *rules* in *MIFIDPRU* 6 (Liquidity) on an individual basis; and

(b) the exemption is appropriate, taking into account the nature, scale and complexity of the *investment firm group*.

[**Note:** article 7(4) of the *IFR*.]

2.5.20 R A *UK parent entity* must make any application under *MIFIDPRU* 2.5.19R(1) by submitting the form in *MIFIDPRU* 2 Annex 2R in accordance with the instructions in that form.

Application of criteria to be classified as an SNI MIFIDPRU investment firm on a consolidated basis

2.5.21 R (1) This *rule* applies for the purpose of determining whether a *UK parent entity* that is subject to consolidation under this section should be treated as an *SNI MIFIDPRU investment firm* when applying the relevant chapters of *MIFIDPRU* specified in *MIFIDPRU* 2.5.7R and 2.5.11R on a *consolidated basis*.

(2) Where any individual *MIFIDPRU investment firm* within the *investment firm group* has been classified as a *non-SNI MIFIDPRU investment firm* in accordance with *MIFIDPRU* 1.2 (including on a combined basis under *MIFIDPRU* 1.2.10R), the *UK parent entity* in (1) must comply with the relevant chapters of *MIFIDPRU* that apply on a *consolidated basis* as if it were a *non-SNI MIFIDPRU investment firm*.

(3) Where no individual *MIFIDPRU investment firm* within the *investment firm group* has been classified as a *non-SNI MIFIDPRU investment firm* (including on a combined basis under *MIFIDPRU* 1.2.10R), the *UK parent entity* in (1) must apply the criteria and comply with the calculation requirements in *MIFIDPRU* 1.2 on the basis of the *consolidated situation*.

(4) When applying the criteria in *MIFIDPRU* 1.2 in accordance with (3), if any entity included within the *consolidated situation* is *dealing on own account*, the *UK parent entity* in (1) must comply with the relevant chapters of *MIFIDPRU* that apply on a *consolidated basis* as if it were a *non-SNI MIFIDPRU investment firm*.

(5) For the purposes of (3), when calculating the contribution of a *collective portfolio management investment firm* to the *consolidated situation*, the *UK parent entity* is required to include only amounts that are attributable to the *investment services and/or activities* undertaken by that *collective portfolio management investment firm*.

2.5.22 G (1) Firms should note that *MIFIDPRU* 2.5.21R(3) requires the relevant *UK parent entity* to consolidate all of the relevant metrics for the criteria in *MIFIDPRU* 1.2.1R.

(2) The situation in (1) should not be confused with the application of only certain metrics (being *AUM*, *COH*, the on- and off-balance sheet total and the total annual gross revenue) on a combined basis to an individual *MIFIDPRU investment firm* under *MIFIDPRU* 1.2.10R.

(3) Where, when applying *MIFIDPRU* 1.2.1R on a *consolidated basis*, any of the thresholds in that *rule* are exceeded, the relevant chapters of *MIFIDPRU* specified in *MIFIDPRU* 2.5.7R and 2.5.11R apply to the *UK parent entity* as if it were a *non-SNI MIFIDPRU investment firm*. Conversely, if none of the relevant thresholds in *MIFIDPRU* 1.2.1R are exceeded on a *consolidated basis*, the relevant chapters of *MIFIDPRU* that apply on a *consolidated basis* apply to the *UK parent entity* as if it were an *SNI MIFIDPRU investment firm*.

Prudential consolidation in practice: own funds

2.5.23 G (1) *MIFIDPRU* 2.5.7R requires that the total consolidated *own funds requirement* of an *investment firm group* be met by consolidated *own funds*. Consolidated *own funds* must satisfy the requirements of *MIFIDPRU* 3 and the deductions from consolidated *own funds* must be applied in accordance with that chapter as it applies on a *consolidated basis*.

(2) *MIFIDPRU* 2.5.10R also applies the provisions on minority interests and *additional tier 1 instruments* and *tier 2 instruments* issued by *subsidiaries* in Title II of Part Two of the *UK CRR* to a *UK parent entity*, but with the modifications set out in that *rule*.

(3) The determination of consolidated *own funds* should be consistent with any reporting of consolidated financial statements that the *FCA* may require. In appropriate cases, the *FCA* may require a *UK parent entity* to provide independent verification of the calculation of its consolidated *own funds* in accordance with section 165(6) and (7) of the *Act*.

Prudential consolidation in practice: capital requirements

General

2.5.24 G (1) Generally, the same approach to *own funds requirements* that applies to a *MIFIDPRU investment firm* on an individual basis under *MIFIDPRU* 4 applies to a *UK parent entity* on a *consolidated basis*.

(2) The consolidated *own funds requirement* under *MIFIDPRU* 2.5.7R is the highest of the components of the *own funds requirement* specified in *MIFIDPRU* 4.3 as they apply on a *consolidated basis* – i.e. the highest of:

(a) the consolidated *fixed overheads requirement*;

(b) the consolidated *permanent minimum capital requirement*; or

(c) if the *UK parent entity* is treated as a *non-SNI MIFIDPRU investment firm* in accordance with *MIFIDPRU* 2.5.21R, the consolidated *K-factor requirement*.

Consolidated fixed overheads requirement

2.5.25 R (1) This *rule* applies for the purposes of a *UK parent entity's* calculation of the *fixed overheads requirement* on a *consolidated basis* in accordance with *MIFIDPRU* 2.5.7R.

(2) A *UK parent entity* must:

(a) use figures arising from its most recent:

(i) audited consolidated *annual financial statements* after distribution of profits; or

(ii) unaudited consolidated *annual financial statements*, where audited financial statements are not available; or

(b) if the relevant figures under (a) are not available, calculate the consolidated fixed overheads as the sum of the following:

(i) the individual fixed overheads of the *UK parent entity*;

(ii) the full amount of the individual fixed overheads of each *relevant financial undertaking* which is fully consolidated within the *consolidated situation*; and

(iii) the relevant proportion of the individual fixed overheads of each *relevant financial undertaking* which is subject to proportional consolidation on a *consolidated basis*.

(3) Where such amounts are not already included in the relevant figures under (2), a *UK parent entity* must include within its calculation of the consolidated fixed overheads any fixed expenses incurred by a third party, including a *tied agent*, on behalf of:

(a) the *UK parent entity*; or

(b) any *relevant financial undertaking* included in the *consolidated situation*.

(4) Where the figures under (2)(b) include expenses that are incurred between entities included in the *consolidated situation*, the *UK parent entity* may adjust the consolidated fixed overheads figure to the extent necessary to avoid double-counting of such amounts.

2.5.26 G Where the *FCA* considers that there has been a material change in the activities of the *investment firm group*, the *FCA* may exercise its powers under section 55L or [section 143K][10] of the *Act* to require a *UK parent entity* to use an appropriate adjusted figure as the consolidated *fixed overheads requirement*.

Consolidated permanent minimum capital requirement

[10] *Editor's note:* References in this chapter to section 143K of the Financial Services and Markets Act 2000 are to that section as it would be inserted by the Financial Services Bill, which was introduced to the House of Commons on 20 October 2020. This reference may change if the Bill is amended during the parliamentary process.

2.5.27 R (1) This *rule* applies for the purposes of a *UK parent entity's* calculation of the *permanent minimum capital requirement* on a *consolidated basis* in accordance with *MIFIDPRU* 2.5.7R.

(2) The consolidated *permanent minimum capital requirement* is the sum of the following:

(a) for entities that are fully consolidated within the *consolidated situation*, the full amount of each of the following:

(i) the individual *permanent minimum capital requirement* of each *MIFIDPRU investment firm*; and

(ii) where applicable, the base own funds requirement or initial capital requirement of any other *relevant financial undertaking*; and

(b) for entities that are subject to proportional consolidation under the *consolidated situation*, the relevant proportion of each of the amounts specified in (a).

(3) For the purposes of (2):

(a) references to a *MIFIDPRU investment firm* include a *third country* entity within the *investment firm group* which would fall within that definition if it were established in the *UK*; and

(b) the individual *permanent minimum capital requirement*, base own funds requirement or initial capital requirement of any *third country* entity in (a) shall be deemed to be the individual requirement that would apply if that entity were established in the *UK*.

[**Note:** article 10 of the draft consolidation RTS.]

Consolidated K-Factor Requirement

2.5.28 G (1) The general principle is that the consolidated *K-factor requirement* should be calculated on the basis of the *consolidated situation* of a *UK parent entity*, such that the entities included in the *consolidated situation* are treated as if they form a single *MIFIDPRU investment firm*. This is subject to any *rules* in this section which require a modified approach to the relevant calculation on a *consolidated basis*.

(2) As is the case when calculating the *K-factor requirement* on an individual basis, the *K-factor metrics* that are relevant to the *consolidated situation* will depend upon the *investment services*

and/or activities (or equivalent activities in the case of a *third country* entity) undertaken by relevant entities within the *investment firm group*. The consolidated *K-factor requirement* should be calculated in accordance with the relevant provisions in *MIFIDPRU* 4 applicable to those *K-factor metrics,* but on the basis of the *consolidated situation*.

(3) *MIFIDPRU* 2.5.6G contains additional *guidance* on how the consolidated *K-factor requirement* applies in relation to *tied agents* which are included within the *consolidated situation*.

[**Note:** article 11(1) to 11(2) of the draft consolidation RTS.]

Consolidated K-AUM, K-COH and K-DTF requirements

2.5.29 R (1) This *rule* applies for the purposes of a *UK parent entity's* calculation on a *consolidated basis* in accordance with *MIFIDPRU* 2.5.7R of the following:

(a) the *K-AUM requirement*;

(b) the *K-COH requirement*; and

(c) the *K-DTF requirement*.

(2) For the purposes of (1), the consolidated *AUM*, *COH* or *DTF* is the sum of the following:

(a) the full amount of the relevant individual *K-factor metrics* of each *MIFIDPRU investment firm* which is fully consolidated within the *consolidated situation*; and

(b) the relevant proportion of the relevant individual *K-factor metrics* of each *MIFIDPRU investment firm* which is subject to proportional consolidation on a *consolidated basis*.

(3) For the purposes of (2):

(a) references to a *MIFIDPRU investment firm* shall be deemed to include a *third country* entity within the *investment firm group* which would fall within that definition if it were established in the *UK*; and

(b) the relevant individual *K-factor metric* of any *third country* entity in (a) shall be deemed to be the individual *K-factor metric* that would be attributable to that entity if that entity were established in the *UK*.

(4) Where the consolidated *AUM*, *COH* or *DTF* under (2) includes amounts attributable to transactions or arrangements between two or more entities included within the *consolidated situation*,

the *UK parent entity* may adjust the consolidated *K-factor metric* figure to the extent necessary to avoid double-counting of such amounts.

Consolidated K-CMH and K-ASA requirements

2.5.30 R The consolidated *K-CMH requirement* and consolidated *K-ASA requirement* for an *investment firm group* must be calculated in accordance with the following:

(1) the contribution of any individual *MIFIDPRU investment firm* to the *consolidated situation* must be determined by applying the relevant *rules* for calculating *CMH* and *ASA* in *MIFIDPRU* [4.8] and [4.9] to that individual *firm*; and

(2) the contribution of any other entity ("X") in the *investment firm group* to the *consolidated situation* must be determined by:

(a) identifying:

(i) any *money* held by X that was received from its *clients*; or

(ii) any assets held by X belonging to its *clients*;

in the course of, or in connection with, business which would be *MiFID business* if it were carried on by a *MIFIDPRU investment firm* in the *UK*;

(b) subject to (3), treating:

(i) the amounts identified in (a)(i) as *CMH*;

(ii) the amounts identified in (a)(ii) as *ASA*;

and applying the calculation *rules* in *MIFIDPRU* [4.8] or [4.9] to those amounts; and

(c) where an amount under (a) was originally received by X from a client in the form of money but has subsequently been placed in a collective investment undertaking to meet segregation requirements, treating the relevant amount as:

(i) *ASA* if, on the insolvency of X, the relevant client would be considered to have a direct proprietary interest in the relevant units, *shares* or equivalent interests in the collective investment undertaking; or

(ii) *CMH* in any other circumstance.

(3) when applying the calculation *rules* in *MIFIDPRU* [4.8], an arrangement operated by X in relation to client money may be classified as a *segregated account* only if (ignoring *MIFIDPRU* [4.8.xE], which does not apply for these purposes) it meets the conditions in *MIFIDPRU* [4.8.xR].[11]

2.5.31 R Where the *UK parent entity* of the *investment firm group* has been unable to ascertain whether:

(1) the money or assets referred to in *MIFIDPRU* 2.5.30R(2)(a) were received or are held in the course of, or in connection with, business which would be *MiFID business* if it were carried on by a *MIFIDPRU investment firm* in the *UK*, it must treat such amounts as if they were received or are held in connection with such business;

(2) any amount treated as *CMH* held by X under *MIFIDPRU* 2.5.30R(2) is held in an account which meets the conditions to be classified as a *segregated account*, it must treat the relevant amount as held in a *non-segregated account*; and

(3) a client would be considered to have a direct proprietary interest in a unit, *share* or equivalent interest in a collective investment undertaking on the insolvency of X for the purposes of *MIFIDPRU* 2.5.30R(2)(c), it must treat the relevant amount as *CMH*.

Consolidated K-NPR and K-CMG requirements

2.5.32 R A *UK parent entity* must apply the relevant provisions for the calculation of the *K-NPR requirement* in *MIFIDPRU* 4 to a position or exposure included in the *consolidated situation* unless a *rule* in this section:

(1) permits the *UK parent entity* to include that position or exposure within the calculation of the consolidated *K-CMG requirement*; or

(2) otherwise permits the position or exposure to be excluded from the calculation of the consolidated *K-NPR requirement*.

[11] *Editor's note*: The draft Handbook provisions relating to the calculation of client money held (CMH) are not included in this instrument, but will be published in a subsequent consultation. It is currently anticipated that the conditions for a segregated account in those rules will be broadly equivalent to the conditions contained in article 1 of the European Banking Authority's draft regulatory technical standards on the definition of a segregated account, contained in EBA/CP/2020/06 published on 4 June 2020.

2.5.33 G For the *K-NPR requirement* there is no coefficient in *MIFIDPRU* 4. The requirement is instead based upon the concept of positions and exposures.

2.5.34 R (1) This *rule* applies to a *UK parent entity* when calculating the *K-NPR requirement* on a *consolidated basis* in accordance with *MIFIDPRU* 2.5.7R.

(2) The *UK parent entity* may only use positions in one *undertaking* to offset positions in another *undertaking* if it has obtained permission to do so in accordance with (3).

(3) The permission in (2) will only be granted where:

(a) the *UK parent entity* has applied to the *FCA* in accordance with (4); and

(b) the application in (a) has demonstrated to the satisfaction of the *FCA* that the conditions in article 325b of the *UK CRR* have been met.

(4) An entity that is seeking permission under (3) must submit an application to [*Editor's note*: contact details to be inserted] using the form in [*Editor's note*: a reference to the relevant permissions form will be inserted following consultation on the form in a future consultation paper].

2.5.35 G The effect of *MIFIDPRU* 2.5.34R is that there is no automatic offsetting of positions held by different *undertakings* within an *investment firm group* for the purposes of applying the *K-NPR requirement* on a *consolidated basis*. If a *UK parent entity* has not obtained the necessary permission under *MIFIDPRU* 2.5.34R, it must include all positions held by the relevant *undertakings* within the *investment firm group* within its calculation of the consolidated *K-NPR requirement* without netting such positions.

2.5.36 G (1) *MIFIDPRU* 2.5.37R to 2.5.42R explain the circumstances in which a *UK parent entity* may calculate a *K-CMG requirement* when applying *MIFIDPRU* 4 on a *consolidated basis*. Where a *UK parent entity* is not permitted to calculate a *K-CMG requirement* in relation to a relevant position included within its *consolidated situation*, it must include that position within its calculation of the consolidated *K-NPR requirement*.

(2) *MIFIDPRU* 4.13 permits a *MIFIDPRU investment firm* on an individual basis to calculate a *K-CMG requirement* for a portfolio in *trading book* if it has obtained a *K-CMG permission* from the *FCA*. A *MIFIDPRU investment firm* must calculate a *K-NPR requirement* in relation to all other *trading book* positions, and positions other than *trading book* positions where such positions give rise to foreign exchange risk or commodity

risk. Such positions must be included within the calculation of the *consolidated K-NPR requirement*.

2.5.37 R A *UK parent entity* may calculate a consolidated *K-CMG requirement* for the purposes of *MIFIDPRU* 2.5.7R in relation to *portfolios* that form part of its *consolidated situation* in accordance with *MIFIDPRU* 2.5.38R to 2.5.42R.

2.5.38 R (1) This *rule* applies where a *MIFIDPRU investment firm*:

(a) is included within the *consolidated situation* of a *UK parent entity*; and

(b) has been granted a *K-CMG permission* in relation to a *portfolio* on an individual basis.

(2) Where this *rule* applies, the *UK parent entity* may include the *portfolio* in (1)(b) within its calculation of the consolidated *K-CMG requirement* without requiring a further *K-CMG permission*.

2.5.39 G *MIFIDPRU* 2.5.38R sets out the only circumstance in which a *UK parent entity* can include a *portfolio* of a *MIFIDPRU investment firm* within the calculation of the consolidated *K-CMG requirement*. Unlike for *designated investment firms* under *MIFIDPRU* 2.5.40R and *third country* entities under *MIFIDPRU* 2.5.41R, it is not possible to make a separate application to calculate a *K-CMG requirement* in relation to such a *portfolio* only on a *consolidated basis*. This reflects the *FCA's* view that the choice of whether to calculate a *K-NPR requirement* or a *K-CMG requirement* in relation to a specific *portfolio* must be applied consistently on both an individual and consolidated level.

2.5.40 R (1) This *rule* applies where a *designated investment firm* ("A") is included within the *consolidated situation* of a *UK parent entity*.

(2) A *UK parent entity* may include a *portfolio* of A within the calculation of the *UK parent entity's* consolidated *K-CMG requirement* if:

(a) the *UK parent entity*, or a *MIFIDPRU investment firm* within the same *investment firm group*, has applied to the *FCA* in accordance with *MIFIDPRU* 2.5.42R; and

(b) the application in (a) has demonstrated to the satisfaction of the *FCA* that A would meet the requirements in *MIFIDPRU* 4.13 as modified by (3) to obtain a *K-CMG permission* in respect of the portfolio on an individual basis.

(3) For the purposes of (2), the following modifications shall apply to the *rules* relating to the calculation of the *K-CMG requirement* in *MIFIDPRU* 4.13:

(a) references to the "*MIFIDPRU investment firm*" or "*firm*" shall be read as references to A;

(b) the clearing member in *MIFIDPRU* 4.13.9R(2)(c) may be one of the following:

(i) A itself;

(ii) another *designated investment firm*; or

(iii) a *credit institution*;

(c) the reference in *MIFIDPRU* 4.13.12R to *MIFIDPRU* 4.13.9R should be read as a reference to *MIFIDPRU* 4.13.9R as modified by this *rule*; and

(d) the requirement in *MIFIDPRU* 4.13.13R(1)(b) does not apply, but A must ensure that its ongoing processes and systems for assessing the nature and level of risks to which it is, or might be, exposed take into account the understanding of relevant individuals within A of the margin model for the purposes of considering whether:

(i) the resulting consolidated *K-CMG requirement* for the portfolio(s) is sufficient to cover the relevant risks to which A is exposed; and

(ii) the *K-CMG permission* remains appropriate in relation to the portfolio(s) in respect of which it was granted.

2.5.41 R (1) This *rule* applies where a *third country* entity ("B") is included within the *consolidated situation* of a *UK parent entity*.

(2) A *UK parent entity* may include a portfolio of B within the calculation of the *UK parent entity's* consolidated *K-CMG requirement* if:

(a) the *UK parent entity*, or a *MIFIDPRU investment firm* within the same *investment firm group*, has applied to the *FCA* in accordance with *MIFIDPRU* 2.5.42R; and

(b) the application in (a) has demonstrated to the satisfaction of the *FCA* that B would meet the requirements in *MIFIDPRU* 4.13 as modified by (3) to obtain a *K-CMG permission* in respect of the portfolio on an individual basis.

(3) For the purposes of (2), the following modifications shall apply to the *rules* relating to the calculation of the *K-CMG requirement* in *MIFIDPRU* 4.13:

(a) references to the "*MIFIDPRU investment firm*" or "*firm*" should be read as references to B;

(b) the requirement in *MIFIDPRU* 4.13.9R(2)(c) does not apply, but:

(i) the application in (1)(a) must demonstrate that the *clearing member* is subject to appropriate prudential regulation and supervision in the jurisdiction in which it operates; and

(ii) the *clearing member* may be B itself, provided that the application demonstrates that B satisfies the conditions in (i);

(c) references to the "*clearing member*" should be read as references to the *clearing member* in (b);

(d) the reference to *MIFIDPRU* 4.13.9R in *MIFIDPRU* 4.13.12R should be read as a reference to *MIFIDPRU* 4.13.9R as modified by this *rule*; and

(e) the obligation in *MIFIDPRU* 4.13.13R(1)(b) to integrate understanding of the margin model into the *ICARA process* applies in relation to the *UK parent entity*, but only if the *FCA* has directed under *MIFIDPRU* [7][12] that the relevant *investment firm group* must operate the *ICARA process* on a *consolidated basis*.

2.5.42 R (1) A *UK parent entity* or a *MIFIDPRU investment firm* within the same *investment firm group* that wishes to apply for a *K-CMG permission* in relation to one or more *portfolios* included in the *consolidated situation* of its *investment firm group* must complete the application form in [*Editor's note*: a reference to the relevant permissions form will be inserted following consultation on the form in a future consultation paper] and submit it to [*Editor's note*: contact details to be inserted].

(2) A single application under (1) may be made in respect of multiple portfolios of multiple entities referenced in *MIFIDPRU* 2.5.40R or 2.5.41R, provided that the application contains sufficient information to demonstrate to the *FCA* how the relevant conditions in *MIFIDPRU* 4.13.9R (as modified by

[12] *Editor's note:* The FCA will consult on the content of the individual capital and risk assessment process and other risk management and governance requirements in MIFIDPRU 7 in a subsequent consultation paper.

MIFIDPRU 2.5.40R(3) in relation to a *portfolio* of a *designated investment firm* or *MIFIDPRU* 2.5.41R(3) in relation to a *portfolio* of a *third country* entity) are satisfied in respect of each such *portfolio*.

(3) Any *UK parent entity* or *MIFIDPRU investment firm* which submits an application under (1) must have the necessary authority to make the application on behalf of all entities within the *investment firm group* whose portfolios are the subject of that application.

Consolidated K-TCD requirement

2.5.43 G (1) For the *K-TCD requirement* there is no coefficient in *MIFIDPRU* 4. The requirement is instead based upon the concept of positions and exposures. The relevant provisions in *MIFIDPRU* 4 for calculating the *K-TCD requirement* should therefore also be applied to transactions included in the *consolidated situation*.

(2) For the avoidance of doubt, when calculating the *K-TCD requirement* on a *consolidated basis*, transactions between counterparties included in the *consolidated situation* are disregarded. This is the case irrespective of whether the exclusion in *MIFIDPRU* 4.14.6R applies to a transaction when a *MIFIDPRU investment firm* is calculating its *K-TCD requirement* on an individual basis.

2.5.44 R (1) When calculating its *K-TCD requirement* on a *consolidated basis* in accordance with *MIFIDPRU* 2.5.7R, a *UK parent entity* may only net offsetting transactions entered into between one or more entities included in the *consolidated situation* and a third-party counterparty if the conditions in *MIFIDPRU* 4.14.28R, as modified by (2), are met.

(2) When applying *MIFIDPRU* 4.14.28R on the basis of the *consolidated situation*, the following modifications apply:

(a) any netting agreement or netting contract referenced in that *rule* must cover all entities included in the *consolidated situation* whose transactions with the same third-party counterparty are being netted;

(b) any references in that *rule* to the rights and obligations of the "*firm*" should be read as references to the rights and obligations of the entities included in the *consolidated situation* whose transactions with the same third-party counterparty are being netted; and

(c) the legal opinion referenced in *MIFIDPRU* 4.14.28R(3)(c):

(i) may be obtained by the *UK parent entity* or any *MIFIDPRU investment firm* in the *investment firm group*; but

(ii) must address the relevant claims and obligations of all entities included in the *consolidated situation* whose transactions with the same third-party counterparty are being netted.

Consolidated K-CON requirement

2.5.45 G (1) The *K-CON requirement* under *MIFIDPRU* 5 applies to a *MIFIDPRU investment firm* on an individual basis in relation to positions held in its *trading book*. Broadly, the *K-CON requirement* is calculated by reference to all relevant *trading book* exposures that exceed the *concentration risk soft limit*.

(2) *MIFIDPRU* 2.5.46R explains how the *K-CON requirement* applies on a *consolidated basis*.

2.5.46 R When a *UK parent entity* is calculating a *K-CON requirement* on the basis of its *consolidated situation* in accordance with *MIFIDPRU* 2.5.7R, the provisions in *MIFIDPRU* 5 shall apply, subject to the following:

(1) the *exposure value* with regard to an individual *client* or *group of connected clients* shall be calculated on the basis of all relevant exposures included in the *consolidated situation*;

(2) to the extent that the calculation *rules* for the *K-NPR requirement* or *K-TCD requirement* are relevant to the calculation of an *exposure value* under *MIFIDPRU* 5.4 or the *OFR* under *MIFIDPRU* 5.7.3R(2), the *UK parent entity* must apply the methods for the calculation of the consolidated *K-NPR requirement* in *MIFIDPRU* 2.5.32R to 2.5.34R and consolidated *K-TCD requirement* in 2.5.43G to 2.5.44R; and

(3) the *own funds* to be used for the purposes of calculating the limits in *MIFIDPRU* 5.5 and *MIFIDPRU* 5.9 on a *consolidated basis* shall be the consolidated *own funds* of the *investment firm group*, as calculated in accordance with *MIFIDPRU* 2.5.7R and the *guidance* in *MIFIDPRU* 2.5.23G.

Prudential consolidation in practice: liquidity

2.5.47 R When applying *MIFIDPRU* 6 on a *consolidated basis* in accordance with *MIFIDPRU* 2.5.11R, a *UK parent entity* must ensure that the total *liquid assets* held by the *UK* entities included within the *consolidated situation* are equal to or greater than the consolidated *liquid assets* requirement.

2.5.48 G (1) *MIFIDPRU* 2.5.11R requires a *UK parent entity* to comply with the liquidity requirements in *MIFIDPRU* 6 on the basis of its *consolidated situation*. In practice, this means that the *UK parent entity* must ensure that the *investment firm group* holds *liquid assets* equivalent to one third of the consolidated *fixed overhead requirement*, plus 1.6% of the total amount of any guarantees provided to *clients* by entities included within the *consolidated situation*.

(2) As stated in *MIFIDPRU* 2.5.47R, the required amount of consolidated liquid assets must be held by the *UK* entities included within the *consolidated situation*. This means that while *third country* entities may contribute to the consolidated *liquid assets* requirement (due to their contribution to the consolidated *fixed overheads requirement*), any *liquid assets* held by a *third country* entity cannot count towards the *liquid assets* held by the *investment firm group* for the purposes of meeting that requirement.

(3) *UK parent entities* are reminded that:

(a) the consolidated *liquid assets* requirement applies only where the *UK parent entity* is subject to consolidation obligations under *MIFIDPRU* 2.5.11R. It does not apply where the *group capital test* under *MIFIDPRU* 2.6 applies to an *investment firm group* instead (although *MIFIDPRU* 6 will continue to be relevant to *MIFIDPRU investment firms* within that *investment firm group* on an individual basis in such circumstances); and

(b) a *UK parent entity* that is subject to consolidation obligations under *MIFIDPRU* 2.5.11R will be exempt from the consolidated liquidity requirement if the conditions in *MIFIDPRU* 2.5.19R are met.

Prudential consolidation in practice: disclosure by investment firms

2.5.49 [x] [*Editor's note*: content to be consulted on at a later date.]

Prudential consolidation in practice: reporting by investment firms

2.5.50 G Under *MIFIDPRU* 2.5.7R, a *UK parent entity* is required to comply with the reporting obligations in *MIFIDPRU* 9 on a *consolidated basis*. In practice, this involves reporting the same categories of information that would be reported by a *MIFIDPRU investment firm* to the *FCA* on an individual basis, but using the figures that result from applying the relevant requirements on a *consolidated basis* in accordance with this section.

Prudential consolidation in practice: governance requirements

2.5.51 [x] [*Editor's note*: content to be consulted on at a later date.]

Prudential consolidation in practice: ICARA requirements

2.5.52 [x] [*Editor's note*: content to be consulted on at a later date.]

2.6 The group capital test

2.6.1 R This section applies to an *investment firm group* which has been granted permission by the *FCA* to apply the *group capital test* in accordance with *MIFIDPRU* 2.4.17R.

Group capital test: requirements

2.6.2 R For the purposes of *MIFIDPRU* 2.6:

(1) 'own funds instruments' means own funds as defined in *MIFIDPRU* 3, without applying the deductions referred to in point (i) of Article 36(1), point (d) of Article 56, and point (d) of Article 66 of the *UK CRR*;

(2) the terms '*investment firm*', '*financial institution*', '*ancillary services undertaking*', '*tied agent*' and '*relevant financial undertaking*' shall also include *undertakings* established in *third countries*, which, were they established in the *UK*, would meet those definitions.

[**Note:** article 8(2) of the *IFR*.]

2.6.3 G The definition of 'own funds instruments' for the purpose of *MIFIDPRU* 2.6.2R ensures that significant investments in common equity tier 1 instruments, *additional tier 1 instruments* and *tier 2 instruments* of financial sector entities in the *investment firm group* do not need to be deducted by a *parent undertaking* when applying the *group capital test*. This is to avoid 'double counting' of the same amount.

2.6.4 G *MIFIDPRU* 3.7 contains *rules* and *guidance* on the composition of capital for *parent undertakings* subject to the *group capital test*.

2.6.5 R Where the *FCA* has granted an application under *MIFIDPRU* 2.4.17R, a *UK parent entity* and any other *parent undertakings* incorporated in the *UK* or with their registered office (or if they have no registered office, their head office) in the *UK* that are *relevant financial undertakings* in the *investment firm group* must hold own funds instruments sufficient to cover at least the sum of the following:

(1) the sum of the full book value of their holdings, subordinated claims and instruments referred to in point (i) of article 36(1), point (d) of article 56, and point (d) of article 66 of *UK CRR* in *relevant financial undertakings* in the *investment firm group*; and

(2) the total amount of their contingent liabilities in favour of *relevant financial undertakings* in the *investment firm group*.

[**Note:** article 8(3) of the *IFR*.]

2.6.6 G (1) Each *parent undertaking* in the *investment firm group* which is a *relevant financial undertaking* must satisfy the *group capital test*, not only the *UK parent entity*. The *group capital test* therefore applies at each level within the group structure. This mitigates the risk of leverage or capital gearing being introduced at levels underneath the ultimate *parent undertaking* in the *UK*.

(2) The requirement in *MIFIDPRU* 2.6.5R only applies directly to *parent undertakings* in the *UK*. However, in order to ensure that *leverage* and capital gearing are not introduced into the *investment firm group* through intermediate *parent undertakings* established in a *third country*, *MIFIDPRU* 2.6.7R imposes obligations on *parent undertakings* in the *UK* in relation to their *subsidiaries* which are *parent undertakings* established in a *third country*.

2.6.7 R (1) This *rule* applies where:

(a) an *investment firm group* has been granted permission to apply the *group capital test* in accordance with *MIFIDPRU* 2.4.17R; and

(b) a *parent undertaking* in that *investment firm group* is an *undertaking* which:

(i) is established in a *third country*; and

(ii) is a *relevant financial undertaking* in accordance with *MIFIDPRU* 2.6.2R(2).

(2) Where this *rule* applies, the *responsible UK parent* must either:

(a) ensure that the *undertaking* in (1)(b) holds own funds instruments sufficient to cover at least the sum of the amounts in *MIFIDPRU* 2.6.5R(1) and (2) as they would apply to that *third country undertaking*; or

(b) hold own funds instruments sufficient to cover at least the sum of the amounts in *MIFIDPRU* 2.6.5R(1) and (2) as they:

(i) apply to the *responsible UK parent* itself; and

(ii) would apply to the *undertaking* in (1)(b).

2.6.8 G (1) The effect of *MIFIDPRU* 2.6.7R can be illustrated through the example of a hypothetical *investment firm group* which contains the following *undertakings*:

(a) a *UK parent entity* ("A");

(b) an intermediate *investment holding company* ("B"), which is incorporated in the *UK* and is a direct *subsidiary* of A;

(c) an *undertaking* established in a *third country* ("C") which would be an *investment holding company* if it were established in the *UK* and which is a direct *subsidiary* of B;

(d) an *undertaking* established in a *third country* ("D") which would be a *MIFIDPRU investment firm* if it were established in the *UK* and which is a direct *subsidiary* of C;

(e) a *MIFIDPRU investment firm* ("E") which is a direct *subsidiary* of D;

(f) a *tied agent* ("F") which is established in the *UK* and which is a direct *subsidiary* of B; and

(g) an *undertaking* established in a *third country* ("G") which would be a *financial institution* if it were established in the *UK* and which is a direct *subsidiary* of C.

(2) The *group capital test*:

(a) applies directly to A and B because they are both *parent undertakings* incorporated in the *UK* or with their registered offices (or if they have no registered office, their head office) in the *UK*;

(b) applies only indirectly to C and D, by virtue of the obligations imposed on the *responsible UK parent*, because C and D are *parent undertakings* established in a *third country*; and

(c) does not apply to E, F or G because they are not *parent undertakings*.

(3) In this example, B is the *responsible UK parent* because:

(a) B has two *subsidiaries* (a direct *subsidiary*, C, and an indirect *subsidiary*, D) which are both *parent undertakings* established in a *third country* and which would be *relevant financial undertakings* if they were established in the *UK*; and

(b) B does not have a *subsidiary* in the *UK* which is the *parent undertaking* of C or D. (Although F is a *UK subsidiary* of B, F is not a *parent undertaking*.) This means that there is no intermediate *UK parent undertaking* between B and either of C or D.

(4) A is not a *responsible UK parent* in this example because A has a *subsidiary*, B, which is a *parent undertaking* of C and D and which is incorporated in the *UK*. B is therefore an intermediate *UK parent undertaking* between A on the one hand and C and D on the other.

(5) B is a *responsible UK parent*. Note that B is the *responsible UK parent* of both C and D, even though D is only an indirect *subsidiary* of B. This is because there is no *parent undertaking* between C and D which is established in the *UK* and the definition of a *subsidiary* includes *subsidiaries* of *subsidiaries*.

(6) Under *MIFIDPRU* 2.6.7R(2), B therefore has the choice of whether to:

(a) ensure that both C and D comply with the requirements of the *group capital test* as it would apply to them if they were established in the *UK*; or

(b) hold own funds instruments that are sufficient to cover the sum of the requirements of the *group capital test* that apply to B and would apply to C and D if they were established in the *UK*.

(7) If B chooses the approach in (6)(a), B must:

(a) hold sufficient own funds instruments to cover the sum of B’s holdings in, and contingent liabilities in favour of, C and F;

(b) ensure that C holds sufficient own funds instruments to cover the sum of C’s holdings in, and contingent liabilities in favour of, D and G; and

(c) ensure that D holds sufficient own funds instruments to cover the sum of D’s holdings, and contingent liabilities in favour of, in E.

(8) If B chooses the approach in (6)(b), B must hold sufficient own funds instruments to cover the sum of:

(a) B's holdings in, and contingent liabilities in favour of, C and F;

(b) C's holdings in, and contingent liabilities in favour of, D and G; and

(c) D's holdings, and contingent liabilities in favour of, in E.

2.6.9 R A *UK parent entity* must have systems in place to monitor and control the sources of capital and funding of all *relevant financial undertakings* within the *investment firm group*.

[**Note:** article 8(5) of the *IFR*.]

Group capital test: reporting requirements

2.6.10 R (1) Where the *FCA* has granted an application under *MIFIDPRU* 2.4.17R, a *UK parent entity* and any other *parent undertakings* in the *UK* that are *relevant financial undertakings* in the *investment firm group* must comply with the reporting requirements in (2).

(2) Each *parent undertaking* in (1) must:

(a) report in accordance with *MIFIDPRU* 9 in respect of how that *parent undertaking* meets the *group capital test*; and

(b) if the *parent undertaking* is a *responsible UK parent*, also report in accordance with *MIFIDPRU* 9 in respect of how:

(i) the *undertaking* established in a *third country* in *MIFIDPRU* 2.6.7R(1)(b) holds at least the amount of own funds instruments referenced in *MIFIDPRU* 2.6.7R(2)(a); or

(ii) the *parent undertaking* holds at least the amount of own funds instruments to cover the amount applicable to the *undertaking* established in a *third country*, as referenced in *MIFIDPRU* 2.6.7R(2)(b).

2.6.11 R For the purposes of *MIFIDPRU* 2.6.10R, an *investment firm group* may designate one *parent undertaking* in the *UK* to submit reports to the *FCA* on behalf of the other *parent undertakings* in the *group* subject to that *rule*.

Inclusion of holding companies in supervision of compliance with the group capital test

2.6.12 G For the avoidance of doubt, *UK investment holding companies* and *UK mixed financial holding companies* are included in the *FCA's* supervision of compliance with the *group capital test*.

[**Note:** article 51 of the *IFD*.]

2.7 Investment holding companies, mixed financial holding companies and mixed-activity holding companies

Qualifications of directors

2.7.1 G Under [section 143R][13] of the *Act*, a *UK investment holding company*, *UK mixed financial holding company* or *UK mixed activity holding company* must take reasonable care to ensure that the members of its *management body* are of sufficiently good repute and possess sufficient knowledge, skills and experience to perform their duties effectively.

[**Note:** article 52 of the *IFD*.]

Mixed-activity holding companies

2.7.2 G

(1) Under section 165 of the *Act*, the *FCA* may require a *parent undertaking* of a *MIFIDPRU investment firm* to provide such information as may be relevant for the *FCA's* supervision of the *MIFIDPRU investment firm*.

(2) Under section 167 of the *Act*, in appropriate cases, the *FCA* may appoint an investigator to verify the information received from a *parent undertaking* of a *MIFIDPRU investment firm* and any *subsidiaries* of that *parent undertaking*.

(3) The powers in (1) and (2) extend to, amongst other *undertakings*, a *mixed-activity holding company*.

[**Note:** article 53(1)(a) and article 53(2) of the *IFD*.]

2.7.3 R Where the *parent undertaking* of a *MIFIDPRU investment firm* is a *UK mixed-activity holding company*, the *MIFIDPRU investment firm* must have in place adequate risk management processes and internal control mechanisms, including sound reporting and accounting procedures to identify, measure, monitor and control transactions between the *firm*, the *UK mixed-activity holding company* and the *subsidiaries* of the latter.

[**Note:** article 53(1)(b) of the *IFD*.]

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[13] *Editor's note:* References in this chapter to sections 143O, 143R and 143W of the Financial Services and Markets Act 2000 are to those sections as they would be inserted by the Financial Services Bill, which was introduced in the House of Commons on 20 October 2020. These references may change if the Bill is amended during the parliamentary process.

Sanctions

2.7.4 G Under [section 143W] of the *Act*, the *FCA* may impose disciplinary measures aiming to end or mitigate breaches of the requirements imposed on *UK investment holding companies*, *UK mixed financial holding companies* and *UK mixed-activity holding companies*, or the members of the *management body* of such entities by rules in the *MIFIDPRU* sourcebook or by [section 143R] of the *Act*.

[**Note:** article 54 of the *IFD*.]

Application to FCA for an exemption from application of specific requirements on an individual basis

2 Annex 1 R [*Editor's note*: the form can be found at this address: https://www.fca.org.uk/publication/forms/[xxx]]

Application to FCA for an exemption from liquidity requirements on a consolidated basis

2 Annex 2 R [*Editor's note*: the form can be found at this address: https://www.fca.org.uk/publication/forms/[xxx]]

Application to FCA to be subject to the group capital test

2 Annex 3 R [*Editor's note*: the form can be found at this address: https://www.fca.org.uk/publication/forms/[xxx]]

3 Own funds

3.1 Application and purpose

Application

3.1.1 R This chapter applies to:

(1) a *MIFIDPRU investment firm*; and

(2) a *UK parent entity* that is required by *MIFIDPRU* 2.5.7R to comply with *MIFIDPRU* 3 on the basis of its *consolidated situation*.

3.1.2 R This chapter also applies to a *parent undertaking* that is subject to the *group capital test* in accordance with *MIFIDPRU* 2.6.5R, but with the following modifications:

(1) the definitions in *MIFIDPRU* 2.6.2R apply when calculating the *own funds instruments* of the *parent undertaking* for the purposes of the *group capital test*; and

(2) *MIFIDPRU* 3.2.2R and *MIFIDPRU* 3.2.3R do not apply, but *MIFIDPRU* 3.7 applies instead.

3.1.3 R For the purposes of this chapter:

(1) where a term is not italicised but is defined in the *UK CRR*, the definition given to that term in the *UK CRR* shall apply;

(2) where this chapter applies to a *parent undertaking* that is not a *firm*, any reference to a "*MIFIDPRU investment firm"* or a "*firm*" includes a reference to that *parent undertaking*; and

(3) where this chapter applies on the basis of the *consolidated situation* of an entity under *MIFIDPRU* 3.1.1R(2), any reference in this chapter to a "*firm*" is to be interpreted as a reference to the hypothetical single *MIFIDPRU investment firm* created under the *consolidated situation*.

Purpose

3.1.4 G This chapter contains requirements relating to the calculation of a *MIFIDPRU investment firm's own funds* for the purposes of *MIFIDPRU*. These requirements are based on the provisions in Title I of Part Two of the *UK CRR*, but with the modifications set out in this chapter.

3.2 Composition of own funds and initial capital

3.2.1 R The *own funds* of a *firm* are the sum of its:

(1) *common equity tier 1 capital*;

(2) *additional tier 1 capital*; and

(3) *tier 2 capital*.

[**Note:** article 9(1) of the *IFR*.]

3.2.2 R A *firm* must, at all times, have *own funds* which meet all of the following conditions:

(1) the *firm's common equity tier 1 capital* must be equal to or greater than 56% of the *firm's own funds requirement* under *MIFIDPRU* 4.3;

(2) the sum of the *firm's*:

(a) *common equity tier 1 capital*; and

(b) *additional tier 1 capital*;

must be equal to or greater than 75% of the *firm's own funds requirement* under *MIFIDPRU* 4.3; and

(3) the *firm's own funds* must be equal to or greater than 100% of the *firm's own funds requirement* under *MIFIDPRU* 4.3.

[**Note:** article 9(1) of the *IFR*.]

3.2.3 R A *firm's initial capital* must be comprised of *own funds*.

[**Note:** article 11 of the IFD.]

3.2.4 G For the purposes of this chapter, the categorisation and the valuation of assets and off-balance sheet items should be undertaken in accordance with the applicable accounting framework, except to the extent that a *rule* directs otherwise.

3.3 Common equity tier 1 capital

3.3.1 R (1) A *firm* must determine its *common equity tier 1 capital* in accordance with Chapter 2 of Title I of Part Two of the *UK CRR*, as modified by the *rules* in this section.

(2) Any reference to the *UK CRR* in this section is to the *UK CRR* as applied by (1) and modified by the *rules* in this section.

[**Note:** article 9(1) of the *IFR*.]

Prior permission to include interim profits or year-end profits in common equity tier 1 capital

3.3.2 R A *firm* that wishes, in accordance with article 26(2) of the *UK CRR*, to apply for permission to include interim or year-end profits in its *common equity tier 1 capital* before the *firm* has taken a formal decision confirming the final profit or loss for the year must submit the form in [*Editor's note*: a reference to the relevant permissions form will be inserted following consultation on the form in a future consultation paper] to the *FCA*.

Prior permission and notification of issuances of common equity tier 1 capital

3.3.3 R A *firm* that wishes, in accordance with article 26(3) of the *UK CRR*, to apply for permission to classify an issuance of capital instruments as *common equity tier 1 capital* must submit the form in [*Editor's note*: a reference to the relevant permissions form will be inserted following consultation on the form in a future consultation paper] to the *FCA*.

3.3.4 G (1) Under article 26(3) of the *UK CRR*, a *firm* must normally obtain the *FCA's* permission before classifying an issuance of capital instruments as *common equity tier 1 capital*.

(2) However, that provision also states that where a *firm* has already obtained permission from the *FCA* for a previous issuance of instruments that have been classified as *common equity tier 1 capital*, the *firm* is not required to obtain the *FCA's* permission for a subsequent issuance of the same form of instruments provided that:

(a) the provisions governing the subsequent issuance are substantially the same as the provisions governing the issuance for which the *firm* has already received permission; and

(b) the *firm* has notified the *FCA* of the subsequent issuance sufficiently far in advance of the classification of the relevant instruments as *common equity tier 1 capital*.

(3) The *FCA* generally expects to receive a notification of a subsequent issuance of an existing form of *common equity tier 1 capital* instruments under article 26(3) of the *UK CRR* no fewer than 20 *business days* before the *firm* intends to classify that issuance as *common equity tier 1 capital*.

Deductions from common equity tier 1 capital

3.3.5 R For the purposes of *MIFIDPRU*:

(1) *MIFIDPRU* 3.3.6R applies in substitution for article 36 of the *UK CRR*; and

(2) any reference to article 36 of the *UK CRR* (or where applicable, any part of article 36 of the *UK CRR*) contained in:

(a) another provision of the *UK CRR* which is incorporated by reference into any part of *MIFIDPRU*; or

(b) in any applicable technical standard that applies to a *MIFIDPRU investment firm* under a provision of the *UK CRR* to which (a) applies;

is to be read as a reference to *MIFIDPRU* 3.3.6R (or where applicable, to the equivalent part of that *rule*).

3.3.6 R A *MIFIDPRU investment firm* must deduct the following from its common equity tier 1 items:

(1) losses for the current financial year;

(2) intangible assets;

(3) deferred tax assets that rely on future profitability;

(4) defined benefit pension fund assets on the balance sheet of the *firm*;

(5) direct, indirect and synthetic holdings by the *firm* of its own *common equity tier 1 instruments*, including own *common equity tier 1 instruments* that the *firm* is under an actual or contingent obligation to purchase by virtue of an existing contractual obligation;

(6) direct, indirect and synthetic holdings of the *common equity tier 1 instruments* of *financial sector entities* where those entities have a reciprocal cross holding with the *firm* that the *FCA* considers has been designed to inflate artificially the *own funds* of the *firm*;

(7) the applicable amount of direct, indirect and synthetic holdings by the *firm* of *common equity tier 1 instruments* of *financial sector entities* where the *firm* does not have a significant investment in those entities;

(8) the applicable amount of direct, indirect and synthetic holdings by the *firm* of the *common equity tier 1 instruments* of *financial sector entities* where the *firm* has a significant investment in those entities;

(9) the amount of items required to be deducted from additional tier 1 items pursuant to article 56 of the *UK CRR* that exceeds the additional tier 1 items of the *firm*; and

(10) any tax charge relating to common equity tier 1 items foreseeable at the moment of its calculation, except where the *firm* suitably adjusts the amount of common equity tier 1 items insofar as such tax charges reduce the amount up to which those items may be used to cover risks or losses.

Deferred tax assets that rely on future profitability

3.3.7 R A *firm* must deduct deferred tax assets that rely on future profitability from its common equity tier 1 items under *MIFIDPRU* 3.3.6R(3) without applying:

(1) article 39 of the *UK CRR* (tax overpayments, tax loss carry backs and deferred tax assets that do not rely on future profitability); or

(2) article 48 of the *UK CRR* (threshold exemptions from deduction from common equity tier 1 items).

[**Note:** article 9(2)(a) of the *IFR*.]

Defined benefit pension fund assets on the firm's balance sheet

3.3.8 R A *firm* must deduct defined benefit pension fund assets on its balance sheet from its common equity tier 1 items under *MIFIDPRU* 3.3.6R(4) without applying article 41 of the *UK CRR* (deduction of defined benefit pension fund assets).

[**Note:** article 9(2)(b) of the *IFR*.]

Holdings of common equity tier 1 instruments of financial sector entities

3.3.9 R (1) This *rule* applies to a *firm's* holdings of capital instruments which are not held in its *trading book*.

(2) Subject to *MIFIDPRU* 3.3.13R, a *firm* must deduct its direct, indirect and synthetic holdings of *common equity tier 1 instruments* of *financial sector entities* under *MIFIDPRU* 3.3.6R(7) without applying article 46 of the *UK CRR* (deduction of holdings of common equity tier 1 instruments where an institution does not have a significant investment in a financial sector entity).

[**Note:** article 9(2)(c) of the *IFR*.]

3.3.10 R The following provisions do not apply in relation to *common equity tier 1 instruments* held in the *trading book* of a *firm*:

(1) *MIFIDPRU* 3.3.6R(7); and

(2) article 46 of the *UK CRR*.

[**Note:** article 9(2)(e)(ii) of the *IFR*.]

3.3.11 R Subject to *MIFIDPRU* 3.3.13R, a *firm* must deduct its direct, indirect and synthetic holdings in the *common equity tier 1 instruments* of *financial sector entities* under *MIFIDPRU* 3.3.6R(8) without applying article 48 of the *UK CRR* (threshold exemptions from deduction from common equity tier 1 items).

[**Note:** article 9(2)(d) of the *IFR*.]

3.3.12 R Article 49 of the *UK CRR* (requirement for deduction where consolidation, supplementary supervision or institutional protection schemes are applied) does not apply for the purposes of this section.

[**Note:** article 9(2)(e)(i) of the *IFR*.]

Holdings of common equity tier 1 instruments issued by a financial sector entity within an investment firm group

3.3.13 R A *firm* is not required to deduct holdings of *common equity tier 1 instruments* issued by a *financial sector entity* from the *firm's* common equity tier 1 items in accordance with *MIFIDPRU* 3.3.6R where all of the following conditions are met:

(1) the *financial sector entity* forms part of the same *investment firm group* as the *firm*;

(2) there is no current or foreseen material, practical or legal impediment to the prompt transfer of capital or repayment of liabilities by the *financial sector entity*;

(3) the risk evaluation, measurement and control procedures of the *parent undertaking* include the *financial sector entity*; and

(4) the *group capital test* under *MIFIDPRU* 2.6 does not apply to the *investment firm group*.

[**Note:** article 9(5) of the *IFR*.]

Qualifying holdings outside the financial sector

3.3.14 R (1) A *firm* must deduct from its common equity tier 1 items any amounts in excess of the following limits:

(a) a *qualifying holding* in a *non-financial sector entity* which exceeds 15% of the *firm's own funds*; and

(b) the total of all the *qualifying holdings* of the *firm* in *non-financial sector entities* which exceeds 60% of the *firm's own funds*.

(2) When calculating any amounts in (1), the following shall not be included:

(a) shares in *non-financial sector entities* where any of the following conditions is met:

(i) those shares are held temporarily during a financial assistance operation referred to in article 79 of the *UK CRR*;

(ii) the holding of those shares is an underwriting position held for five *business days* or fewer; or

(iii) those shares are held in the name of the *firm* on behalf of others; and

(b) shares which are not fixed financial assets under Directive 86/635/EEC UK law (as defined in article 4(1)(128B) of the *UK CRR*).

[**Note:** article 10 of the *IFR*.]

Common equity tier 1 instruments of partnerships

3.3.15 R A *partner's* account in relation to a *firm* that is a *partnership* will meet the conditions in article 28(1)(e) (perpetual) and article 28(1)(f) (reduction or repayment) of the *UK CRR* where the account is one:

(1) into which capital contributed by *partners* is paid; and

(2) from which under the terms of the partnership agreement an amount representing capital may be withdrawn by a *partner* ("A") only if:

(a) A ceases to be a *partner* and an equal amount is transferred to another such account by A's former *partners* or any *person* replacing A as their *partner*;

(b) the *partnership* is wound up or otherwise dissolved; or

(c) the *firm* has ceased to be *authorised* or no longer has a *Part 4A permission*.

Common equity tier 1 instruments of limited liability partnerships

3.3.16 R A member's account in relation to a *firm* that is a *limited liability partnership* will meet the conditions in article 28(1)(e) (perpetual) and article 28(1)(f) (reduction or repayment) of the *UK CRR* where the account is one:

(1) into which capital contributed by the members is paid; and

(2) from which, under the terms of the *limited liability partnership* agreement, an amount representing capital may be withdrawn by a *partner* ("B") only if:

(a) B ceases to be a member and an equal amount is transferred to another such account by B's former fellow members or any *person* replacing B as a member;

(b) the *limited liability partnership* is wound up or otherwise dissolved; or

(c) the *firm* has ceased to be *authorised* or no longer has a *Part 4A permission*.

3.4 Additional Tier 1 capital

3.4.1 R (1) A *firm* must determine its *additional tier 1 capital* in accordance with Chapter 3 of Title I of Part Two of the *UK CRR*, as modified by the *rules* in this section.

(2) Any reference to the *UK CRR* in this section is to the *UK CRR* as applied by (1) and modified by the *rules* in this section.

[**Note:** article 9(1) of the *IFR*.]

Trigger events and write-down or conversion

3.4.2 R The following provisions of the *UK CRR* do not apply in relation to the *additional tier 1 capital* of a *MIFIDPRU investment firm*:

(1) article 54(1)(a); and

(2) article 54(4)(a).

3.4.3 R (1) A *firm* must specify one or more trigger events for the purposes of article 52(1)(n) of the *UK CRR* in the terms of an *additional tier 1 instrument*.

(2) The trigger events specified under (1) must at least include a trigger event that occurs where the *common equity tier 1 capital* of the *firm* falls below a level specified by the *firm* that is no lower than 64% of the *firm's own funds requirement*.

(3) Article 54 of the *UK CRR* shall apply as if references to the trigger event in article 54(1)(a) of the *UK CRR* are references to the trigger event in (1).

(4) The full principal amount of an *additional tier 1 instrument* must be written down or converted upon the occurrence of a trigger event.

[**Note:** article 9(2)(e)(iii) and (iv) of the *IFR*.]

3.4.4 G *MIFIDPRU* 3.4.3R requires that the principal amount of an *additional tier 1 instrument* will convert into *common equity tier 1 capital* or will be written down where the *firm's common equity tier capital* falls below a specified level, which must be set by the *firm* at no lower than 64% of the *firm's own funds requirement*. The *firm* may therefore choose to set the relevant trigger at a higher level (such as 70% of its *own funds requirement*) if it wishes. The *firm* may also choose to specify additional trigger events alongside the required trigger event in *MIFIDPRU* 3.4.3R(1).

Holdings of additional tier 1 instruments of financial sector entities

3.4.5 R (1) This *rule* applies to a *firm's* holdings of capital instruments which are not held in its *trading book*.

(2) A *firm* must deduct its direct, indirect and synthetic holdings in *additional tier 1 instruments* of *financial sector entities* under article 56(c) of the *UK CRR* without applying article 60 of the *UK CRR* (deduction of holdings of additional tier 1 instruments where an institution does not have a significant investment in a financial sector entity).

(3) The requirement in article 56(c) of the *UK CRR* does not apply in the circumstances set out in *MIFIDPRU* 3.4.7R.

[**Note:** article 9(2)(c) of the *IFR*.]

3.4.6 R The following provisions do not apply in relation to *additional tier 1 instruments* held in the *trading book* of a *firm*:

(1) article 56(c) of the *UK CRR*; and

(2) article 60 of the *UK CRR*.

[**Note:** article 9(2)(e)(ii) of the *IFR*.]

Holdings of additional tier 1 instruments issued by a financial sector entity within an investment firm group

3.4.7 R A *firm* is not required to deduct holdings of *additional tier 1 instruments* issued by a *financial sector entity* from the *firm's* additional tier 1 items in accordance with article 56 of the *UK CRR* where all of the following conditions are met:

(1) the *financial sector entity* forms part of the same *investment firm group* as the *firm*;

(2) there is no current or foreseen material, practical or legal impediment to the prompt transfer of capital or repayment of liabilities by the *financial sector entity*;

(3) the risk evaluation, measurement and control procedures of the *parent undertaking* include the *financial sector entity*; and

(4) the *group capital test* under *MIFIDPRU* 2.5 does not apply to the *investment firm group*.

[**Note:** article 9(5) of the *IFR*.]

3.5 Tier 2 capital

3.5.1 R (1) A *firm* must determine its *tier 2 capital* in accordance with Chapter 4 of Title I of Part Two of the *UK CRR*, as modified by the *rules* in this section.

(2) Any reference to the *UK CRR* in this section is to the *UK CRR* as applied by (1) and modified by the *rules* in this section.

[**Note:** article 9(1) of the *IFR*.]

Holdings of tier 2 instruments of financial sector entities

3.5.2 R (1) This *rule* applies to a *firm's* holdings of capital instruments which are not held in its *trading book*.

(2) A *firm* must deduct its direct, indirect and synthetic holdings in the *tier 2 instruments* of *financial sector entities* under article 66(c) of the *UK CRR* without applying article 70 of the *UK CRR* (deduction of tier 2 instruments where an institution does not have a significant investment in the relevant entity).

(3) The requirement in article 66(c) of the *UK CRR* does not apply in the circumstances set out in *MIFIDPRU* 3.5.4R.

[**Note:** article 9(2)(c) of the *IFR*.]

3.5.3 R The following provisions do not apply in relation to *tier 2 instruments* held in the *trading book* of the *firm*:

(1) article 66(c) of the *UK CRR*; and

(2) article 70 of the *UK CRR*.

[**Note:** article 9(2)(e)(ii) of the *IFR*.]

Holdings of tier 2 instruments issued by a financial sector entity within an investment firm group

3.5.4 R A *firm* is not required to deduct holdings of *tier 2 instruments* issued by a *financial sector entity* from the *firm's tier 2 items* in accordance with article 66 of the *UK CRR* where all of the following conditions are met:

(1) the *financial sector entity* forms part of the same *investment firm group* as the *firm*;

(2) there is no current or foreseen material, practical or legal impediment to the prompt transfer of capital or repayment of liabilities by the *financial sector entity*;

(3) the risk evaluation, measurement and control procedures of the *parent undertaking* include the *financial sector entity*; and

(4) the *group capital test* under *MIFIDPRU* 2.6 does not apply to the *investment firm group*.

[**Note:** article 9(5) of the *IFR*.]

3.6 General requirements for own funds instruments

3.6.1 R (1) A *firm* must comply with the provisions in Chapter 6 of Title I of Part Two of the *UK CRR*, as modified by the *rules* in this section.

(2) Any reference to the *UK CRR* in this section is to the *UK CRR* as applied by (1) and modified by the *rules* in this section.

[**Note:** article 9(3) of the *IFR*.]

Reduction of own funds instruments

3.6.2 R A *firm* that wishes to apply for permission for the purposes of articles 77 and 78 of the *UK CRR* to:

(1) reduce, redeem or repurchase any of its *common equity tier 1 instruments*;

(2) reduce, distribute or reclassify as another *own funds* item the share premium accounts related to any of its *own funds instruments*; or

(3) effect the call, redemption, repayment or repurchase of its *additional tier 1 instruments* or *tier 2 instruments* prior to the date of their contractual maturity;

must submit the form in [*Editor's note*: reference to the applicable form to be inserted. The FCA intends to consult on the relevant form in a subsequent CP] to the *FCA*.

3.6.3 R Permission under *MIFIDPRU* 3.6.2R will be deemed to have been granted where the following conditions are met:

(1) either of the conditions in *MIFIDPRU* 3.6.4R apply;

(2) the *firm* has notified the *FCA* of:

(a) the proposed reduction, repurchase, call or redemption; and

(b) the basis on which the *firm* has concluded that the circumstances in (1) apply;

no later than the 20th *business day* before the *day* on which the reduction, repurchase, call or redemption is proposed to occur using the form in [*Editor's note*: reference to the applicable form to be inserted. The FCA intends to consult on the relevant form in a subsequent CP]; and

(3) the *FCA* has not notified the *firm* of any objections to the proposal before the *day* on which the reduction, repurchase, call or redemption is proposed to occur.

3.6.4 R The conditions referred to in *MIFIDPRU* 3.6.3R are that:

(1) earlier than or at the same time as the reduction, repurchase, call or redemption, the *firm* replaces the relevant *own funds instruments* with *own funds instruments* of equal or higher quality at terms that are sustainable for the income capacity of the *firm*; or

(2) the *firm* is redeeming *additional tier 1 instruments* or *tier 2 instruments* within five years of their date of issue and either of the following applies:

(a) there is a change in the regulatory classification of those instruments which would be likely to result in their exclusion from *own funds* or reclassification as a lower quality form of *own funds*, and both the following conditions are met:

(i) there are reasonable grounds to conclude that the change is sufficiently certain; and

(ii) the regulatory reclassification of the instruments was not reasonably foreseeable at the time of their issuance; or

(b) there is a change in the applicable tax treatment of those instruments which is material and was not reasonably foreseeable at the time of their issuance.

[**Note:** article 9(3) of the *IFR*.]

3.7 Composition of capital for parent undertakings subject to the group capital test

3.7.1 R This section applies to a *parent undertaking* in accordance with *MIFIDPRU* 3.1.2R.

3.7.2 R A *parent undertaking* must, at all times, have *own funds instruments* which meet the following conditions:

(1) the *parent undertaking's common equity tier 1 capital* must be at least equal to:

(a) the sum of the book value of the *parent undertaking's* holdings of the *common equity tier 1 capital* of the *relevant financial undertakings* under *MIFIDPRU* 2.6.5R; plus

(b) the total amount of all the *parent undertaking's* contingent liabilities in favour of the *relevant financial undertakings* under *MIFIDPRU* 2.6.5R;

(2) the sum of *common equity tier 1 capital* and *additional tier 1 capital* of the *parent undertaking* must be at least equal to the sum of:

(a) the amounts in (1)(a) and (1)(b); plus

(b) the sum of the book value of the *parent undertaking's holdings* in the *additional tier 1 capital* of the *relevant financial undertakings under MIFIDPRU* 2.6.5R; and

(3) the sum of the *parent undertaking's own funds instruments* must be at least equal to the total requirement under *MIFIDPRU* 2.6.5R.

[**Note:** article 8(2)(a) and article 9 of the *IFR*.]

3.7.3 G As explained in *MIFIDPRU* 2.6.6G, a separate *group capital test* applies to each *parent undertaking* within an *investment firm group*. In effect, therefore, the *group capital test* applies at the level of each intermediate *parent undertaking*, as well as to the ultimate *parent undertaking* of the *investment firm group*.

4 Own funds requirements

4.1 Application

4.1.1 R This chapter applies to:

(1) a *MIFIDPRU investment firm*; and

(2) a *UK parent entity* that is required by *MIFIDPRU* 2.5.7R to comply with *MIFIDPRU* 4 on the basis of its *consolidated situation*.

4.1.2 R Where this chapter applies on the basis of the *consolidated situation* of a *UK parent entity*, it applies with the following modifications:

(1) *MIFIDPRU* 4.2.1R (Initial capital requirement) does not apply; and

(2) any references to a "*firm*" or "*MIFIDPRU investment firm*" in this chapter are to be interpreted as references to the hypothetical single *MIFIDPRU investment firm* created under the *consolidated situation*.

4.1.3 G *MIFIDPRU* 2.5 contains additional *guidance* on how a *UK parent entity* should apply the requirements in this chapter on a *consolidated basis*.

4.2 Initial capital requirement

4.2.1 R (1) At the point at which a *firm* is first authorised as a *MIFIDPRU investment firm*, it must hold *initial capital* of not less than the amount in (2).

(2) The relevant amount is the *permanent minimum capital requirement* that would apply if the *firm* had been granted the *permissions* that it has requested in its application for *authorisation*.

[**Note:** article 9 of the *IFD*.]

4.2.2 G (1) The initial capital requirement in *MIFIDPRU* 4.2.1R applies only at the point at which the *FCA* is first granting *permission* to a *MIFIDPRU investment firm* to carry on *investment services and/or activities*. After a *firm* has been authorised as a *MIFIDPRU investment firm*, the *permanent minimum capital requirement* applies on an ongoing basis instead.

(2) Where a *MIFIDPRU investment firm* applies to vary its *permissions* to add new *investment services and/or activities* that would result in an increase in its *permanent minimum capital requirement*, the *FCA* would generally expect to refuse the application unless the *firm* demonstrates that it can comply with the new *permanent minimum capital requirement*.

(3) The *FCA's* approach to the application of the initial capital requirement under *MIFIDPRU* is based on the existence of the *permanent minimum capital requirement* for *MIFIDPRU investment firms*. For the avoidance of doubt, this *guidance* does not affect the *FCA's* approach to whether the initial capital requirement under another prudential sourcebook applies on an ongoing basis.

4.3 Own funds requirement

4.3.1 R A *MIFIDPRU investment firm* must at all times maintain *own funds* that are at least equal to its *own funds requirement*.

4.3.2 R The *own funds requirement* of a *non-SNI MIFIDPRU investment firm* is the highest of:

(1) its *permanent minimum capital requirement* under *MIFIDPRU* 4.4;

(2) its *fixed overheads requirement* under *MIFIDPRU* 4.5; or

(3) its *K-factor requirement* under *MIFIDPRU* 4.6.

[**Note:** article 11(1) of the *IFR*.]

4.3.3 R The *own funds requirement* of an *SNI MIFIDPRU investment firm* is the higher of:

(1) its *permanent minimum capital requirement* under *MIFIDPRU* 4.4; or

(2) its *fixed overheads requirement* under *MIFIDPRU* 4.5.

[**Note:** article 11(2) of the *IFR*.]

4.4 Permanent minimum capital requirement

4.4.1 R (1) Where a *MIFIDPRU investment firm* has *permission* to carry on any of the *investment services and/or activities* in (2), its *permanent minimum capital requirement* is £750,000.

(2) The relevant *investment services and/or activities* are:

(a) *dealing on own account*;

(b) underwriting of *financial instruments* and/or placing of *financial instruments* on a firm commitment basis; or

(c) *operating an organised trading facility*, if the *firm* is not subject to a *limitation* that prevents it from carrying on the activities otherwise permitted by *MAR* 5A.3.5R.

[**Note:** article 9(1) and (4) of the *IFD*.]

4.4.2 G (1) Under *MAR* 5A.3.5R (Proprietary trading), a *firm* that has *permission* to *operate an organised trading facility* may *deal on own account* in the following ways without requiring separate *permissions* for *dealing on own account*:

(a) by undertaking *matched principal trading* in the course of operating the *OTF*; or

(b) by *dealing on own account* in relation to *sovereign debt* instruments for which there is no liquid market.

(2) A *firm* that is *operating an organised trading facility* and does not wish to carry on the activities in (1) may apply to the *FCA* under section 55H of the *Act* for a *limitation* that prohibits the *firm* from carrying on those activities in reliance on that *permission*.

(3) The effect of *MIFIDPRU* 4.4.1R(2)(c) is that if a *firm* is *operating an organised trading facility* and is not subject to the *limitation* described in (2), the *firm's permanent minimum capital requirement* will be £750,000.

4.4.3 R (1) Where a *MIFIDPRU investment firm* meets the conditions in (2), its *permanent minimum capital requirement* is £150,000.

(2) The relevant conditions are:

(a) the *firm* has *permission* to do any of the following:

(i) *operating a multilateral trading facility*;

(ii) *operating an organised trading facility*, if the *firm* is subject to a *limitation* that prevents it from carrying on the activities otherwise permitted by *MAR* 5A.3.5R;

(iii) holding *client money* and/or client assets in the course of *MiFID business*; and

(b) the *firm* does not have *permission* to do any of the following:

(i) *dealing on own account*;

(ii) underwriting of *financial instruments* and/or placing of *financial instruments* on a firm commitment basis;

(iii) *operating an organised trading facility*, if the *firm* is not subject to a *limitation* that prevents it from carrying on the activities otherwise permitted by *MAR* 5A.3.5R.

[**Note:** article 9(3) of the *IFD*.]

4.4.4 R (1) Where a *MIFIDPRU investment firm* meets the conditions in (2), its *permanent minimum capital requirement* is £75,000.

(2) The relevant conditions are:

(a) the only *investment services and/or activities* that the *firm* has *permission* to carry on are one or more of the following:

(i) reception and transmission of orders in relation to one or more *financial instruments*;

(ii) *execution of orders on behalf of clients*;

(iii) *portfolio management*;

(iv) *investment advice*; or

(v) placing of *financial instruments* without a firm commitment basis; and

(b) the *firm* is not permitted to hold *client money* or client assets in the course of *MiFID business*.

[**Note:** article 9(2) of the *IFD*.]

4.5 Fixed overheads requirement

[*Editor's note*: The provisions in this section will be published in a subsequent consultation paper.]

4.6 Overall K-factor requirement

4.6.1 R The *K-factor requirement* of a *MIFIDPRU investment firm* is the sum of each of the following that apply to the *firm*:

(1) *K-AUM requirement*;

(2) *K-CMH requirement*;

(3) *K-ASA requirement*;

(4) *K-COH requirement*;

(5) *K-NPR requirement*;

(6) *K-CMG requirement*;

(7) *K-TCD requirement*;

(8) *K-DTF requirement*; and

(9) *K-CON requirement*.

[**Note:** article 15(1) of the *IFR*.]

4.7 K-AUM requirement

[*Editor's note*: The provisions in this section will be published in a subsequent consultation paper.]

4.8 K-CMH requirement

[*Editor's note*: The provisions in this section will be published in a subsequent consultation paper.]

4.9 K-ASA requirement

[*Editor's note*: The provisions in this section will be published in a subsequent consultation paper.]

4.10 K-COH requirement

[*Editor's note*: The provisions in this section will be published in a subsequent consultation paper.]

4.11 Trading book and dealing on own account: general provisions

4.11.1 G References to *trading book* positions in *MIFIDPRU* include all *trading book* positions of the *firm*, including positions in:

(1) equity instruments;

(2) debt instruments (including securitisation instruments);

(3) collective investment undertakings;

(4) foreign exchange;

(5) gold; and

(6) commodities and emissions allowances.

[**Note:** article 21(3) of the *IFR*.]

4.11.2 G (1) For the purposes of the definition of a *position held with trading intent* in relation to the *trading book*, positions arising from client servicing include those arising out of contracts in relation to which a *firm* is acting as principal (even in the context of activity described as 'broking' or 'customer business'). This applies even if the nature of the business means that the only risks incurred by the *firm* are counterparty risks (i.e. no market risk charges apply).

(2) If the nature of the business means that the only risks incurred by the *firm* are counterparty risks, the position will generally still be a *position held with trading intent*.

(3) The *FCA* understands that business carried out under International Uniform Brokerage Execution ("Give-Up")

Agreements involve back to back trades as principal. If so, positions arising out of business carried out under such agreements should be allocated to a *firm's trading book*.

4.11.3 R (1) A *MIFIDPRU investment firm* must manage its *trading book* in accordance with Chapter 3 of Title I of Part Three of the *UK CRR*, with the following modifications:

(a) if a *firm* is unsure whether a position is a *position held with trading intent* or is held to hedge a *position held with trading intent*, the *firm* must include that position within its *trading book*;

(b) the following provisions of the *UK CRR* do not apply:

(i) article 102(1);

(ii) article 102(4);

(iii) article 104(2)(g); and

(iv) article 106;

(c) the reference in article 104(1) of the *UK CRR* to "policies and procedures for determining which position to include in the trading book" shall be read as "policies and procedures for identifying which positions form part of the trading book".

(2) Any reference to the *UK CRR* in this *rule* is to the *UK CRR* as applied and modified by (1).

[**Note:** article 21(2) of the *IFR*.]

4.11.4 R The following requirements only apply to a *firm* that *deals on own account*, whether on its own behalf or on behalf of its *clients*:

(1) the *K-NPR requirement*;

(2) the *K-CMG requirement*;

(3) the *K-TCD requirement*; and

(4) the *K-DTF requirement*.

4.11.5 G *MIFIDPRU investment firms* that *deal on own account* are reminded that they are also subject to the *K-CON requirement* in accordance with *MIFIDPRU* 5.

4.11.6 G A *MIFIDPRU investment firm* that has *permission* to *operate an organised trading facility* may rely on that *permission* to:

(1) engage in *matched principal trading* in certain types of *financial instruments* with *client* consent, in accordance with *MAR* 5A.3.5R(1); and

(2) *deal on own account* in illiquid *sovereign debt* instruments in accordance with *MAR* 5A.3.5R(2).

In either case, the *firm* will be *dealing on own account* and is therefore subject to the requirements in *MIFIDPRU* 4.11.4R to the extent relevant to the transactions it undertakes. *MIFIDPRU* 5 explains how the *K-CON requirement* applies to such *firms*.

4.11.7 R A *firm* to which *MIFIDPRU* 4.11.4R applies is required to calculate its *K-NPR requirement* and *K-CMG requirement* only in relation to:

(1) *trading book* positions; and

(2) positions other than *trading book* positions where such positions give rise to foreign exchange risk or commodity risk.

[**Note:** article 21(1) and (4) of the *IFR*.]

4.11.8 R A *firm* to which *MIFIDPRU* 4.11.4R applies is required to calculate its *K-TCD requirement* only in relation to the following:

(1) transactions that form part of its *trading book*; and

(2) transactions of the type specified in *MIFIDPRU* 4.14.3R(7).

4.12 K-NPR requirement

4.12.1 R A *MIFIDPRU investment firm* must calculate its *K-NPR requirement* by reference to every position referred to in *MIFIDPRU* 4.11.7R that does not form part of a *portfolio* for which the *firm* has been granted a *K-CMG permission*.

4.12.2 R (1) The *K-NPR requirement* of a *MIFIDPRU investment firm* must be calculated in accordance with Title IV of Part Three of the *UK CRR* in the form in which it stood at [*Editor's note*: insert date immediately before the earlier of the date that the MIFIDPRU sourcebook begins to apply or the date that the CRR 2 amendments to the UK CRR take effect].

(2) Any reference in this section to the *UK CRR* is to the *UK CRR* as applied by (1) and modified by the *rules* in this section.

(3) When applying the *UK CRR* in accordance with (1):

(a) any provision in the *UK CRR* relating to the effect that the market risk of a position has on the "own funds requirement" should be interpreted as relating instead to the effect that the position has on the *K-NPR requirement* of the *MIFIDPRU investment firm*;

(b) article 363 of the *UK CRR* does not apply;

(c) any references in Title IV of Part Three of the *UK CRR* to:

(i) article 363 of the *UK CRR* (permission to use internal models) shall be deemed to refer to *MIFIDPRU* 4.12.4R to *MIFIDPRU* 4.12.7R; and

(ii) permissions granted under article 363 of the *UK CRR* shall be deemed to refer to equivalent permissions granted under *MIFIDPRU* 4.12.4R to *MIFIDPRU* 4.12.7R.

[**Note:** articles 22 and 57(2) of the *IFR*.]

Instruments for which no treatment is specified in the UK CRR

4.12.3 R (1) Where a *MIFIDPRU investment firm* has a position in a *financial instrument* for which no treatment has been specified in the *UK CRR*, it must consider whether:

(a) the position is sufficiently similar to a position for which an existing treatment has been specified in the *UK CRR*; and

(b) the application of the treatment in (a) would be prudent and appropriate.

(2) If there is a treatment in the *UK CRR* that meets the conditions in (1), the *firm* must calculate the *K-NPR requirement* resulting from that position by applying that treatment.

(3) If there are multiple treatments in the *UK CRR* that meet the conditions in (1), the *firm* must calculate the *K-NPR requirement* resulting from that position by applying the most appropriate treatment.

(4) If there are no appropriate treatments in the *UK CRR*, the *firm* must add an appropriate percentage of the current value of the position to its overall *K-NPR requirement*. An appropriate percentage is either 100%, or a percentage that takes into account the characteristics of the position.

(5) A *firm* must document its policies and procedures for calculating the *K-NPR requirement* in respect of positions to which this *rule* applies in its *trading book* policy statement.

Permission to use internal models

4.12.4 R (1) A *firm* must obtain the prior permission of the *FCA* before using an internal model to calculate any of the following requirements under Part Three, Title IV, Chapter 5 of the *UK CRR*:

(a) general risk of equity instruments;

(b) specific risk of equity instruments;

(c) general risk of debt instruments;

(d) specific risk of debt instruments;

(e) foreign exchange risk; and

(f) commodities risk.

(2) To obtain the permission referred to in (1), a *firm* must:

(a) complete the application form in [*Editor's note*: a reference to the relevant permissions form will be inserted following consultation on the form in a future consultation paper] and submit it in accordance with the instructions in that form; and

(b) as part of the application in (a), demonstrate to the satisfaction of the *FCA* that:

(i) the relevant conditions for the use of the internal model specified in Part Three, Title IV, Chapter 5 of the *UK CRR*, as supplemented by the *rules* and *guidance* in this section, are met; and

(ii) the internal model for which permission is sought covers a significant share of the positions of the relevant risk category in (1).

(3) A *firm* must obtain a separate permission under this *rule* in relation to each risk category in (1).

4.12.5 G *MIFIDPRU* 4.12.8R to 4.12.65G contain *rules* and *guidance* setting out requirements for internal models and explaining the factors that the *FCA* will consider when deciding whether to grant permission to use an internal model.

4.12.6 R (1) A *firm* which has obtained a permission under *MIFIDPRU* 4.12.4R must obtain the approval of the *FCA* before doing the following in relation to the model to which that permission relates:

(a) implementing a material change to the use of the model; or

(b) making a material extension to the use of the model.

(2) To determine if a change or extension is material for the purposes of (1), a *firm* must apply the criteria and methodology set out in articles 3, 7a and 7b of the *Market Risk Model Extensions and Changes RTS*.

(3) To obtain the approval in (1), a *firm* must:

(a) complete the application form in [*Editor's note*: a reference to the relevant permissions form will be inserted following consultation on the form in a future consultation paper] and submit it in accordance with the instructions in that form; and

(b) perform an initial calculation of stressed value-at-risk in accordance with article 365(2) of the *UK CRR* on the basis of the model as changed or extended and submit the results of that calculation as part of the application in (a).

4.12.7 R (1) A *firm* which has obtained a permission under *MIFIDPRU* 4.12.4R must notify the *FCA* before:

(a) implementing a change to the use of the model to which that permission relates which is not a material change; or

(b) extending the use of the model to which that permission relates in a manner which is not material.

(2) A *firm* should make the notification in (1) using the form in [*Editor's note*: a reference to the relevant notification form will be inserted following consultation on the form in a future consultation paper] and submit it in accordance with the instructions in that form.

Use of internal models: risk capture

4.12.8 R A *MIFIDPRU investment firm* that has a permission to use an internal model in accordance with Part Three, Title IV, Chapter 5 of the *UK CRR*:

(1) must identify any material risks (or group of risks that when considered in aggregate are material) that are not captured by those models;

(2) must ensure that it holds *own funds* to cover those risk(s) in addition to the *own funds* required to meet its *K-NPR requirement* calculated in accordance with Part Three, Title IV, Chapter 5 of the *UK CRR*; and

(3) must ensure that it holds additional *own funds* for value at risk (VaR) and stressed VaR models that apply to the *firm*.

4.12.9 G (1) The methodology for identifying the risks in *MIFIDPRU* 4.12.8R and calculating those additional *own funds* for value-at-risk (VaR) and stressed value-at-risk (stressed VaR) models is called the "Risks not in VaR (RNIV) framework". A *firm* is responsible for identifying these additional risks and this should be an opportunity for risk managers and the *firm's* management to better understand the shortcomings of the *firm's* models. Following this initial assessment, the *FCA* will engage with the *firm* to provide challenge and ensure an appropriate outcome.

(2) The RNIV framework is intended to ensure that *own funds* are held to meet all risks that are not captured, or not captured adequately, by the *firm's* VaR and stressed VaR models. These include, but are not limited to, missing and/or illiquid risk factors such as cross-risks, basis risks, higher-order risks, and calibration parameters. The RNIV framework is also intended to cover event risks that could adversely affect the relevant business.

(3) A *firm* should systematically identify and measure all risks that are not captured, or not captured adequately. This analysis should be carried out at least quarterly, or more frequently if requested by the *FCA*. The measurement of these risks should capture the losses that could arise due to the risk factor(s) of all products that are within the scope of the relevant internal model permission, but are not adequately captured by the relevant internal models.

(4) On a quarterly basis, the *firm* should identify and assess individual risk factors covered by the RNIV framework. The *FCA* will review the results of this exercise and may require that *firms* identify additional risk factors as being eligible for measurement.

(5) (a) Where sufficient data is available, and where it is appropriate to do so, the *FCA* expects a *firm* to calculate a VaR and stressed VaR metric for each risk factor within scope of the framework. The stressed period for the RNIV framework should be consistent with that used for stressed VaR. No offsetting or diversification may be recognised across risk factors included in the

RNIV framework. The multipliers used for VaR and stressed VaR should be applied to generate a *K-NPR requirement*.

(b) If it is not appropriate to calculate a VaR and stressed VaR metric for a risk factor, a *firm* should instead measure the size of the risk based on a stress test. The confidence level and capital horizon of the stress test should be commensurate with the liquidity of the risk, and should be at least as conservative as comparable risk factors under the internal model approach. The capital charge should be at least equal to the losses arising from the stress test.

Standardised approach for options

4.12.10 R A *MIFIDPRU investment firm* may use its own estimates for delta for the purposes of the standardised approach for options under article 329 of the *UK CRR* if:

(1) the model the *firm* uses meets the minimum standards set out in *MIFIDPRU* 4.12.12G to *MIFIDPRU* 4.12.18G (Minimum standards for own estimates of delta) for each type of option for which it calculates delta; and

(2) the *firm* has notified the *FCA* that the minimum standards in (1) are met before the *firm* begins to use its own estimates for the relevant delta.

4.12.11 G If a *MIFIDPRU investment firm* has notified the *FCA* under *MIFIDPRU* 4.12.10R that a model meets the minimum standards for a particular option type, but is subsequently unable to demonstrate to the *FCA* that the model meets those minimum standards, the *FCA* may apply a capital add-on and agree a risk mitigation plan. If a *firm* is unable to comply with the risk mitigation plan within the mandated time-frame, the *FCA* may take further supervisory measures. This may include variation of a *firm's Part 4A permission* so that it is no longer allowed to trade those particular types of options for which it does not meet the minimum standards.

Minimum standards for own estimates of delta

4.12.12 G The level of sophistication of the pricing models used to calculate own estimates of delta for use in the standardised approach for options should be proportionate to the complexity and risk of each option, and the overall risk of the *firm's* options trading business. In general, the *FCA* considers that the risk of sold options will be higher than the risk of the same options when bought.

4.12.13 G Delta should be re-calculated at least daily. A *firm* should also recalculate delta promptly following significant movements in the market parameters used as inputs to calculate delta.

4.12.14 G The pricing model used to calculate delta should be:

(1) based on appropriate assumptions that have been assessed and challenged by suitably qualified parties independent of the development process;

(2) independently tested, including validation of the mathematics, assumptions, and software implementation; and

(3) developed or approved independently of the trading desk.

4.12.15 G A *firm* should use generally accepted industry standard pricing models for the calculation of own deltas where these are available, such as for relatively simple options.

4.12.16 G The IT systems used to calculate delta should be sufficient to ensure that delta can be calculated accurately and reliably.

4.12.17 G A *firm* should have adequate systems and controls in place when using a pricing model to calculate a delta. This should include the following documented policies and procedures:

(1) clearly defined responsibilities of the various areas involved in the calculation;

(2) frequency of independent testing of the accuracy of the model used to calculate delta; and

(3) guidelines for the use of unobservable inputs, where relevant.

4.12.18 G A *firm* should ensure its risk management functions are aware of weaknesses of the model used to calculate a delta. Where a *firm* identifies weaknesses, it should ensure that estimates of delta result in a prudent contribution to the *K-NPR requirement*. The outcome should be prudent across the whole portfolio of options and underlying positions at all times.

Netting: convertible

4.12.19 R The netting of a *convertible* and an offsetting position in the underlying instrument is permitted for the purposes of article 327(2) of the *UK CRR* (Netting).

4.12.20 G For the purposes of article 327(2) of the *UK CRR*, the *convertible* should be:

(1) treated as a position in the *equity* into which it converts; and

(2) the component of the *firm's K-NPR requirement* attributable to the general and specific risk in its *equity* instruments should be adjusted by making:

(a) an addition equal to the current value of any loss that the *firm* would make if it did convert to *equity*; or

(b) a deduction equal to the current value of any profit that the *firm* would make if it did convert to *equity* (subject to a maximum deduction equal to the *K-NPR requirement* that would be attributable to the notional position underlying the *convertible*).

Offsetting derivative instruments

4.12.21 G Article 331(2) of the *UK CRR* (Interest rate risk in derivative instruments) states conditions that must be met before a *firm* not using interest rate pre-processing models can fully offset interest-rate risk on derivative instruments. One of the conditions is that the reference rate (for floating-rate positions) or coupon (for fixed-rate positions) should be 'closely matched'. The *FCA* will normally consider a difference of less than 15 basis points as indicative of the reference rate or coupon being 'closely matched' for the purposes of this requirement.

Exclusion of overshootings when determining multiplication factor addends

4.12.22 G (1) The *FCA's* starting assumption is that all overshootings should be taken into account for the purpose of the calculation of addends. If a *firm* believes that an overshooting should not count for that purpose, then it should seek a variation of its VaR model permission from the *FCA* in accordance with *MIFIDPRU* 4.12.4R in order to exclude that particular overshooting.

(2) One example of when a *firm's* overshooting might properly be disregarded is when it has arisen as a result of a risk that is not captured in its VaR model but against which *own funds* are already held.

Derivation of notional positions for standardised approaches: general

4.12.23 G *MIFIDPRU* 4.12.24G to *MIFIDPRU* 4.12.38G set out *guidance* for the derivation of notional positions for standardised approaches to market risk under the *UK CRR*.

Futures and forwards on a basket or index of debt securities

4.12.24 G Futures or forwards on a basket or index of debt securities should be converted into forwards on single debt securities as follows:

(1) futures or forwards on a single currency basket or index of debt securities should be treated as either:

(a) a series of forwards, one for each of the constituent debt securities in the basket or index, of an amount that is a proportionate part of the total underlying the contract, according to the weighting of the relevant debt security in the basket; or

(b) a single forward on a notional debt security; and

(2) futures or forwards on multiple currency baskets or indices of debt securities should be treated as either:

(a) a series of forwards (using the method in (1)(a)); or

(b) a series of forwards, each one on a notional debt security to represent one of the currencies in the basket or index, of an amount that is a proportionate part of the total underlying the contract according to the weighting of the relevant currency in the basket.

4.12.25 G Notional debt securities derived through this treatment should be assigned a specific risk position risk adjustment and a general market risk position risk adjustment equal to the highest that would apply to the debt securities in the basket or index.

4.12.26 G The debt security with the highest specific risk position risk adjustment within the basket might not be the same as the one with the highest general market risk position risk adjustment. A *firm* should select the highest percentages, even where they relate to different debt securities in the basket or index, and regardless of the proportion of those debt securities in the basket or index.

Bonds where coupons and principal are paid in different currencies

4.12.27 G Where a debt security pays coupons in one currency but will be redeemed in a different currency, it should be treated as:

(1) a debt security denominated in the coupon's currency; and

(2) a foreign currency forward to capture the fact that the debt security's principal will be repaid in a different currency from that in which it pays coupons, specifically:

(a) a notional forward sale of the coupon currency and purchase of the redemption currency, in the case of a long position in the debt security; or

(b) a notional forward purchase of the coupon currency and sale of the redemption currency, in the case of a short position in the debt security.

Interest rate risk on other futures, forwards and swaps

4.12.28 G Other futures, forwards, and swaps where a treatment is not specified in article 328 of the *UK CRR* (Interest rate futures and forwards) should be treated as positions in zero specific risk securities, each of which:

(1) has a zero coupon;

(2) has a maturity equal to that of the relevant contract; and

(3) is long or short according to the table in *MIFIDPRU* 4.12.29G.

4.12.29 G This table belongs to *MIFIDPRU* 4.12.28G.

Instrument	**Notional positions**		
Foreign currency forward or future	A long position denominated in the currency purchased	and	A short position denominated in the currency sold
Gold forward or future	A long position if the forward or future involves an actual (or notional) sale of gold	or	A short position if the forward or future involves an actual (or notional) purchase of gold
Equity forward or future	A long position if the contract involves an actual (or notional) sale of the underlying equity	or	A short position if the contract involves an actual (or notional) purchase of the underlying equity

Deferred start interest rate swaps or foreign currency swaps

4.12.30 G Interest-rate swaps or foreign currency swaps with a deferred start should be treated as the two notional positions (one long, one short). The paying leg should be treated as a short position in a zero specific risk security with a coupon equal to the fixed rate of the swap. The receiving leg should be treated as a long position in a zero specific risk security that also has a coupon equal to the fixed rate of the swap.

4.12.31 G The maturities of the notional positions are shown in the table in *MIFIDPRU* 4.12.32G.

4.12.32 G This table belongs to *MIFIDPRU* 4.13.31G.

	Paying leg	**Receiving leg**
Receiving fixed and paying floating	The maturity equals the start date of the swap	The maturity equals the end date of the swap
Paying fixed and receiving floating	The maturity equals the end date of the swap	The maturity equals the start date of the swap

Swaps where only one leg is an interest rate leg

4.12.33 G For interest-rate risk, a *firm* should treat a swap (such as an equity swap) with only one interest rate leg as a notional position in a zero specific risk security:

(1) with a coupon equal to that on the interest rate leg;

(2) with a maturity equal to the date that the interest rate will be reset; and

(3) that is a long position if the *firm* is receiving interest payments and short if making interest payments.

Foreign exchange forwards, futures and contracts for differences

4.12.34 G (1) A *firm* should treat a foreign currency forward, future or contract for differences as two notional currency positions as follows:

(a) a long notional position in the currency that the *firm* has contracted to buy; and

(b) a short notional position in the currency that the *firm* has contracted to sell.

(2) In (1), the notional positions should have a value equal to either:

(a) the contracted amount of each currency to be exchanged in a forward, future or contract for differences held outside the *trading book*; or

(b) the present value of the amount of each currency to be exchanged in a forward, future or contract for differences held in the *trading book*.

Foreign currency swaps

4.12.35 G (1) A *firm* should treat a foreign currency swap as:

(a) a long notional position in the currency in which the *firm* has contracted to receive interest and principal; and

(b) a short notional position in the currency in which the *firm* has contracted to pay interest and principal.

(2) In (1), the notional positions should have a value equal to either:

(a) the nominal amount of each currency underlying the swap if it is held outside the *trading book*; or

(b) the present value amount of all cash flows in the relevant currency in the case of a swap held in the *trading book*.

Futures, forwards and contract for differences on a single commodity

4.12.36 G Where a forward, future or contract for differences settles according to:

(1) the difference between the price set on trade date and that prevailing at contract expiry, then the notional position should:

(a) equal the total quantity underlying the contract; and

(b) have a maturity equal to the expiry date of the contract;

(2) the difference between the price set on trade date and the average of prices prevailing over a certain period up to contract expiry, then a notional position should be derived for

each of the reference dates used in the averaging period to calculate the average price, that:

(a) equals a fractional share of the total quantity underlying the contract; and

(b) has a maturity equal to the relevant reference date.

Buying or selling a single commodity at an average of spot prices prevailing in the future

4.12.37 G Commitments to buy or sell at the average spot price of the commodity prevailing over some period between trade date and maturity should be treated as a combination of:

(1) a position equal to the full amount underlying the contract with a maturity equal to the maturity date of the contract, which should be:

(a) long, where the *firm* will buy at the average price; or

(b) short, where the *firm* will sell at the average price; and

(2) a series of notional positions, one for each of the reference dates where the contract price remains unfixed, each of which should:

(a) be long if the position under (1) is short, or short if the position under (1) is long;

(b) equal to a fractional share of the total quantity underlying the contract; and

(c) have a maturity date of the relevant reference date.

Cash legs of repurchase agreements and reverse repurchase agreements

4.12.38 G The forward cash leg of a repurchase agreement or reverse repurchase agreement should be treated as a notional position in a zero specific risk security that:

(1) is a short notional position in the case of a repurchase agreement and a long notional position in the case of a reverse repurchase agreement;

(2) has a value equal to the market value of the borrowing or deposit;

(3) has a maturity equal to that of the borrowing or deposit, or the next date the interest rate is reset (if earlier); and

(4) has a coupon equal to:

(a) zero, if the next interest payment date coincides with the maturity date; or

(b) the interest rate on the borrowing or deposit, if any interest is due to be paid before the maturity date.

Expectations relating to internal models

4.12.39 G *MIFIDPRU* 4.12.40G to *MIFIDPRU* 4.12.65G describe some of the standards that the *FCA* expects to be met when it is considering an application under *MIFIDPRU* 4.12.4R.

High-level standards

4.12.40 G A *firm* should be able to demonstrate that it meets the risk management standards in article 368 of the *UK CRR* (Qualitative requirements) on a legal entity and business-line basis where appropriate. This is particularly important for a *subsidiary* in a *group* subject to matrix management where the business lines cut across legal entity boundaries.

Categories of position

4.12.41 G A VaR model permission will generally set out the broad classes of position within each risk category in its scope. It may also specify how individual products within one of those broad classes may be brought into or taken out of scope of the VaR model permission. These broad classes of permission are as follows:

(1) linear products, which comprise securities with linear pay-offs (such as bonds and *equities*) and derivative products which have linear pay-offs in the underlying risk factor (such as interest rate swaps, *FRAs*, and total return swaps);

(2) European, American and Bermudan put and call options (including caps, floors, and swaptions) and investments with these features;

(3) Asian options, digital options, single barrier options, double barrier options, look-back options, forward-starting options, compound options and investments with these features; and

(4) all other option-based products (such as basket options, quantos, outperformance options, timing options, and correlation-based products) and investments with these features.

Data standards

4.12.42 G A *firm* should ensure that the data series used by its VaR model is reliable. Where a reliable data series is not available, proxies or any other reasonable value-at-risk measurement may be used if the *firm* meets the requirements in article 367(2)(e) of the *UK CRR* (Requirements for risk measurement). The technique must be appropriate and must not materially understate the modelled risks.

4.12.43 G Data may be deemed insufficient if, for example, it contains missing data points, or data points that contain stale data. For less liquid risk factors or positions, the *FCA* expects the *firm* to make a conservative assessment of those risks, using a combination of prudent valuation techniques and alternative VaR estimation techniques to ensure there is a sufficient cushion against risk over the close-out period, that takes account of the illiquidity of the risk factor or position.

4.12.44 G A *firm* is expected to update data sets to ensure standards of reliability are maintained in accordance with the frequency set out in its VaR model permission, or more frequently if volatility in market prices or rates necessitates more frequent updating. This is in order to ensure a prudent calculation of the VaR measure.

Aggregating VaR measures

4.12.45 G (1) In determining whether it is appropriate for a *firm* to use empirical correlations within risk categories and across risk categories within a model, the *FCA* will consider whether such an approach is sound and implemented with integrity. In general, the *FCA* expects a *firm* to determine the aggregate VaR measure by adding the relevant VaR measure for each category, unless the *firm's* permission provides for a different method of aggregating VaR measures that is empirically sound.

(2) The *FCA* does not expect a *firm* to use the square root of the sum of the squares approach when aggregating measures across risk categories unless the assumption of zero correlation between these categories is empirically justified. If correlations between risk categories are not empirically justified, the VaR measures for each category should simply be added to determine its aggregate VaR measure. However, to the extent that a *firm's* VaR model permission provides for a different way of aggregating VaR measures:

(a) that method applies instead; and

(b) if the correlations between risk categories used for that purpose cease to be empirically justified then the *firm* is expected to notify the *FCA* immediately.

Testing prior to model validation

4.12.46 G The *FCA* expects a *firm* to provide evidence of its ability to comply with the requirements for a VaR model permission. In general, a *firm* should demonstrate this by having a back-testing programme in place and should provide 3 *months* of back-testing history.

4.12.47 G The *FCA* expects a *firm* to carry out a period of initial monitoring or live testing before the *FCA* will recognise a VaR model. This will be agreed on a *firm*-by-*firm* basis.

4.12.48 G The *FCA* will take into account the results of internal model validation procedures used by the *firm* to assess the VaR model when assessing the *firm's* VaR model and risk management.

Back-testing

4.12.49 G *MIFIDPRU* 4.12.50G to *MIFIDPRU* 4.12.53G provide further *guidance* on how a *firm* should comply with the requirements in article 366 of the *UK CRR* (Regulatory back testing and multiplication factors).

4.12.50 G If the *day* on which a loss is made is day n, the value-at-risk measure for that *day* will be calculated on day n-1, or overnight between day n-1 and day n. Profit and loss figures are produced on day n+1, and back-testing also takes place on day n+1. The *firm's* supervisor should be notified of any overshootings by close of business on day n+2.

4.12.51 G Any overshooting initially counts for the purpose of the calculation of the plus factor, even if subsequently the *FCA* agrees to exclude it. Thus, where the *firm* experiences an overshooting and already has four or more overshootings during the previous 250 *business days*, changes to the multiplication factor arising from changes to the plus factor become effective at day n+3.

4.12.52 G A longer time period generally improves the power of back-testing. However, a longer time period may not be desirable if the VaR model or market conditions have changed to the extent that historical data is no longer relevant.

4.12.53 G The *FCA* will review, as part of a *firm's* VaR model permission application under *MIFIDPRU* 4.12.4R, the processes and documentation relating to the derivation of profit and loss used for back-testing. A *firm's* documentation should clearly set out the basis for cleaning profit and loss. To the extent that certain profit and loss elements are not updated every *day* (for example, certain reserve calculations) the documentation should clearly set out how such elements are included in the profit and loss series.

Planned changes to the VaR model

4.12.54 G In accordance with *MIFIDPRU* 4.12.6R, a *firm* will need to provide to, and discuss with, the *FCA* details of any significant planned changes to the VaR model before those changes are implemented.

These details must include detailed information about the nature of the change, including an estimate of the impact on VaR numbers and the incremental risk charge. *Firms* are reminded that material changes to internal models or material extensions to the use of internal models will require prior approval from the *FCA*.

Bias from overlapping intervals for 10-day VaR and stressed VaR

4.12.55 G The use of overlapping intervals of 10-*day* holding periods for article 365 of the *UK CRR* (VaR and stressed VaR (sVaR) calculation) introduces an autocorrelation into the data that would not exist should truly independent 10-*day* periods be used. This may give rise to an under-estimation of the volatility and the VaR at the 99% confidence level. To obtain clarity on the materiality of the bias, a *firm* should measure the bias arising from the use of overlapping intervals for 10-*day* VaR and sVaR when compared to using independent intervals. A report on the analysis, including a proposal for a multiplier on VaR and sVaR to adjust for the bias, should be submitted to the *FCA* for review and approval.

Stressed VaR calculation

4.12.56 G Article 365 of the *UK CRR* (VaR and sVaR calculation) requires a *firm* that uses an internal model for calculating its *K-NPR requirement* to calculate, at least weekly, a sVaR of their current portfolio. The *FCA* would expect a sVaR internal model to contain the features in *MIFDIPRU* 4.12.57G to *MIFIDPRU* 4.12.60G before the *FCA* will grant permission to use the relevant model.

Quantile estimator

4.12.57 G The *firm* should calculate the sVaR measure to be greater than or equal to the average of the 2nd and 3rd worst loss in a 12-*month* time series comprising of 250 observations. The FCA expects, as a minimum, that a corresponding linear weighting scheme should be applied if the *firm* uses a larger number of observations.

Meaning of ‘period of significant financial stress relevant to the institution’s portfolio’

4.12.58 G The *firm* should ensure that the sVaR period chosen is equivalent to the period that would maximise VaR, given the *firm’s* portfolio. There is an expectation that a stressed period should be identified at each legal entity level at which capital is reported. Therefore, group level sVaR measures should be based on a period that maximises the group level VaR, whereas entity level sVaR should be based on a period that maximises VaR for that entity.

Antithetic data

4.12.59 G The *firm* should consider whether the use of antithetic data in the calculation of the sVaR measure is appropriate to the *firm's* portfolio. The *firm* should provide a justification to the *FCA* for using or not using antithetic data as part of an application to use an internal model.

Absolute and relative shifts

4.12.60 G In its application to use an internal model, the *firm* should explain the rationale for the choice of absolute or relative shifts for both VaR and sVaR methodologies. In particular, the *firm* should evidence the statistical processes driving the risk factor changes for both VaR and sVaR.

4.12.61 R A *firm* that is using an internal model must submit the following information to the *FCA* on a quarterly basis:

(1) analysis to support the equivalence of the *firm's* current approach to a VaR-maximising approach on an ongoing basis;

(2) the rationale behind the selection of key major risk factors used to find the period of significant financial stress;

(3) summary of ongoing internal monitoring of stressed period selection with respect to current portfolio;

(4) analysis to support capital equivalence of upscaled 1-*day* VaR and sVaR measures to corresponding full 10-*day* VaR and sVaR measures;

(5) a graphed history of sVaR/VaR ratio;

(6) analysis to demonstrate accuracy of partial revaluation approaches specifically for sVaR purposes (for *firms* using revaluation ladders or spot/vol-matrices), which should include a review of the ladders/matrices or spot/vol-matrices, ensuring that they are extended to include wider shocks to risk factors that incur in stress scenarios; and

(7) minutes of risk committee meeting or other form of evidence to reflect governance and senior management oversight of stressed VaR methodology.

4.12.62 G Article 372 of the *UK CRR* (Requirement to have an internal IRC model) requires a *firm* that uses an internal model for calculating own funds requirements for specific risk of traded debt instruments to also have an internal incremental default and migration risk (IRC) model in place to capture the default and migration risk of its trading book positions that are incremental to the risks captured by its VaR model. When the *FCA* considers a *firm's* application for permission to use an IRC internal model under *MIFIDPRU* 4.12.4R, it expects that the matters in *MIFIDPRU* 4.12.63G to *MIFIDPRU* 4.12.65G will be included to demonstrate compliance with the standards in article 372.

Basis risks for migration

4.12.63 G The *FCA* expects the IRC model to capitalise pre-default basis risk. In this respect, the model should reflect that in periods of stress the basis could widen substantially. The *firm* should disclose to the *FCA* its material basis risks that are incremental to those already captured in existing market risk capital measures (VaR-based and others). This must take actual close-out periods during periods of illiquidity into account.

Price/spread change model

4.12.64 G The price/spread change model used to capture the profit and loss impact of migration should calibrate spread changes to long-term averages of differences between spreads for relevant ratings. These should either be conditioned on actual rating events, or using the entire history of spreads regardless of migration. Point-in-time estimates are not considered acceptable, unless they can be shown to be as conservative as using long-term averages.

Dependence of the recovery rate on the economic cycle

4.12.65 G To achieve a soundness standard comparable to those under the IRB approach, loss given default (LGD) estimates should reflect the economic cycle. Therefore, the *FCA* expects a *firm* to incorporate dependence of the recovery rate on the economic cycle into the IRC model. If the *firm* uses a conservative parameterisation to comply with the IRB standard of the use of downturn estimates, the *firm* should submit evidence of this in quarterly reporting to the *FCA*, bearing in mind that for trading portfolios, which contain long and short positions, downturn estimates would not in all cases be a conservative choice.

4.13 K-CMG requirement

4.13.1 R (1) Subject to (2), the *K-CMG requirement* applies to a *MIFIDPRU investment firm* in relation to *portfolios* for which the *firm* has been granted a *K-CMG permission*.

(2) A *MIFIDPRU investment firm* must include a position specified in *MIFIDPRU* 4.11.7R within the calculation of its *K-NPR requirement* if that position:

(a) is included in a *portfolio* for which the *firm* has been granted a *K-CMG permission*;

(b) is a proprietary position of the *firm* that results from a trade that has settled;

(c) is not included in the calculation of the required margin under the margin model of the *clearing member* or *authorised central counterparty* in *MIFIDPRU* 4.13.9R(2)(b); and

(d) is not a position to which the *clearing member* or *authorised central counterparty* has applied a "haircut" of the type specified in *MIFIDPRU* 4.13.6R(2).

4.13.2 G *MIFIDPRU* 4.13.1R(2) is intended to cover the risks arising from proprietary trades that form part of a *portfolio* for which a *firm* has a *K-CMG permission*. Where such trades have settled, the resulting proprietary position of the *firm* may no longer be included within the margin requirement calculated by the *clearing member* or *authorised central counterparty* for that *portfolio* and therefore would not contribute to the *firm's K-CMG requirement*. The *firm* should therefore include such positions within its calculation of the *K-NPR requirement* to take account of the resulting market risk. For these purposes, a *firm* is not required to apply this approach to a position that results from client servicing.

4.13.3 G As part of any application for a *K-CMG permission*, a *firm* will need to identify each *portfolio* for which it wishes to calculate a *K-CMG requirement*.

4.13.4 G *MIFIDPRU investment firms* that *deal on own account* are reminded that *MIFIDPRU* 4.11.7R(2) includes positions held outside the *trading book* that give rise to foreign exchange or commodities risk. The *FCA* considers that it is unlikely that such positions would be eligible for a *K-CMG permission*. Therefore, even if the *FCA* has granted a *K-CMG permission* in relation to all *portfolios* in the *firm's trading book*, a *firm* may still need to calculate a *K-NPR requirement* in relation to positions it holds outside of the *trading book*.

4.13.5 R The *K-CMG requirement* of a *MIFIDPRU investment firm* must be determined in accordance with the following formula:

K-CMG requirement = TM * 1.3

where TM is the third highest amount of total margin as calculated under *MIFIDPRU* 4.13.6R required from the *firm* on a daily basis over the preceding 3 *months*.

[**Note:** article 23(2) of the *IFR*.]

4.13.6 R For the purposes of *MIFIDPRU* 4.13.5R, the total margin must be calculated as the sum of the following in relation to all *clearing members* and (to the extent that *MIFIDPRU* 4.13.9R(2)(c)(i) applies) all *authorised central counterparties*:

(1) the amount of margin required by the margin model referenced in *MIFIDPRU* 4.13.9R(2)(e); plus

(2) the value of any "haircut" applied by the *clearing member* or *authorised central counterparty* to positions included in the *portfolio* that represent settled trades and which the *clearing member* or *authorised central counterparty* is treating as collateral to secure the present or future obligations of the *MIFIDPRU investment firm*.

4.13.7 G *MIFIDPRU* 4.13.6R requires a *MIFIDPRU investment firm* to determine the amount of margin that is required under the relevant margin model of each *clearing member* (or, for a self-clearing *firm*, of each *authorised central counterparty*) for *portfolios* in respect of which the *firm* has been granted a *K-CMG permission*. For these purposes, the *clearing member's* (or, where applicable, *authorised central counterparty's*) margin model must meet the criteria in *MIFIDPRU* 4.13.14R. The effect of *MIFIDPRU* 4.13.6R is that if, notwithstanding the requirement under the margin model, the *MIFIDPRU investment firm* agrees with the *clearing member* or *authorised central counterparty* to provide a different amount of margin, it is the amount required under the model that must be used for the purposes of calculating the *firm's K-CMG requirement* and not the amount of margin that is actually provided by the *firm*. This ensures that the *firm's K-CMG requirement* is not artificially reduced by subsequent commercial negotiations that may result in the *clearing member* or *authorised central counterparty* accepting a lower amount of margin than the model requires on any given *day*.

4.13.8 G The calculation in *MIFIDPRU* 4.13.5R means that for each trading *day* during the relevant calculation period, the *firm* must calculate the total combined margin (as determined in accordance with *MIFIDPRU* 4.13.6R) provided to all clearing members in aggregate in respect of the relevant *portfolios*. The *K-CMG requirement* is then calculated on the basis of the third highest daily aggregate amount.

4.13.9 R To obtain a *K-CMG permission* in relation to a *portfolio*, a *firm* must:

(1) complete the application form in [*Editor's note*: a reference to the relevant permissions form will be inserted following consultation on the form in a future consultation paper] and submit it in accordance with the instructions in that form;

(2) as part of the application in (1), demonstrate to the satisfaction of the *FCA* that all the following conditions are met:

(a) the *firm* is not part of a *group* containing a *credit institution*;

(b) the clearing and settlement of the transactions in the relevant *portfolio* take place under the responsibility of a *clearing member* of an *authorised central counterparty*;

(c) the *clearing member* in (b) is one of the following:

(i) the *firm* itself;

(ii) a *UK credit institution*; or

(iii) a *designated investment firm*;

(d) transactions in the relevant *portfolio* are either:

(i) centrally cleared in an *authorised central counterparty*; or

(ii) settled on a delivery-versus-payment basis under the responsibility of the *clearing member* in (b);

(e) the *firm* is required to provide total margin calculated on the basis of a margin model that satisfies the criteria in *MIFIDPRU* 4.13.14R and is operated by:

(i) in the case of a *firm* that is a self-clearing *firm* under (c)(i), the *authorised central counterparty* in (b); or

(ii) in any other case, the relevant *clearing member* in (b);

(f) the rationale for the *firm's* choice of calculating a *K-CMG requirement* in relation to the *portfolio* has been clearly documented and has been approved by the *firm's management body* or risk management function; and

(g) the choice of the *portfolio* to be subject to a *K-CMG requirement* has not been made with a view to engaging in regulatory arbitrage between the *K-NPR requirement* and the *K-CMG requirement* in a disproportionate or prudentially unsound manner.

[**Note:** article 23(1), first subparagraph of the *IFR*.]

4.13.10 R A *firm* that has been granted a *K-CMG permission* in respect of a *portfolio* must notify the *FCA* immediately if it becomes aware that any of the conditions in *MIFIDPRU* 4.13.9R have ceased to be met in relation to the *portfolio*.

4.13.11 G The *FCA* may revoke a *K-CMG permission* in respect of a *portfolio* where one or more of the conditions in *MIFIDPRU* 4.13.9R ceases to be met in relation to that *portfolio*. The *FCA* would expect to review the appropriateness of any *K-CMG permissions* as part of any *SREP* it undertakes in relation to the *firm* in accordance with *MIFIDPRU* [7][14].

4.13.12 R A *firm* that is an *indirect client* of a *clearing member* may obtain a *K-CMG permission* provided that:

(1) the indirect clearing arrangement satisfies all of the conditions in *MIFIDPRU* 4.13.9R; and

(2) the *FCA* is satisfied that the relevant arrangement does not otherwise result in undue risks.

4.13.13 R (1) A *firm* that is relying on a *K-CMG permission* must ensure that:

(a) the relevant individuals within the *firm* who are responsible for the *firm's* risk management function, or for the oversight of that function, have a reasonable understanding of the operation of the margin model referred to in *MIFIDPRU* 4.13.9R(2)(e); and

(b) the *firm* integrates such understanding of the relevant margin model into its *ICARA process* for the purposes of considering whether:

(i) the resulting *K-CMG requirement* is sufficient to cover the relevant risks to which the *firm* is exposed; and

(ii) the *K-CMG permission* remains appropriate in relation to the *portfolio(s)* in respect of which it was granted.

(2) For the purposes of (1), a *firm* may use suitable advice or analysis provided by an appropriate third party, but the *firm* retains ultimate responsibility for ensuring that the individuals in (1)(a) have the necessary knowledge and understanding of the margin model.

(3) An appropriate third party under (2) may include:

(a) a suitably qualified professional adviser;

(b) the relevant *clearing member*; or

(c) another *undertaking* within the same *investment firm group* as the *firm* where individuals within that *undertaking* have the requisite knowledge and understanding of the margin model.

[14] *Editor's note:* The FCA will consult on the content of MIFIDPRU 7 in a subsequent consultation paper.

4.13.14 R (1) The criteria referred to in *MIFIDPRU* 4.13.9R(2)(e) are that:

(a) the margin requirements are sufficient to cover losses that may result from at least 99% of the exposures movements over an appropriate time horizon with at least a two-*business day* holding period; and

(b) the margin model used by the *clearing member* or *authorised central counterparty* to call the margin is always designed to achieve a level of prudence similar to that required in the provisions on margin requirements in article 41 of *EMIR*.

(2) If the parameters of a margin model operated by a *clearing member* or *authorised central counterparty* do not meet the criteria in (1)(a), those criteria shall nonetheless be deemed to be met if:

(a) an adjustment mechanism is applied to produce an alternative margin requirement; and

(b) the alternative requirement in (a) is at least equivalent to the margin requirement that would be produced by a margin model that meets the criteria in (1)(a).

(3) Any adjustment mechanism under (2) may be applied by either of the following, provided that the conditions in (4) are met:

(a) the relevant *clearing member*; or

(b) the *MIFIDPRU investment firm* that has been granted the relevant *K-CMG permission*.

(4) The conditions are that the *MIFIDPRU investment firm* that has been granted the relevant *K-CMG permission*:

(a) can provide to the *FCA* upon request a reasonable explanation of the adjustment that has been applied under (2); and

(b) monitors and reviews the effectiveness of the adjustment mechanism on an ongoing basis as part of its *ICARA process*.

[**Note:** article 23(1), third subparagraph of the *IFR*.]

4.13.15 G (1) *MIFIDPRU* 4.13.14R(2) permits the output of a margin model of a *clearing member* or *authorised central counterparty* to be adjusted to meet the criteria in *MIFIDPRU* 4.13.14R(1)(a). For the avoidance of doubt, such an adjustment is used solely to determine the *K-CMG requirement* of a *firm*. It does not affect the actual amount of margin that the *clearing member* or *authorised central counterparty* will receive from the *firm*, which will continue to be determined by the underlying (unadjusted) model.

(2) For example, the *clearing member's* or *authorised central counterparty's* original margin model may produce margin requirements that are sufficient to cover losses that may result from at least 95% of the exposures movements over a two-*business day* holding period. This would not meet the minimum criteria in *MIFIDPRU* 4.13.14R(1)(a). To determine the *firm's K-CMG requirement*, the output of that model may be adjusted to produce a requirement that would cover losses that may result from at least 99% of the exposures movements over that same holding period. Provided that the conditions in *MIFIDPRU* 4.13.14R(3) and (4) are satisfied, the minimum criteria in *MIFIDPRU* 4.13.14R(1)(a) will be deemed to be met when the adjustment is applied. This is the case even though the actual margin received by the *clearing member* or *authorised central counterparty* continues to be determined by the original (unadjusted) model.

4.13.16 G Where the margin model of a *clearing member* uses parameters that are more conservative than the minimum criteria in *MIFIDPRU* 4.13.14R(1), the output of the model may be adjusted downwards under *MIFIDPRU* 4.13.14R(2) to produce margin requirements that are consistent with the minimum criteria. The requirements in *MIFIDPRU* 4.13.14R(3) and (4) still apply to any such adjustment. For the avoidance of doubt, a *firm* is not required to apply a downwards adjustment to a more conservative model.

4.13.17 G The *FCA* will consider whether the *firm's* rationale for choosing a *K-CMG requirement* under *MIFIDPRU* 4.13.9R(2)(f) has taken adequate account of the nature of, and risks arising from, the *firm's* trading activities, including whether:

(1) the main activities of the *firm* are essentially trading activities that are subject to clearing and margining under the responsibility of a *clearing member*; and

(2) other activities performed by the *firm* are immaterial in comparison to those main activities.

[**Note:** article 23(1)(d) of the *IFR*.]

4.13.18 G (1) For the purposes of *MIFIDPRU* 4.13.9R(2)(g), the fact that the application of a *K-CMG permission* to a *portfolio* may result in a *K-CMG requirement* that is lower than the equivalent *K-NPR requirement* for that *portfolio* does not necessarily mean that the choice to apply a *K-CMG* *requirement* has been made with a view to engaging in regulatory arbitrage in a disproportionate or prudentially unsound manner.

(2) When considering whether the condition in *MIFIDPRU* 4.13.9R(2)(g) is satisfied, a *firm* should consider whether the *K-CMG requirement* that would result from the relevant *K-CMG permission* more closely reflects the underlying economic risk of the relevant *portfolio* when compared with the equivalent *K-NPR requirement* for the same *portfolio*.

(3) The *FCA* considers that even in circumstances where the *K-CMG requirement* is considerably lower than the equivalent *K-NPR requirement*, this does not automatically prevent a *firm* from meeting the conditions for a *K-CMG permission*. In certain situations, a significant difference between the two requirements may result from the calculation of the *K-CMG requirement* being better adapted for capturing the economic risks of the particular *portfolio* in question. For example, the margin model underlying the *K-CMG requirement* may have been specifically designed for *firms* that specialise in trading the relevant type of *portfolio*. However, the *FCA* expects a *firm* to provide a clear explanation of how the conditions in *MIFIDPRU* 4.13.9R(2) are satisfied in respect of any *portfolio* for which a *K-CMG permission* is sought and the *firm* should keep the appropriateness of a *K-CMG permission* under regular review as part of its *ICARA process*.

4.13.19 R (1) Except where (2) applies, a *firm* that has obtained a *K-CMG permission* in relation to a *portfolio* must calculate a *K-CMG requirement* for that *portfolio* for a continuous period of at least 24 *months* from the date that the permission is granted.

(2) The requirement in (1) ceases to apply if:

(a) the *FCA* revokes the relevant *K-CMG permission* in relation to that *portfolio* on its own initiative in the circumstances described in *MIFIDPRU* 4.13.11G; or

(b) the business strategy or operations of the *trading desk* with responsibility for the relevant *portfolio* have changed to such an extent that it has become a different *trading desk*.

4.13.20 R (1) Where a *firm* that has been granted a *K-CMG permission* in relation to a *portfolio* subsequently chooses to calculate a *K-NPR requirement* for that *portfolio* instead, the *firm* must submit the notification in (2) to the *FCA* before the *firm* begins to calculate the *K-NPR requirement*.

(2) The notification in (1) must:

(a) confirm that the requirement in *MIFIDPRU* 4.13.19R(1) has been met in relation to the *portfolio*, or that the circumstance in *MIFIDPRU* 4.13.19R(2)(b) applies instead; and

(b) specify the date on which the relevant *K-CMG permission* should cease to apply to the *firm*.

4.13.21 G Where a *firm* has submitted the notification in *MIFIDPRU* 4.13.20R(2) to the *FCA* in relation to a *portfolio*, the *FCA* will not normally grant another *K-CMG permission* in relation to the same *portfolio* until at least 24 *months* after the previous *K-CMG permission* ceased to apply.

4.14 K-TCD requirement

4.14.1 R (1) The *K-TCD requirement* of a *MIFIDPRU investment firm* shall be an amount equal to the sum of the *TCD own funds requirement* for all transactions specified in (2).

(2) This *rule* applies to the transactions in *MIFIDPRU* 4.14.3R where those transactions:

(a) are recorded in the *trading book* of a *firm dealing on own account* (whether for itself or on behalf of a *client*); or

(b) in the case of the transactions specified in *MIFIDPRU* 4.14.3R(7), are undertaken by a *firm* that has the necessary *permissions* to *deal on own account*.

[**Note:** article 24 of the *IFR*.]

4.14.2 G (1) The effect of *MIFIDPRU* 4.14.1R(2)(b) is that where a *firm* is authorised to *deal on own account,* it must include in the calculation of its *K-TCD requirement* any transactions of the type specified in *MIFIDPRU* 4.14.3R(7), even where the *firm's* involvement in the specific transaction may not constitute *dealing on own account* and the transaction may not be recorded in its *trading book.*

(2) However, a *firm* that is not authorised to *deal on own account* is not subject to the *K-TCD requirement* under *MIFIDPRU* 4.14.1R, even though it may be involved in a transaction that would otherwise fall within *MIFIDPRU* 4.14.3R(7).

Transactions to which K-TCD applies

4.14.3 R Subject to *MIFIDPRU* 4.14.5R, the transactions to which *MIFIDPRU* 4.14.1R applies are as follows:

(1) derivative contracts listed in Annex II to the *UK CRR*, with the exception of the following:

(a) derivative contracts directly or indirectly cleared through a *central counterparty*, where all of the following conditions are met:

(i) the positions and assets of the *firm* related to those contracts are distinguished and segregated, at the level of both the *clearing member* and the *central counterparty*, from the position and assets of both the *clearing member* and the other clients of that *clearing member* and, as a result of that distinction and segregation, those positions and assets are bankruptcy remote under applicable law in the event of default or insolvency of the *clearing member* or one or more of its other clients;

(ii) the legal requirements applicable to or binding the *clearing member* facilitate the transfer of the client's positions relating to those contracts and of the corresponding collateral to another *clearing member* within the applicable margin period of risk in the event of default or insolvency of the original *clearing member*; and

(iii) the *firm* has obtained an independent, written and reasoned legal opinion that concludes that, in the event of a legal challenge, the *firm* would bear no losses on account of the insolvency of its *clearing member* or of any of its *clearing member's* clients;

(b) exchange-traded derivative contracts; and

(c) derivative contracts held for hedging a position of the *firm* resulting from an activity outside the *trading book*;

(2) *long settlement transactions*;

(3) *repurchase transactions*;

(4) *securities or commodities lending or borrowing transactions*;

(5) *margin lending transactions*;

(6) any other types of *securities financing transactions*; and

(7) credits and loans referred to in the activity in point 2 of paragraph 1 of Part 3A of Schedule 2 to the *Regulated Activities Order*, if the *firm* is:

(a) executing the trade in the name of the *client*; or

(b) receiving and transmitting the order without executing it.

[**Note:** article 25(1) of the *IFR*.]

4.14.4 R A derivative contract that is directly or indirectly cleared through an *authorised central counterparty* shall be deemed to meet the conditions in *MIFIDPRU* 4.14.3R(1)(a).

[**Note:** article 25(1), second paragraph of the *IFR*.]

4.14.5 R The *K-TCD requirement* does not apply to transactions with the following types of counterparties:

(1) central governments and central banks, where the underlying exposures would receive a 0% risk weight under article 114 of the *UK CRR*;

(2) multilateral development banks listed in article 117(2) of the *UK CRR*; or

(3) international organisations listed in article 118 of the *UK CRR*.

[**Note:** article 25(2) of the *IFR*.]

4.14.6 R (1) With the prior consent of the *FCA*, a *firm* may exclude transactions with the following counterparties from the calculation of its *K-TCD requirement* under *MIFIDPRU* 4.14.1R:

(a) its *parent undertaking*;

(b) its *subsidiary*;

(c) a *subsidiary* of its *parent undertaking*; or

(d) an *undertaking* with which the *firm* is linked by *majority common management*.

(2) In order to obtain the *FCA* consent in (1), the *firm* must demonstrate all of the following to the satisfaction of the *FCA*:

(a) the counterparty is subject to appropriate prudential requirements and is one of the following:

(i) a *credit institution*;

(ii) an *investment firm*; or

(iii) a *financial institution*;

(b) the counterparty is:

(i) included in the same prudential consolidation group as the *firm* on a full basis in accordance with the *UK CRR* or the consolidation provisions in *MIFIDPRU* 2.5; or

(ii) supervised along with the *firm* for compliance with the group capital test in *MIFIDPRU* 2.6;

(c) the counterparty is subject to the same risk evaluation, measurement and control procedures as the *firm*;

(d) the counterparty is established in the *UK*; and

(e) there is no current or foreseen material practical or legal impediment to the prompt transfer of *own funds* or repayment of liabilities from the counterparty to the *firm*.

(3) A *firm* wishing to apply for *FCA* consent for the purposes of this *rule* must complete the form in [*Editor's note*: a reference to the relevant permissions form will be inserted following consultation on the form in a future consultation paper] and submit it in accordance with the instructions on that form.

[**Note:** article 25(3) of the *IFR*.]

Calculation of TCD own funds requirement

4.14.7 R The *TCD own funds requirement* for each transaction or *netting set* must be determined in accordance with the following formula:

TCD own funds requirement = α * EV * RF * CVA

where:

(1) α = 1.2

(2) EV = the exposure value calculated in accordance with *MIFIDPRU* 4.14.8R

(3) RF = the risk factor applicable to the counterparty type as set out in the table in *MIFIDPRU* 4.14.29R

(4) CVA = the credit valuation adjustment calculated in accordance with *MIFIDPRU* 4.14.30R.

[**Note:** article 26 of the *IFR*.]

Exposure value

4.14.8 R The exposure value must be determined in accordance with the following formula:

Exposure value = Max (0; RC + PFE – C)

where:

(1) RC = the replacement cost calculated in accordance with *MIFIDPRU* 4.14.9R

(2) PFE = potential future exposure calculated in accordance with *MIFIDPRU* 4.14.10R

(3) C = collateral as determined in accordance with *MIFIDPRU* 4.14.24R and 4.14.25R

[**Note:** article 27 of the *IFR*.]

Replacement cost

4.14.9 R (1) A *firm* must calculate the replacement cost for all transactions referred to in *MIFIDPRU* 4.14.3R.

(2) The replacement cost must be determined as follows:

(a) for derivative contracts, the replacement cost is the *CMV*;

(b) for *long settlement transactions*, the replacement cost is the settlement amount of cash to be paid or to be received by the *firm* upon settlement, with a receivable being treated as a positive amount and a payment being treated as a negative amount;

(c) unless (d) applies, for *repurchase transactions* and *securities or commodities lending or borrowing transactions*, the replacement cost is the amount of cash lent or borrowed, with cash lent by the *firm* being treated as a positive amount and cash borrowed by the *firm* being treated as a negative amount;

(d) for *securities financing transactions*, where both legs of the transaction are securities, the replacement cost is the *CMV* of the security lent by the *firm*, increased by the corresponding volatility adjustment in *MIFIDPRU* 4.14.25R; and

(e) for *margin lending transactions* and the credits and loans referred to in *MIFIDPRU* 4.14.3R(7), the replacement cost is the book value of the asset in accordance with the applicable accounting framework.

[**Note:** article 28 of the *IFR*.]

Potential future exposure

4.14.10 R (1) A *firm* is only required to calculate potential future exposure for derivative contracts.

(2) A *firm* must calculate the potential future exposure for derivative contracts in a *netting set* using one of the following approaches:

(a) the hedging approach in *MIFIDPRU* 4.14.14R; or

(b) the derivative netting ratio approach in *MIFIDPRU* 4.14.18R.

[**Note:** article 29(1) and (8) of the *IFR*.]

4.14.11 R Where a single derivative contract cannot be allocated to a *netting set* with other derivative contracts, it must be treated as a separate *netting set* for the purposes of *MIFIDPRU* 4.14.10R.

4.14.12 R A *firm* must apply its chosen approach under *MIFIDPRU* 4.14.10R:

(1) continuously for at least 24 *months*; and

(2) consistently across all its *netting sets*.

Potential future exposure: hedging approach

4.14.13 G (1) If a derivative contract has a negative replacement cost, a *firm* should still calculate a potential future exposure (PFE) in relation to that contract if it is possible for the replacement cost to become positive before the maturity date.

(2) As the replacement cost of an individual written option can never be a positive amount, written options are exempt from the requirement to calculate a PFE, unless they are subject to netting with other derivative contracts for the purposes of calculating PFE in accordance with *MIFIDPRU* 4.14.14R and *MIFIDPRU* 4.14.16R.

(3) If a written option is subject to netting for the purposes of calculating PFE, the PFE in relation to that option is capped at an amount that would result in a replacement cost of zero.

4.14.14 R (1) For the purposes of calculating the PFE of derivative contracts included within a *netting set* under *MIFIDPRU* 4.14.16R, a *firm* must:

(a) calculate the effective notional amount of each contract (EN) in accordance with *MIFIDPRU* 4.14.20R;

(b) allocate each derivative contract to an asset class in accordance with (2) and (3); and

(c) calculate a separate net notional amount for each asset class in (b) by netting the EN of all derivative contracts allocated to that asset class.

(2) Subject to (3), a *firm* must assign derivative contracts to separate asset classes as follows:

(a) except as specified in (b) – (d), a derivative contract must be allocated to the relevant asset class specified in the table in *MIFIDPRU* 4.14.22R;

(b) interest rate derivatives must be allocated to separate asset classes according to their currency;

(c) foreign exchange derivatives must be allocated to separate asset classes according to each currency pair; and

(d) derivative contracts falling within the "other" class in *MIFIDPRU* 4.14.22R may be allocated to the same class if their primary risk driver is identical, but otherwise must each be treated as a separate class.

(3) Derivative contracts that would fall within a specific asset class under (2) must be allocated to a separate asset class where:

(a) they reference the basis between two risk factors and are denominated in a single currency (i.e. they are basis transactions), in which case all basis transactions referencing that same pair of risk factors must be allocated to a separate asset class; or

(b) they reference the volatility of a risk factor (i.e. they are volatility transactions), in which case all volatility transactions referencing that same risk factor must be allocated to a separate asset class.

4.14.15 G (1) *MIFIDPRU* 4.14.14R(2) defines the main asset classes to which derivative contracts should be assigned to calculate the potential future exposure of a *netting set*. For example, a single name equity derivative would be allocated to the equity single name asset class in *MIFIDPRU* 4.14.22R, while a credit derivative would be allocated to the credit asset class in that *rule*.

(2) *MIFIDPRU* 4.14.14R(3) requires basis transactions or volatility swaps that would otherwise fall within one of the main asset classes in *MIFIDPRU* 4.14.14R(2) to be allocated to separate asset classes. Those separate asset classes are defined according to the relevant risk factor or pair of risk factors.

(3) For example, an equity index future on Equity Index A and another equity index future on Equity Index B would be allocated to the same asset class under *MIFIDPRU* 4.14.14R(2)(a), as they both fall within the asset class (i.e. equity indices) in *MIFIDPRU* 4.14.22R. However, a volatility swap that references Equity Index A must be allocated to a separate class under *MIFIDPRU* 4.14.14R(3)(b), but can be grouped with another volatility swap that also references Equity Index A (i.e. the same risk factor).

4.14.16 R For the purposes of *MIFIDPRU* 4.14.10R(2)(a), a *firm* must calculate the potential future exposure of derivative contracts included within a *netting set* by:

(1) multiplying the net notional amount under *MIFIDPRU* 4.14.14R(1)(c) for each asset class within the *netting set* by the supervisory factor for that asset class specified in *MIFIDPRU* 4.14.22R;

(2) adding together the product of the calculation in (1) for all asset classes within the *netting set*; and

(3) multiplying the sum under (2) by:

(a) 0.42, for *netting sets* of transactions with financial or non-financial counterparties for which, if required, collateral is exchanged bilaterally with the counterparty in accordance with the conditions laid down in article 11 of *EMIR*; or

(b) 1, for other *netting sets*.

Potential future exposure: derivative netting ratio approach

4.14.17 G (1) If a derivative contract has a negative replacement cost, a *firm* should still calculate a potential future exposure (PFE) in relation to that contract if it is possible for the replacement cost to become positive before the maturity date.

(2) As the replacement cost of an individual written option can never be a positive amount, written options are exempt from the requirement to calculate a PFE, unless they are subject to netting with other derivative contracts for the purposes of calculating PFE in accordance with *MIFIDPRU* 4.14.18R.

4.14.18 R A *firm* must calculate a net potential future exposure for each *netting set* in accordance with the following formula:

$$\mathrm{PFEnet} = \frac{\mathrm{RCnet}}{\mathrm{RCgross}} \cdot \mathrm{PFEgross}$$

where:

(1) PFEnet = the net potential future exposure for the *netting set*

(2) PFEgross = the sum of the potential future exposure of all derivative contracts included in the *netting set*, calculated by multiplying the effective notional amount of each derivative contract (as calculated in accordance with *MIFIDPRU* 4.14.20R) by the relevant supervisory factor for the corresponding asset class specified in *MIFIDPRU* 4.14.22R.

(3) RCnet = the sum of the replacement cost (as determined in accordance with *MIFIDPRU* 4.14.9R) of all transactions included in the *netting set*, unless that sum is a negative amount, in which case RCnet shall be zero.

(4) RCgross = the sum of the replacement cost (as determined in accordance with *MIFIDPRU* 4.14.9R) of all transactions included in the *netting set* that have a positive *CMV*.

4.14.19 R For the purposes of *MIFIDPRU* 4.14.10R(2)(b), the potential future exposure for the derivative contracts included within a *netting set* is the product of multiplying PFEnet (as determined in accordance with *MIFIDPRU* 4.14.18R) by:

(1) 0.42, for *netting sets* of transactions with financial or non-financial counterparties for which, if required, collateral is exchanged bilaterally with the counterparty in accordance with the conditions laid down in article 11 of *EMIR*; or

(2) 1, for other *netting sets*.

Effective notional amount

4.14.20 R (1) The effective notional amount must be calculated as follows:

Effective notional amount = N * D * SD

where:

(a) N = the notional amount, determined in accordance with (2);

(b) D = the duration, calculated in accordance with (3);

(c) SD = the supervisory delta, calculated in accordance with (5).

(2) The notional amount, unless clearly stated and fixed until maturity, must be determined as follows:

(a) for foreign exchange derivative contracts:

(i) if one leg of the contract is in the domestic currency, the notional amount is the notional amount of the foreign currency leg of the contract, converted into the domestic currency;

(ii) if both legs of the contract are denominated in currencies other than the domestic currency, the notional amount of each leg must be converted into the domestic currency and the leg with the larger value in the domestic currency is the notional amount; and

(iii) the term "domestic currency", when used in this *rule*, refers to the currency in which the *firm* reports to the *FCA*;

(b) for equity and commodity derivatives contracts and emissions allowances and derivatives thereof, the notional amount is the product of the market price of one unit of the instrument and the number of units referenced by the trade;

(c) for transactions with multiple pay-offs that are state contingent including digital options or target redemption forwards, a *firm* must calculate the notional amount for each state and use the largest resulting calculation;

(d) where the notional is a formula of market values, the *firm* must use the *CMVs* to determine the trade notional amount;

(e) for variable notional swaps such as amortising and accreting swaps, a *firm* must use the average notional over the remaining life of the swap as the trade notional amount;

(f) leveraged swaps must be converted to the notional amount of the equivalent unleveraged swap so that where all the rates in a swap are multiplied by a factor, the stated notional amount is multiplied by the factor on the interest rates to determine the notional amount; and

(g) for a derivative contract with multiple exchanges of principal, the stated notional amount must be multiplied by the number of exchanges of principal in the derivative contract to determine the notional amount.

(3) The duration must be determined in accordance with the following:

(a) for all derivative contracts other than interest rate contracts and credit derivative contracts, the duration is 1;

(b) for interest rate contracts and credit derivative contracts, the duration is determined in accordance with the following formula in which the time to maturity is specified in years:

Duration = (1 – exp (-0.05 * time to maturity)) / 0.05

(4) The maturity of a contract must be determined as follows:

(a) for an option, the maturity is the latest contractual exercise date as specified by the contract;

(b) for a derivative contact that is structured such that on specified dates, any outstanding exposure is settled and the terms are reset so that the fair value of the contract is zero, the remaining maturity is the time until the next reset date;

(c) for any other derivative contract, the maturity is the latest date on which the contract may still be executed; and

(d) in each case, if the derivative contract references the value of another interest rate or credit instrument, the time period must be determined on the basis of that underlying instrument.

(5) The supervisory delta must be determined as follows:

(a) for options and swaptions, the *firm* may calculate the supervisory delta itself by using an appropriate model if:

(i) the model the *firm* uses meets the minimum standards set out in *MIFIDPRU* 4.12.12G to 4.12.18G (Minimum standards for own estimates of delta), as modified by *MIFIDPRU* 4.14.21R, for each type of option or swaption for which it calculates delta; and

(ii) the *firm* has notified the *FCA* that the minimum standards in (i) are met before the *firm* begins to use its own estimates for the relevant supervisory delta;

(b) for transactions other than options and swaptions, or transactions in respect of which a *firm* is unable to use an appropriate model in accordance with (a), the supervisory delta shall be 1.

[**Note:** article 29(2) to (6) of the *IFR*.]

4.14.21 R (1) When applying the minimum standards in *MIFIDPRU* 4.12.12G to 4.12.18G for the purposes of *MIFIDPRU* 4.14.20R(5)(a), those standards apply with the following modifications:

(a) references to the "standardised approach" should be read as references to the *rules* in this section relating to the calculation of the *K-TCD requirement*; and

(b) references to the *K-NPR requirement* should be read as references to the *K-TCD requirement*.

(2) In addition to the minimum standards in *MIFIDPRU* 4.12.12G to 4.12.18G a *firm* must also confirm to the *FCA* that the relevant model estimates the rate of change of the value of the option with respect to small changes in the market value of the underlying.

[**Note:** article 29(6) of the *IFR*.]

4.14.22 R The supervisory factor for each asset class is set out in the following table:

Asset class	**Supervisory factor**
Interest rate	0.5%

Foreign exchange	4%
Credit	1%
Equity single name	32%
Equity index	20%
Commodity and emission allowance	18%
Other	32%

[**Note:** article 29(7) of the *IFR*.]

4.14.23 R Transactions relating to gold or gold derivatives must be allocated to the foreign exchange asset class in *MIFIDPRU* 4.14.22R.

Value of collateral

4.14.24 R (1) This *rule* applies for the purposes of determining the value of C under *MIFIDPRU* 4.14.8R.

(2) For the transactions specified in *MIFIDPRU* 4.14.3R(1), (5) and (7), the value of the C is the notional amount of collateral received by the *firm*, decreased in accordance with the relevant volatility adjustment specified in *MIFIDPRU* 4.14.25R.

(3) Unless (4) applies, for the transactions specified in *MIFIDPRU* 4.14.3R(2), (3), (4) and (6), the value of the C is the sum of:

(a) the *CMV* of the *security* leg; and

(b) the net amount of collateral posted or received by the *firm*.

(4) For *securities financing transactions* where both legs of the transaction are *securities*, the value of the C is the *CMV* of the *security* borrowed by the *firm*.

(5) Where the *firm* is purchasing or has lent the *security*, the *CMV* of the *security* shall be treated as a negative amount and shall be decreased to a larger negative amount, using the volatility adjustment specified in *MIFIDPRU* 4.14.25R.

(6) Where the *firm* is selling or has borrowed the security, the *CMV* of the *security* shall be treated as a positive amount and be decreased by the volatility adjustment specified in *MIFIDPRU* 4.14.25R.

(7) Where different types of transactions are covered by a contractual netting agreement that meets the requirements in *MIFIDPRU* 4.14.28R(3), the applicable volatility adjustments in column C (volatility adjustment other transactions) of the table in *MIFIDPRU* 4.14.25R must be applied to the respective amounts calculated under (3)(a) and (b) on an issuer basis within each asset class.

(8) Where there is a currency mismatch between the transaction and the collateral received or posted, an additional currency mismatch volatility adjustment of 8% shall apply.

[**Note:** article 30(2) and (3) of the *IFR*.]

4.14.25 R (1) A *firm* must apply the volatility adjustments in (2) for all transactions referred to in *MIFIDPRU* 4.14.3R.

(2) All collateral for both bilateral and cleared transactions shall be subject to volatility adjustments in accordance with the following table:

(A)		**(B)**	**(C)**
Asset class		**Volatility adjustment: repurchase transactions and securities lending and borrowing transactions**	**Volatility adjustment: other transactions**
Debt securities issued by central governments or central banks	≤ 1 year	0.707%	1%
	> 1 year ≤ 5 years	2.121%	3%
	> 5 years	4.243%	6%
Debt securities issued by other entities	≤ 1 year	1.414%	2%
	> 1 year ≤ 5 years	4.243%	6%
	> 5 years	8.485%	12%
Securitisation positions (excluding re-securitisation positions)	≤ 1 year	2.828%	4%
	> 1 year ≤ 5 years	8.485%	12%
	> 5 years	16.970%	24%
Listed equities and convertibles		14.143%	20%

Other financial instruments (including re-securitisation positions) and commodities	17.678%	25%
Gold	10.607%	15%
Cash	0%	0%

[**Note:** article 30(1) of the *IFR*.]

4.14.26 G The references to years in column A of the table in *MIFIDPRU* 4.14.25R are references to the remaining maturity of the relevant security or position.

4.14.27 G The following is an example of how the volatility adjustment under *MIFIDPRU* 4.14.24R and 4.14.25R applies in practice. A *firm* enters into an OTC derivative contract and receives collateral in the form of a debt security issued by a central bank with a maturity of 6 years. The notional value of the debt security is 100. *MIFIDPRU* 4.14.24R(2) requires the notional value of the collateral to be decreased by the applicable volatility adjustment. In accordance with the table in *MIFIDPRU* 4.14.25R, the relevant volatility adjustment is 6%. The resulting value of the collateral after the volatility adjustment had been applied is therefore 94.

Netting

4.14.28 R For the purposes of calculating its *K-TCD requirement* under this section, a *firm* may, in the following order:

(1) first, treat perfectly matching contracts included in a netting agreement as if they were a single contract with a notional principal equivalent to the net receipts;

(2) second, net other transactions subject to novation under which all obligations between the *firm* and its counterparty are automatically amalgamated in such a way that the novation legally substitutes one set single net amount for the previous gross obligations; and

(3) third, net other transactions where the *firm* ensures that the following conditions have been met:

(a) those transactions are covered by netting contract with the counterparty, or by another agreement that creates a single legal obligation, such that the *firm* would have either a claim to receive, or obligation to pay, only the net sum of the positive and negative mark-to-market values of the individual transactions if a counterparty fails to perform due to any of the following:

(i) default;

(ii) bankruptcy;

(iii) liquidation; or

(iv) similar circumstances;

(b) the netting contract does not contain any clause that, in the event of default of a counterparty, permits a non-defaulting counterparty to make limited payments only, or no payments at all, to the estate of the defaulting party even if the defaulting party is a net creditor;

(c) the *firm* has obtained an independent, written and reasoned legal opinion that, in the event of a legal challenge to the netting agreement, the *firm's* claims and obligations would be equivalent to those referred to in (a) under each of the following legal regimes:

(i) the law of the jurisdiction in which the counterparty is incorporated;

(ii) if a foreign branch of a counterparty is involved, the law of the jurisdiction in which the branch is located;

(iii) the law that governs the individual transactions included in the netting agreement; or

(iv) the law that governs any contract or agreement necessary to effect the netting.

[**Note:** article 31 of the *IFR*.]

Risk factor

4.14.29 R The risk factor for a counterparty is set out in the following table:

Counterparty type	**Risk factor**
Central governments, central banks and public sector entities	1.6%
Credit institutions and *investment firms*	1.6%
Other counterparties	8%

Credit valuation adjustment

4.14.30 R (1) For the purposes of this *rule*, the "credit valuation adjustment" (CVA) means an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty that reflects the *CMV* of the credit risk of the counterparty to the *firm*, but does not reflect the *CMV* of the credit risk of the *firm* to the counterparty.

(2) The CVA for all transactions is 1.5, except for the transactions in (3).

(3) The CVA for the following transactions is 1:

(a) the following transactions, if they do not exceed the clearing threshold specified in article 10(3) and (4) of *EMIR*:

(i) transactions with non-financial counterparties (as defined in point (9) of article 2 of *EMIR*); or

(ii) transactions with non-financial counterparties established in a third country;

(b) intra-group transactions as provided for in article 3 of *EMIR*;

(c) *long settlement transactions*;

(d) *securities financing transactions* unless the *FCA* has notified the *firm* that the *firm's* CVA risk exposures arising from those transactions are material;

(e) credits and loans referred to in *MIFIDPRU* 4.14.3R(7).

[**Note:** article 32 of the *IFR*.]

4.15 K-DTF requirement

4.15.1 R (1) The *K-DTF requirement* of a *MIFIDPRU investment firm* is equal to the sum of:

(a) 0.1% of *DTF* attributable to *cash trades*; and

(b) 0.01% of *DTF* attributable to *derivatives trades*.

(2) A *firm* must calculate its *DTF* in accordance with the *rules* in this section.

[**Note:** article 15 of the *IFR*.]

4.15.2 G (1) The definition of *DTF* includes transactions that a *firm* enters into when *dealing on own account* or when executing client orders in the *firm's* own name.

(2) A *firm* that has *permission* to *operate an organised trading facility* may engage in:

(a) *matched principal trading* in certain types of *financial instruments* with *client* consent, in accordance with *MAR* 5A.3.5R(1); and/or

(b) *dealing on own account* in illiquid *sovereign debt* instruments in accordance with *MAR* 5A.3.5R(2).

Where a *firm* engages in either activity, it must include those transactions in the calculation of its *DTF*.

(3) Except for the transactions in (2), *DTF* does not include orders that a *firm* handles in the course of *operating an organised trading facility*. However, *DTF* will include transactions entered into by a *firm* in its own name through an *organised trading facility* where the *firm* is not operating that *organised trading facility*.

4.15.3 R A *firm* must calculate its *K-DTF requirement* on the first *business day* of each *month*.

[**Note:** article 33(1), third paragraph of the *IFR*.]

4.15.4 R (1) A *firm* must calculate the amount of its *DTF* as:

(a) the rolling average of the value of the total *daily trading flow*;

(b) measured throughout each *business day* over the previous 9 *months*;

(c) excluding the most recent 3 *months*,

(2) A *firm* must calculate the rolling average in (1) as the arithmetic mean of the daily values for the remaining 6 *months*, after the values in (1)(c) have been excluded.

[**Note:** article 33(1), first and second paragraphs of the *IFR*.]

4.15.5 R (1) When measuring its *DTF*, a *firm* must use the sum of the absolute value of each buy order and sell order, as determined in accordance with the remainder of this *rule*.

(2) For *cash trades* relating to *financial instruments*, the value of the order is the amount paid or received on the trade.

(3) For *derivatives trades* other than orders relating to interest rate derivatives, the value of the order is the notional amount of the contract, determined in accordance with *MIFIDPRU* 4.14.20R(2).

(4) For orders relating to interest rate derivatives, the value of the order is the notional amount of the contract determined in accordance with *MIFIDPRU* 4.14.20R(2), adjusted in accordance with *MIFIDPRU* 4.15.7R.

4.15.6 G For *cash trades* relating to exchange-traded options, the amount paid or received on the trade under *MIFIDPRU* 4.15.5R(2) is the premium paid for the option.

4.15.7 R (1) For the purposes of *MIFIDPRU* 4.15.5R(4), a *firm* must adjust the notional amount of an interest rate derivative by multiplying that notional amount by the duration.

(2) For the purposes of (1), the duration must be determined in accordance with the following formula:

Duration = time to maturity (in years) / 10

[**Note:** article 33(2), second subparagraph of the *IFR*.]

4.15.8 G When calculating *DTF* for the purposes of *MIFIDPRU* 4.15.4R, a *firm* must:

(a) include transactions executed by a *firm* in its own name either for itself or on behalf of a *client*; and

(b) exclude transactions executed by the *firm* for the purpose of providing *portfolio management* services on behalf of investment funds.

[**Note:** article 33(3) of the *IFR*.]

4.15.9 R (1) This *rule* applies where a *firm* has had a *daily trading flow* for less than 9 *months*.

(2) For the purposes of its calculation of *DTF* under *MIFIDPRU* 4.15.4R, a *firm* must use:

(a) historical data for the relevant period as soon as such data becomes available; or

(b) such other amounts as the *FCA* may specify to replace any missing data points, based on the business projections that the *firm* submitted to the *FCA* when obtaining *permission* to perform the relevant activities.

4.16 K-CON requirement

4.16.1 G *MIFIDPRU* 5 contains the provisions relating to the calculation of the *K-CON requirement* of a *MIFIDPRU investment firm*.

5 Concentration risk

5.1 Application and purpose

Application: Who?

5.1.1 R This chapter applies to:

(1) a *MIFIDPRU investment firm*; and

(2) a *UK parent entity* that is required by *MIFIDPRU* 2.5.7R to comply with *MIFIDPRU* 5 on the basis of its *consolidated situation*.

5.1.2 R Where this chapter applies on the basis of the *consolidated situation* of the *UK parent entity*, any references to a "*firm*" or "*MIFIDPRU investment firm*" in this chapter are to be interpreted as references to the hypothetical single *MIFIDPRU investment firm* created under the *consolidated situation*.

5.1.3 G *MIFIDPRU* 2.5.45G and 2.5.46G contain additional *guidance* on how a *UK parent entity* should apply the requirements in this chapter on a *consolidated basis*.

5.1.4 G *MIFIDPRU* 5.2 to 5.10 do not apply to a *commodity and emission allowance dealer* in the circumstances set out in *MIFIDPRU* 5.11.

Application: What?

5.1.5 R *MIFIDPRU* 5.2 applies to all of a *firm's* activities which may give rise to *concentration risk*.

5.1.6 G *MIFIDPRU* 5.2 is therefore relevant to a *MIFIDPRU investment firm* that *deals on own account* and one that does not (e.g. an *SNI MIFIDPRU investment firm*).

5.1.7 R *MIFIDPRU* 5.3 to 5.10 apply to a *firm* when *dealing on own account* in relation to transactions which are recorded in the *trading book*.

[**Note:** article 24 of the *IFR*.]

5.1.8 G *MIFIDPRU* 5.3 to 5.10 apply whether a *firm* is *dealing on own account* for itself or on behalf of a *client*.

5.1.9 G A *MIFIDPRU investment firm* that has *permission* to *operate an organised trading facility* may rely on that *permission* to:

(1) engage in *matched principal trading* in certain types of *financial instruments* with *client* consent, in accordance with *MAR* 5A.3.5R(1); and

(2) *deal on own account* in illiquid sovereign debt instruments in accordance with *MAR* 5A.3.5R(2).

In either case, the *firm* will be *dealing on own account* and is therefore subject to the requirements in *MIFIDPRU* 5.3 to 5.10 to the extent relevant to the transactions it undertakes.

Purpose

5.1.10 G This chapter contains:

(1) *Rules* and *guidance* on how a *MIFIDPRU investment firm* must monitor and control *concentration risk* (*MIFIDPRU* 5.2).

(2) *Rules* and *guidance* on the concentration risk requirements that apply to the *trading book* exposures of a *MIFIDPRU investment firm* that is *dealing on own account* (*MIFIDPRU* 5.3 to 5.10). An overview of these requirements is set out in *MIFIDPRU* 5.3.

(3) *Rules* and *guidance* on when a *commodity and emission allowance dealer* will be exempt from the requirements of this chapter (*MIFIDPRU* 5.11).

Interpretation

5.1.11 G In this chapter, references to *client* include any counterparty of the *firm*.

5.1.12 R Subject to *MIFIDPRU* 5.1.13R to *MIFIDPRU* 5.1.16R, a *group of connected clients* means:

(1) two or more *persons* who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has *control* over the other or others; or

(2) two or more *persons* between whom there is no relationship of *control* as described in (1) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would also be likely to encounter funding or repayment difficulties.

5.1.13 R Where a central government has direct *control* over, or is directly interconnected with, more than one *person*, they do not all have to be treated as a single *group of connected clients*. Instead, the existence of a *group of connected clients* may be assessed separately at the level of each *person* directly *controlled* by or directly interconnected with the central government, which must include all of the natural and legal *persons* which are *controlled* by or interconnected with that *person*, including the central government.

5.1.14 R Regional governments and local authorities may be treated in the same way as central governments under *MIFIDPRU* 5.1.13 if there is no difference in the risk they pose compared to central governments.

5.1.15 G (1) There may be no difference in the risk posed by a regional government or local authority if it has specific revenue-raising powers, or if there are specific institutional arrangements which reduce the risk of default.

(2) The *PRA* maintains a list of all regional governments and local authorities within the *United Kingdom* which it treats as exposures to the central government of the *United Kingdom*, in accordance with Article 115 of the *UK CRR*.

5.1.16 R Two or more *persons* do not constitute a single *group of connected clients* solely because of their direct exposure to the same *central counterparty* for clearing purposes.

[**Note:** article 4(1)(19) of the *IFR*.]

Exposures to trustees

5.1.17 R For the purposes of this chapter, if a *firm* has an exposure to a *person* ('A') when A is acting on its own behalf, and also an exposure to A when A acts in the capacity of trustee, custodian or general partner of an investment trust, unit trust, venture capital or other investment fund, pension fund or a similar fund (a "fund"), the *firm* may treat the latter exposure as if it was to the fund as a separate *client*, unless such treatment would be misleading.

5.1.18 G When considering whether such treatment would be misleading, a *firm* should consider factors such as:

(1) the degree of independence of control of the fund, including the relation of the fund's board and senior management to the *firm* or to other funds or to both;

(2) the terms on which the counterparty, when acting as trustee, is able to satisfy its obligation to the *firm* out of the fund of which it is trustee;

(3) whether the beneficial owners of the fund are connected to the *firm*, or related to other funds managed within the *firm's* group, or both; and

(4) for a counterparty that is connected to the *firm* itself, whether the exposure arises from a transaction entered into on an arm's length basis.

5.1.19 G In deciding whether a transaction is at arm's length, the following factors should be taken into account:

(1) the extent to which the *person* to whom the *firm* has an exposure ('A') can influence the *firm's* operations through, for example, the exercise of voting rights;

(2) the management role of A where A is also a director of the *firm*; and

(3) whether the exposure would be subject to the *firm's* usual monitoring and recovery procedures if repayment difficulties emerged.

5.2 Monitoring obligation

5.2.1 R A *firm* must monitor and control its *concentration risk* by means of sound administrative and accounting procedures and robust internal control mechanisms.

[**Note:** article 35(1) of the *IFR*.]

5.2.2 G *MIFIDPRU* 5.2.1R requires a *firm* to monitor and control all sources of *concentration risk*. This is not limited to *trading book* exposures, but also encompasses any concentration in assets not recorded in a *trading book* (for example, trade debts) and off-balance sheet items. It also includes any *concentration risk* that may arise from the following aspects:

(1) the location of *client money*;

(2) the location of *custody assets*;

(3) a *firm's* own cash deposits; and

(4) earnings.

5.3 Overview of concentration risk requirements for dealing on own account

5.3.1 G *MIFIDPRU* 5.4 to 5.10 contain the concentration risk requirements which apply to the *trading book* exposures of a *MIFIDPRU investment firm* that is *dealing on own account*:

(1) *MIFIDPRU* 5.4 explains how a *firm* should calculate the value of its exposure to each *client* or *group of connected clients* (the *exposure value* or *EV*).

(2) *MIFIDPRU* 5.5.1R explains how a *firm* should calculate the *concentration risk soft limit* for its exposure to a *client* or *group of connected clients*.

(3) *MIFIDPRU* 5.5.3R explains how a *firm* should calculate the value by which its exposure to each *client* or *group of connected clients* exceeds the *concentration risk soft limit* (the *exposure value excess* or *EVE*). The *EVE* is relevant to the calculation of the *K-CON requirement*.

(4) *MIFIDPRU* 5.6 contains the obligation to calculate the *K-CON requirement* and to notify the *FCA* if the value of a *firm's* exposure to a *client* or *group of connected clients* exceeds the *concentration risk soft limit*.

(5) *MIFIDPRU* 5.7 explains how to calculate the *K-CON requirement*.

(6) *MIFIDPRU* 5.8 contains *rules* designed to prevent *firms* from avoiding the *K-CON requirement*.

(7) *MIFIDPRU* 5.9 contains the 'hard' concentration risk limits, and associated provisions.

(8) *MIFIDPRU* 5.10 excludes certain exposures from the concentration risk requirements in *MIFIDPRU* 5.4 to 5.9.

5.4 Calculation of exposure value (EV)

5.4.1 R For the purposes of *MIFIDPRU* 5.5 to 5.10, a *firm* must calculate an *exposure value* (*EV*) for each *client* or *group of connected clients* by adding together the following items:

(1) the positive excess of the *firm's* long positions over its short positions in all the *trading book financial instruments* issued by the *client* in question, using the approach specified for K-NPR in *MIFIDPRU* 4.12.2R to calculate the net position for each instrument; and

(2) the exposure value of contracts and transactions referred to in *MIFIDPRU* 4.14.3R with the *client* in question, calculated using the approach specified for K-TCD in *MIFIDPRU* 4.14.8R.

[**Note:** article 36(1) of the *IFR*.]

5.4.2 R For the purposes of *MIFIDPRU* 5.4.1R(1), where a *firm* calculates a *K-CMG requirement* in relation to a *portfolio*, it must calculate its net position for the exposures in that *portfolio* using the approach specified for K-NPR in *MIFIDPRU* 4.12.2R.

[**Note:** article 36(1) of the *IFR*.]

5.4.3 R The *exposure value* with regard to a *group of connected clients* must be calculated by adding together the exposures to the individual *clients* within the group, which must be treated as a single exposure.

[**Note:** article 36(2) of the *IFR*.]

5.4.4 R When calculating *exposure values*, a *firm* must take all reasonable steps to identify underlying assets in relevant transactions and the counterparty of the underlying exposures.

[**Note:** article 36(3) of the *IFR*.]

5.5 The concentration risk soft limit and exposure value excess

The concentration risk soft limit

5.5.1 R (1) The *concentration risk soft limit* for *exposure values* to an individual *client* or *group of connected clients* is 25% of a *firm's own funds*, subject to (2) and (3).

(2) Where an individual *client* is a *MIFIDPRU-eligible institution*, the *concentration risk soft limit* for that *client* is the higher of:

(a) 25% of the *firm's own funds*; or

(b) £150 million or 100% of the *firm's own funds*, whichever is the lower.

(3) Where a *group of connected clients* includes one or more *MIFIDPRU-eligible institutions*, the *concentration risk soft limit* for the group is the higher of:

(a) 25% of the *firm's own funds*; or

(b) £150 million or 100% of the *firm's own funds*, whichever is the lower, provided that for the sum of *exposure values* with regard to all connected *clients* that are not *MIFIDPRU-eligible institutions*, the *concentration risk soft limit* remains at 25% of the *firm's own funds*.

[**Note:** article 37(1) of the *IFR*.]

5.5.2 G The *Handbook* definition of *MIFIDPRU-eligible institution* includes private or public *undertakings*, including the branches of such *undertakings*, provided that those *undertakings*, if they were established in the *UK*, would be *UK credit institutions* or *MIFIDPRU investment firms*, and provided that those *undertakings* have been authorised in a *third country* that applies prudential supervisory and regulatory requirements comparable to those applied in the *UK*.

[**Note:** article 35(2) of the *IFR*.]

The exposure value excess (EVE)

5.5.3 R (1) A *firm* that exceeds the *concentration risk soft limit* for a *client* or *group of connected clients* must calculate the *exposure value excess* (*EVE*).

(2) A *firm* must calculate the *EVE* for an individual *client* or *group of connected clients* in accordance with the following formula:

$$EVE = EV - \mathrm{L}$$

where:

L = the *concentration risk soft limit* specified in *MIFIDPRU* 5.5.1R.

[**Note:** article 37(2) of the *IFR*.]

5.6 Obligations for a firm that exceeds the concentration risk soft limit

5.6.1 R For as long as a *firm* exceeds the *concentration risk soft limit* for one or more *clients* or *groups of connected clients*, it must calculate the *K-CON requirement*.

5.6.2 R When a *firm* exceeds the *concentration risk soft limit* for a *client* or *group of connected clients*, it must notify the *FCA* without delay of the amount of the *EVE*, and the name of the individual *client* or *group of connected clients*.

[**Note:** article 37(2) of the *IFR*.]

5.6.3 R A *firm* must make the notification referred to in *MIFIDPRU* 5.6.2R using the form in *MIFIDPRU* 5 Annex 1R, and must submit it according to the instructions on the form.

5.7 Calculating K-CON

5.7.1 R The *K-CON requirement* of a *MIFIDPRU investment firm* is equal to the sum of the *CON own funds requirements* for each *client* or *group of connected clients* for which the *EV* exceeds the *concentration risk soft limit*.

[**Note:** article 39(1) of the *IFR*.]

5.7.2 R The *CON own funds requirement* for each *client* or *group of connected clients* in *MIFIDPRU* 5.7.1R must be calculated by:

(1) determining the *OFRE* in accordance with *MIFIDPRU* 5.7.3R; and

(2) applying the relevant multiplication factor or factors in accordance with *MIFIDPRU* 5.7.4R.

[**Note:** article 39(1) of the *IFR*.]

5.7.3 R (1) The *OFRE* must be calculated using the following formula:

$$OFRE = \frac{OFR}{EV} \times EVE$$

(2) (a) The *OFR* for an individual *client* is the sum of:

(i) the *TCD own funds requirement* for exposures to that *client*; and

(ii) the *K-NPR requirement* for the exposures to that *client*, subject to (b).

(b) Where exposures arise from the positive excess of a *firm's* long positions over its short positions in all the *trading book financial instruments* issued by the *client* in question, the net position of each instrument calculated in accordance with the approach specified for K-NPR in *MIFIDPRU* 4.12.2R shall only include specific-risk requirements.

(c) A *firm* that calculates a *K-CMG requirement* in relation to a *portfolio* must calculate the *OFR* using the approach specified for K-NPR in *MIFIDPRU* 4.12.2R, subject to (b).

(d) The *OFR* for a *group of connected clients* must be calculated by adding together the exposures to individual *clients* within the group, and then determining a single own funds requirement for exposures to the group as if the group were a single *undertaking*.

[**Note:** article 39(2) of the *IFR*.]

5.7.4 R (1) Where the excess has persisted for 10 *business days* or less, the *CON own funds requirement* is the *OFRE* multiplied by 200%.

(2) Where the excess has persisted for more than 10 *business days*:

(a) the *EVE* must be apportioned according to the tranches in each row of Column 1 of Table [X];

(b) the proportion of the *EVE* in each tranche must be calculated as a percentage of the overall *EVE*;

(c) the *OFRE* must be pro-rated according to the proportion of *EVE* falling within each tranche;

(d) each portion of the *OFRE* must be multiplied by the relevant Factor in Column 2 of Table [X]; and

(e) the *CON own funds requirement* is the sum of the amounts calculated in accordance with (d).

(3)

Table [X]	
Column 1: ***EVE* as a percentage of own funds**	**Column 2: Factors**
For the amount up to and including 40 %	200 %
For the amount over 40 % up to and including 60 %	300 %
For the amount over 60 % up to and including 80 %	400 %
For the amount over 80 % up to and including 100 %	500 %
For the amount over 100 % up to and including 250 %	600 %
For the amount over 250 %	900 %

[**Note:** article 39(1) of the *IFR*.]

5.7.5 G (1) K-CON is an additional *K-factor* own funds requirement in respect of *concentration risk* in the *trading book.*

(2) A *firm* must calculate a *CON own funds requirement* for each *client* or *group of connected clients* for which the *exposure value* exceeds the *concentration risk soft limit*. The *CON own funds requirement* for each *client* or *group of connected clients* is then added together to arrive at the *K-CON requirement*.

(3) Determining the *CON own funds requirement* for each *client* or *group of connected clients* involves a two-step calculation:

(a) The first step involves an exposure-based calculation, known as the *OFRE* (the own funds requirement for the excess).

(b) The second step involves applying a multiplying factor to the *OFRE* (or applying different multiplying factors to tranches of the *OFRE*) based on the length of time for which the excess has persisted and by how much (as a percentage of own funds) the *exposure value* exceeds the *concentration risk soft limit*.

(4) The reference to how long an excess has persisted for relates to how long a *firm* has had an exposure to a *client* or *group of connected clients* that exceeds the *concentration risk soft limit*, irrespective of whether the constituent parts that make up that total exposure change over the duration of that total exposure.

(5) The 10-*business day* period referred to in *MIFIDPRU* 5.7.4R runs from the start of the *business day* on which the excess occurred.

5.7.6 G The following example illustrates how to calculate the *CON own funds requirement* for an excess to a *client* that has persisted for 10 *business days* or less:

(1) A *firm* has:

(a) *own funds* of 1000;

(b) a *concentration risk soft limit* of 250 (25% of 1000);

(c) an *EV* of 262; and

(d) an *EVE* of 12 (262 - 250 = 12).

(2) The exposure is all due to debt securities which have a specific risk own funds requirement of 8% (according to Table 1 in Article 336 of *UK CRR*) for the purposes of K-NPR. There is zero K-TCD to this *client*.

In this example, the *OFR* = 262 × 8% = 20.96

(3) To calculate the *OFRE*:

OFRE = *OFR*/*EV***EVE* = 20.96/262 ×12 = 0.96

(4) As the excess has persisted for 10 *business days* or less:

CON own funds requirement = 0.96 × 200% = 1.92

5.7.7 G The following example illustrates how to calculate the *CON own funds requirement* for an excess that has persisted for more than 10 *business days*:

(1) A *firm* has:

(a) *own funds* of 1000;

(b) a *concentration risk soft limit* of 250 (25% of 1000);

(c) an *EV* of 780; and

(d) an *EVE* of 530 (780 - 250 = 530).

(2) The exposure is all due to debt securities which have a specific risk own funds requirement of 8% (according to Table 1 in Article 336 of *UK CRR*) for the purposes of K-NPR. There is zero K-TCD to this client.

In this example, the *OFR* = 780 × 8% = 62.4

(3) To calculate the *OFRE*:

OFRE = *OFR*/*EV***EVE* = 62.4/780 × 530 = 42.4

(4) As the excess has persisted for more than 10 *business days*, the *CON own funds requirement* is calculated by apportioning the *OFRE* in accordance with the relevant *EVE* tranche in Table [X], multiplying each part of the *OFRE* by the applicable factor, and then adding the resulting amounts together:

Application of Table [X]			
K-CON factor tranche as per Table [X]	*EVE* split by tranche	*OFRE* allocated across K-CON tranche by *EVE* split	*CON own funds requirement* (*OFRE* × factor in Table [X])
Up to 40%	400	400/530 × 42.4 = 32	32 × 200% = 64
40%-60%	130	130/530 × 42.4 = 10.4	10.4 × 300% = 31.2
Total:	530	42.4	95.2

(5) The *CON own funds requirement* is the total amount in the last column, 95.2.

5.8 Procedures to prevent investment firms from avoiding the K-CON own funds requirement

5.8.1 R A *firm* must not deliberately avoid the *K-CON requirement* by:

(1) undertaking artificial transactions to close out an exposure and create a new exposure; or

(2) temporarily transferring an exposure to another *undertaking*, whether within the same group or not.

[**Note:** article 40(1) of the *IFR*.]

5.8.2 R A *firm* must maintain systems which ensure that any closing out or transfer that is prohibited by *MIFIDPRU* 5.8.1R is immediately reported to the *FCA* in accordance with *SUP* 15.7.

[**Note:** article 40(2) of the *IFR*.]

5.9 The 'hard' limits on concentration risk

5.9.1 R (1) Whilst an exposure exceeding the *concentration risk soft limit* has persisted for 10 *business days* or less, a *firm's EV* for the individual *client* or *group of connected clients* must not exceed 500 % of the *firm's own funds*.

(2) Whilst a *firm* has one or more exposures exceeding the *concentration risk soft limit* that have persisted for more than 10 *business days*, the aggregate *EVEs* for all such exposures must not exceed 600% of the *firm's own funds*.

[**Note:** article 37(3) of the *IFR*.]

5.9.2 G (1) An exposure exceeding the *concentration risk soft limit* persists for as long as the overall exposure exceeds the *concentration risk soft limit*, irrespective of whether the constituent parts that make up that total exposure change over the duration of that total exposure.

(2) For the purpose of *MIFIDPRU* 5.9.1R(2), the 600% limit applies to the aggregate of all individual *EVEs* for excesses that have persisted for more than 10 *business days*, irrespective of whether the individual concentrated exposures are connected to one another.

(3) The 10-*business day* period referred to in *MIFIDPRU* 5.9.1R runs from the start of the *business day* on which the excess occurred.

5.9.3 R If a *firm* breaches the requirement in *MIFIDPRU* 5.9.1R, it must notify the *FCA* without delay of:

(1) the amounts of the exposure or exposures which give rise to the breach;

(2) the name or names of the *clients* concerned; and

(3) any steps which the *firm* or any other *person* has taken or intends to take to rectify the breach and prevent any future potential occurrence.

[**Note:** article 38(1) of the *IFR*.]

5.9.4 R A *firm* must make the notification referred to in *MIFIDPRU* 5.9.3R using the form in *MIFIDPRU* 5 Annex 1R, and must submit it according to the instructions on the form.

5.10 Exclusions

5.10.1 R The requirements in *MIFIDPRU* 5.4 to 5.9 do not apply to the following exposures:

(1) exposures which are entirely deducted from a *MIFIDPRU investment firm's own funds*;

(2) exposures incurred in the ordinary course of the settlement of payment services, foreign currency transactions, securities transactions and the provision of money transmission;

(3) exposures constituting claims against:

(a) central governments, central banks, public sector entities, international organisations or multilateral development banks and exposures guaranteed by or attributable to such *persons*, where those exposures would receive a 0 % risk weight under Articles 114 to 118 of the *UK CRR*;

(b) the regional governments and *local authorities* of the *UK*; and

(c) *central counterparties* and default fund contributions to *central counterparties*;

(4) exposures incurred by a *firm* to its *parent undertaking*, to other *subsidiaries* or *connected undertakings* of that *parent undertaking* or to its own *subsidiaries* or *connected undertakings*, insofar as those *undertakings* are supervised on a consolidated basis in accordance with *MIFIDPRU* 2.5 or with *UK CRR*, are supervised for compliance with the *group capital test* in accordance with *MIFIDPRU* 2.6, or are supervised in accordance with comparable standards in force in a *third country*, and provided that the following conditions are met:

(a) there is no current or foreseen material practical or legal impediment to the prompt transfer of capital or repayment of liabilities; and

(b) the risk evaluation, measurement and control procedures of the *parent undertaking* include the *firm* and any relevant *subsidiary* or *connected undertaking*.

[**Note:** article 41 of the *IFR*.]

5.11 Exemption for commodity and emission allowance dealers

5.11.1 R A *commodity and emission allowance dealer* is not required to comply with *MIFIDPRU* 5.2 to 5.10 where all of the following conditions are met:

(1) the other counterparty is a non-financial counterparty;

(2) both counterparties are subject to appropriate centralised risk evaluation, measurement and control procedures;

(3) the transaction can be assessed as reducing risks directly relating to the commercial activity or treasury financing activity of the non-financial counterparty or of that group; and

(4) the *firm* complies with *MIFIDPRU* 5.11.2R.

[**Note:** article 42(1) of the *IFR*.]

5.11.2 R (1) Before relying on the exemption in *MIFIDPRU* 5.11.1R, a *firm* must notify the *FCA*.

(2) A *firm* must notify the *FCA* annually thereafter in order to continue to rely on the exemption in *MIFIDPRU* 5.11.1R.

(3) The notification must explain how the *firm* expects to meet or continue to meet the conditions in *MIFIDPRU* 5.11.1R.

(4) In the event of a material change to the information provided in (1) or (2), a *firm* must notify the *FCA* without delay.

(5) The notifications in (1), (2) and (4) must be made using the form in *MIFIDPRU* 5 Annex 2R, and must be submitted according to the instructions on the form.

[**Note:** article 42(2) of the *IFR*.]

Notification to FCA that limits for concentration risk have been exceeded

5 Annex 1 R [*Editor's note*: The form can be found at this address: https://www.fca.org.uk/publication/forms/[xxx]]

Notification to FCA of use of exemption for commodity and emission allowance dealers

5 Annex 2 R [*Editor's note*: The form can be found at this address: https://www.fca.org.uk/publication/forms/[xxx]]

9 Reporting

9.1 Application

9.1.1 R This chapter applies to:

(1) a *MIFIDPRU investment firm*;

(2) a *UK parent entity* that is required under *MIFIDPRU* 2.5.7R to comply with *MIFIDPRU* 9 on the basis of its *consolidated situation*; and

(3) a *parent undertaking* that is required to submit reports on its compliance with the *group capital test* in accordance with *MIFIDPRU* 2.6.10R.

9.1.2 R (1) The provisions of *SUP* 16.3 (General provisions on reporting) specified in (2) apply to reports submitted under this chapter as if such reports had been submitted under *SUP* 16.

(2) The provisions are:

(a) *SUP* 16.3.6R to *SUP* 16.3.10G (How to submit reports);

(b) *SUP* 16.3.11R to *SUP* 16.3.12G (Complete reporting); and

(c) *SUP* 16.3.14R to *SUP* 16.3.16G (Failure to submit reports).

9.1.3 G *Firms* should note that under *SUP* 16.3.14R (as applied to reports under this chapter by *MIFIDPRU* 9.1.2R), a £250 administrative fee applies where a *firm* does not submit a complete report by the date on which that report is due in accordance with the applicable requirements and submission procedures. *SUP* 16.3.14AG explains that the *FCA* may also take disciplinary action in appropriate cases.

9.2 Periodic reporting requirements

9.2.1 R A *non-SNI MIFIDPRU investment firm* must:

(1) submit the *data items* specified in column (A) of the table in *MIFIDPRU* 9.2.2R to the *FCA* with the frequency specified in column (C) of that table;

(2) complete the *data items* in (1) with data that reflect the position as at the relevant reporting reference date specified in column (D) of the table in *MIFIDPRU* 9.2.2R; and

(3) submit the *data items* in (1) before the submission deadline in column (E) of the table in *MIFIDPRU* 9.2.2R.

[**Note:** article 54(1) of the *IFR*.]

9.2.2 R The following table belongs to *MIFIDPRU* 9.2.1R:

(A) *Data item*	(B) *Data item* description	(C) Reporting frequency	(D) Reporting reference dates	(E) Submission deadline
MIF001	Capital	Quarterly	Last *business day* in: (1) March; (2) June; (3) September; (4) December	20 *business days* after the reporting reference date
MIF002	Liquidity	Quarterly	Last *business day* in: (1) March; (2) June; (3) September; (4) December	20 *business days* after the reporting reference date
MIF003	Metrics monitoring	Quarterly	Last *business day* in: (1) March; (2) June; (3) September; (4) December	20 *business days* after the reporting reference date
MIF004	Non-K-CON concentration risk reporting	Quarterly	Last *business day* in: (1) March; (2) June; (3) September;	20 *business days* after the reporting reference date

			(4) December	
MIF005	K-CON concentration risk reporting	Quarterly	Last *business day* in: (1) March; (2) June; (3) September; (4) December	20 *business days* after the reporting reference date

9.2.3 R An *SNI MIFIDPRU investment firm* must:

(1) submit the *data items* specified in column (A) of the table in *MIFIDPRU* 9.2.4R to the *FCA* with the frequency specified in column (C) of that table;

(2) complete the *data items* in (1) with data that reflect the position as at the relevant reporting reference date specified in column (D) of the table in *MIFIDPRU* 9.2.4R; and

(3) submit the *data items* in (1) before the submission deadline in column (E) of the table in *MIFIDPRU* 9.2.4R.

[**Note:** article 54(1), second paragraph and 54(2) third paragraph of the *IFR*.]

9.2.4 R The following table belongs to *MIFIDPRU* 9.2.3R:

(A) ***Data item***	**(B)** ***Data item* description**	**(C)** **Reporting frequency**	**(D)** **Reporting reference dates**	**(E)** **Submission deadline**
MIF001	Capital	Quarterly	Last *business day* in: (1) March; (2) June; (3) September;	20 *business days* after the reporting reference date

			(4) December	
MIF002 (Note 1)	Liquidity	Quarterly	Last *business day* in: (1) March; (2) June; (3) September; (4) December	20 *business days* after the reporting reference date
MIF003	Metrics monitoring	Quarterly	Last *business day* in: (1) March; (2) June; (3) September; (4) December	20 *business days* after the reporting reference date
Note 1	If, exceptionally, the *FCA* has exempted an *SNI MIFIDPRU investment firm* from the liquidity requirements in *MIFIDPRU* [6][15], the *firm* is not required to submit MIF002.			

9.2.5 R Where a *firm* is required to submit any of *data items* MIF001 to MIF005 under *MIFIDPRU* 9.2.1R or 9.2.3R, it must submit those *data items*:

(1) in the format specified in *MIFIDPRU* 9 Annex 1R; and

(2) in accordance with the instructions in *MIFIDPRU* 9 Annex 2G.

9.2.6 R Where an *investment firm group* contains multiple *MIFIDPRU investment firms*, those *firms* may designate a single *MIFIDPRU investment firm* or the *UK parent entity* to submit all necessary *data items* under this section on their behalf.

9.2.7 G Where a *MIFIDPRU investment firm* ("A") designates another *MIFIDPRU investment firm* or a *UK parent entity* ("B") to submit

[15] *Editor's note*: The FCA intends to consult on the liquidity requirements in MIFIDPRU 6 in a future consultation paper.

data items in accordance with *MIFIDPRU* 9.2.6R, A remains responsible for the timely submission and the accuracy of any *data items* submitted by B on A's behalf.

9.3 Reporting on a consolidated basis

9.3.1 R (1) A *UK parent entity* that is required by *MIFIDPRU* 2.5.7R to comply with this chapter on a *consolidated basis* must:

(a) if it is treated as a *non-SNI MIFIDPRU investment firm* in accordance with *MIFIDPRU* 2.5.21R, submit *data items* in accordance with *MIFIDPRU* 9.2.1R on the basis of its *consolidated situation*; or

(b) if it is treated as an *SNI MIFIDPRU investment firm* in accordance with *MIFIDPRU* 2.5.21R, submit *data items* in accordance with *MIFIDPRU* 9.2.3R on the basis of its *consolidated situation*.

(2) For the purposes of (1), *MIFIDPRU* 9.2 applies with the following modifications:

(a) any reference to a "*firm*" is to be interpreted as a reference to the hypothetical single *MIFIDPRU investment firm* created under the *consolidated situation*; and

(b) the submission deadline for consolidated *data items* under column (E) of the tables in *MIFIDPRU* 9.2.2R and *MIFIDPRU* 9.2.4R is 30 *business days* after the reporting reference date.

9.3.2 G *MIFIDPRU* 2.5 contains guidance on how to apply the requirements in *MIFIDPRU* on the basis of the *consolidated situation* of a *UK parent entity*. That guidance may assist a *UK parent entity* in completing the *data items* required under this section.

9.4 Group capital test reporting

9.4.1 R A *parent undertaking* that is required to report on the *group capital test* under *MIFIDPRU* 2.6.10R must:

(1) submit the *data item* specified in column (A) of the table in *MIFIDPRU* 9.4.2R to the *FCA* with the frequency specified in column (C) of that table;

(2) complete the *data item* in (1) with data that reflect the position as at the relevant reporting reference date specified in column (D) of the table in *MIFIDPRU* 9.4.2R; and

(3) submit the *data item* in (1) before the submission deadline in column (E) of the table in *MIFIDPRU* 9.4.2R.

9.4.2 R The following table belongs to *MIFIDPRU* 9.4.1R:

(A) ***Data item***	**(B)** ***Data item* description**	**(C)** **Reporting frequency**	**(D)** **Reporting reference dates**	**(E)** **Submission deadline**
MIF006	Group capital test reporting	Quarterly	Last *business day* in: (1) March; (2) June; (3) September; (4) December	20 *business days* after the reporting reference date

9.4.3 R (1) This *rule* applies where:

(a) a *parent undertaking* is a *responsible UK parent*; and

(b) *MIFIDPRU* 2.6.10R(2)(b)(i) applies in relation to a *subsidiary* of that *responsible UK parent* which is a *parent undertaking* established in a *third country*.

(2) Where this *rule* applies, the *responsible UK parent* must submit an additional *data item* in accordance with *MIFIDPRU* 9.4.1R which reflects the position of the *subsidiary* in (1)(b).

9.4.4 R Where a *parent undertaking* is required to submit *data item* MIF006 under *MIFIDPRU* 9.4.1R or 9.4.3R, it must submit that *data item*:

(1) in the format specified in *MIFIDPRU* 9 Annex 1R; and

(2) in accordance with the instructions in *MIFIDPRU* 9 Annex 2G.

9.4.5 G *Parent undertakings* are reminded that under *MIFIDPRU* 2.6.11R, they may designate a single *parent undertaking* in the *UK* to submit *data items* to the *FCA* on behalf of all *parent undertakings* within the same *investment firm group* to which this section applies. However, each *parent undertaking* remains responsible for ensuring the timely submission and the accuracy of any *data items* submitted on its behalf.

Data items for MIFIDPRU 9

9 Annex 1 R This annex consists of forms which can be found through the following link:

[*Editor's note*: insert link to document containing data items for MIFIDPRU 9 reporting]

Guidance notes on data items in MIFIDPRU 9 Annex 1R

9 Annex 2 G This annex consists of guidance which can be found through the following link:

[*Editor's note*: insert link to document containing guidance on completing data items in MIFIDPRU 9 Annex 1R]

TP 1 Own funds transitional provisions

Application

1.1 R *MIFIDPRU* TP 1 applies to:

(1) a *MIFIDPRU investment firm*; and

(2) a *UK parent entity* that is required by *MIFIDPRU* 2.5.7R to comply with *MIFIDPRU* 3 on the basis of its *consolidated situation*.

Purpose

1.2 G *MIFIDPRU* TP 1 contains transitional provisions relating to certain permissions granted by the *FCA* before [*Editor's note:* insert date that MIFIDPRU sourcebook begins to apply] for the purposes of the *own funds* provisions of the *UK CRR*. These provisions set out where a *firm* with such a permission may continue to rely on it under the *MIFIDPRU* regime.

1.3 G *MIFIDPRU* TP 1 also contains transitional provisions relating to the potential continued eligibility of *additional tier 1 instruments* issued before [*Editor's note:* insert date that MIFIDPRU sourcebook begins to apply] under the *UK CRR* (in the form in which the *UK CRR* stood prior to that date).

Continuing application of certain UK CRR permissions

1.4 R *MIFIDPRU* TP 1.5 applies for the duration of the relevant permission to which it relates, except to the extent that the *FCA* revokes, varies or replaces that permission.

1.5 R (1) This *rule* applies to any permission listed in column (A) of the table in *MIFIDPRU* TP 1.6R where that permission was granted to a *firm* by the *FCA* for the purposes of the *UK CRR* before [*Editor's note:* insert date that MIFIDPRU sourcebook begins to apply].

(2) Where this *rule* applies, a permission in column (A) of the table in *MIFIDPRU* TP 1.6R shall be deemed to have been granted for its remaining duration on equivalent terms to the relevant *firm* by the *FCA* under the corresponding provision in column (B) in the same row of that table.

1.6 R This table belongs to *MIFIDPRU* TP 1.5R.

(A) ***UK CRR* permission granted before** [*Editor's note:* insert date that MIFIDPRU sourcebook begins to apply]	**(B)** **Deemed basis for permission on or after** [*Editor's note:* insert date that MIFIDPRU sourcebook begins to apply]
Article 26(2) *UK CRR*: inclusion of interim or year-end profits in *common equity tier 1 capital* before the *firm* has taken a formal decision confirming the final profit or loss for the year	*MIFIDPRU* 3.3.2R
Article 26(3) *UK CRR*: classification of an issuance of capital instruments as *common equity tier 1 capital*	*MIFIDPRU* 3.3.3R

1.7 G The effect of *MIFIDPRU* TP 1.5 and *MIFIDPRU* TP 1.6 is that the relevant permission that was initially granted under article 26(2) or 26(3) of the *UK CRR* will continue to produce an equivalent effect under the corresponding provisions in *MIFIDPRU* 3.3. The duration of the original permission is not affected. For example, a relevant permission that was granted on 1 June 2021 for a one-year duration will be treated from [*Editor's note:* insert date that MIFIDPRU sourcebook begins to apply] as if it had been granted under *MIFIDPRU* 3.3, but will still expire on 1 June 2022.

Additional tier 1 capital instruments issued before [*Editor's note:* insert date that MIFIDPRU sourcebook begins to apply]

1.8 R (1) This *rule* applies where:

(a) a *firm* which became a *MIFIDPRU investment firm* on [*Editor's note:* insert date that MIFIDPRU sourcebook begins to apply] issued instruments before that date which met the conditions to be classified as *additional tier 1 instruments* in accordance with the provisions of the *UK CRR* in the form in which it stood immediately before [*Editor's note:* insert date that MIFIDPRU sourcebook begins to apply]; and

(b) the instruments in (1) remain in issue on [*Editor's note:* insert date that MIFIDPRU sourcebook begins to apply].

(2) Where this *rule* applies, a *MIFIDPRU investment firm* must notify the *FCA* by no later than [*Editor's note:* insert date one month after the date that MIFIDPRU sourcebook begins to apply] to confirm whether:

(a) the relevant instruments satisfy the conditions in *MIFIDPRU* 3.4 to be classified as *additional tier 1 instruments* for the purposes of *MIFIDPRU*;

(b) the relevant instruments do not satisfy the relevant conditions in *MIFIDPRU* 3.4 and the *firm* has therefore ceased to recognise them as forming part of its *additional tier 1 capital* for those purposes or has otherwise redeemed or replaced them; or

(b) the *firm* has applied to the *FCA* under section 138A of the *Act* for a modification of the relevant provisions in *MIFIDPRU* 3.4 to continue to allow the *firm* to classify the instruments as *additional tier 1 instruments* for the purposes of *MIFIDPRU*.

1.9 G (1) A *MIFIDPRU investment firm* that immediately before [*Editor's note:* insert date that MIFIDPRU sourcebook begins to apply] was subject to the *UK CRR* may have issued *additional tier 1 instruments* before that date that met the conditions in the *UK CRR* (in the form in which it then stood) which remain in issue on [*Editor's note:* insert date that MIFIDPRU sourcebook begins to apply].

(2) Although *MIFIDPRU* 3.4 contains provisions for the classification of instruments under *MIFIDPRU* as *additional tier 1 instruments* which are broadly equivalent to those in the *UK CRR*, the previous trigger event under article 54(1)(a) of the *UK CRR* does not apply under *MIFIDPRU*. This is because the *own funds requirement* under *MIFIDPRU* is calculated on a different basis and therefore the trigger event for conversion of

additional tier 1 instruments under *MIFIDPRU* must be defined by reference to different criteria.

1.10 G In certain circumstances, it is possible that an *additional tier 1 instrument* issued before [*Editor's note:* insert date that MIFIDPRU sourcebook begins to apply] under the *UK CRR* may nonetheless meet the conditions in *MIFIDPRU* 3.4 so that it can be classified as an *additional tier 1 instrument* for the purposes of *MIFIDPRU*. This may depend upon how the trigger events were defined in the terms of the relevant instrument and whether additional trigger events (i.e. over and above the mandatory *UK CRR* trigger event that was applicable at the time of issuance) were also included.

1.11 G (1) A *firm* may apply to the *FCA* under section 138A of the *Act* to modify the provisions of *MIFIDPRU* 3.4 in relation to existing *additional tier 1 instruments* issued for the purposes of the *UK CRR* before [*Editor's note:* insert date that MIFIDPRU sourcebook begins to apply], so as to allow those instruments to be recognised as *additional tier 1 instruments* under *MIFIDPRU*.

(2) The *FCA* would expect that an application of the type described in (1) would demonstrate how the conversion or write-down of the *additional tier 1 instruments* would function to enable the *firm* to continue to satisfy its *own funds requirement* under *MIFIDPRU* in times of financial stress.

(3) If the *FCA* grants a modification under section 138A of the *Act* in such circumstances, it may choose to do so on a temporary basis to facilitate the *firm's* orderly transition to the *MIFIDPRU* regime.

TP 2 Own funds requirements: transitional

Application

2.1 R *MIFIDPRU* TP 2 applies to a *MIFIDPRU investment firm* on an individual basis.

2.2 R *MIFIDPRU* TP 2.23R applies to a *UK parent entity* when it is applying *MIFIDPRU 4* on the basis of its *consolidated situation* in accordance with *MIFIDPRU* 2.5.

Purpose

2.3 G *MIFIDPRU* TP 2 contains temporary transitional provisions that permit certain *MIFIDPRU investment firms* to apply a lower *own funds requirement* than would otherwise apply under *MIFIDPRU* 4.3. These provisions are designed to provide a smoother transition for *firms* from their regulatory capital requirements under previous prudential regimes to the requirements under *MIFIDPRU*.

2.4 G (1) *MIFIDPRU* TP 2 permits a *firm* (or, in the case of *MIFIDPRU* TP 2.23R, a *UK parent entity*) to substitute an alternative requirement in place of one or more of its standard *permanent minimum capital requirement*, its *fixed overheads requirement* or its *K-factor requirement*. Where a *firm* does so, the alternative requirement also replaces the standard requirement for the purposes of calculating the *firm's own funds requirement* under *MIFIDPRU* 4.3.

(2) For example, under *MIFIDPRU* TP 2.21R, a former *exempt BIPRU commodities firm* may substitute separate alternative requirements for each of its *fixed overheads requirement* and its *K-factor requirement*. During the transitional period, the *own funds requirement* of the *firm* under *MIFIDPRU* 4.3.2R would be the highest of:

(a) its *permanent minimum capital requirement*;

(b) the alternative requirement substituted for its standard *fixed overheads requirement*; and

(c) the alternative requirement substituted for its standard *K-factor requirement*.

References to "UK CRR"

2.5 R Any reference in *MIFIDPRU* TP 2 to the "*UK CRR*" should be interpreted as a reference to the *UK CRR* in the form in which it stood on [*Editor's note*: insert the day before the earlier of the date on which MIFIDPRU enters into force and the date on which the CRR 2 amendments take effect].

Duration of transitional arrangements

2.6 R *MIFIDPRU* TP 2 applies until [*Editor's note*: insert date five years after MIFIDPRU begins to apply], except in the circumstances set out in *MIFIDPRU* TP 2.19R.

Transitional for fixed overheads requirement and K-factor requirement for former IFPRU investment firms and BIPRU firms

2.7 R (1) This *rule* applies to a *MIFIDPRU investment firm* that, under the *rules* in force on [*Editor's note*: insert the date immediately before the day that MIFIDPRU begins to apply], was classified as:

(a) an *IFPRU investment firm* (other than an *exempt IFPRU commodities firm* or a *collective portfolio management investment firm*); or

(b) a *BIPRU firm* (other than an *exempt BIPRU commodities firm* or a *collective portfolio management investment firm*).

(2) A *firm* may substitute the alternative requirement in (3) for each of:

(a) its *fixed overheads requirement* under *MIFIDPRU* [4.5][16]; and

(b) to the extent applicable, its *K-factor requirement* under *MIFIDPRU* 4.6.

(3) Subject to (4), the alternative requirement is an amount equal to twice the following, if it had continued to apply to the *firm*:

(a) for a former *IFPRU investment firm*, the own funds requirement in Chapter 1 of Title I of Part Three of the *UK CRR*; or

(b) for a former *BIPRU firm*, the variable capital requirement in *GENPRU* 2.1.40R and 2.1.45R.

(4) The alternative requirement in (3) is subject to:

(a) for a former *IFPRU investment firm*, article 93(1) of the *UK CRR*, with the reference to the initial capital requirement in that provision being read as a reference to the base own funds requirement that would have applied under *IFPRU* 3.1 if it had continued to apply to the *firm*; or

(b) for a former *BIPRU firm*, the base capital requirement that would have applied under *GENPRU* 2.1.47R and 2.1.48R.

[**Note:** article 57(3)(a) of the *IFR*.]

2.8 G (1) The effect of *MIFIDPRU* TP 2.7R(2) is that even where *MIFIDPRU* TP 2.7R applies, it does not affect the calculation of a *MIFIDPRU investment firm's permanent minimum capital requirement* under *MIFIDPRU* 4.4. The extent to which separate transitional arrangements may also apply to the *permanent minimum capital requirement* of a former *IFPRU*

[16] *Editor's note:* The FCA will consult on the rules for calculating the fixed overheads requirement in MIFIDPRU 4.5 in a subsequent consultation.

investment firm or *BIPRU firm* is set out in *MIFIDPRU* TP 2.13R to 2.18R.

(2) Therefore, where the *permanent minimum capital requirement* (where applicable, as limited by *MIFIDPRU* TP 2.13R to 2.18R) is higher than the alternative requirement in *MIFIDPRU* TP 2.7R(3), the *firm* will still need to ensure that it has sufficient *own funds* to meet that higher *permanent minimum capital requirement* in accordance with *MIFIDPRU* 4.3.

2.9 G Where a *MIFIDPRU investment firm* chooses to apply the transitional arrangements in *MIFIDPRU* TP 2.7, the alternative requirement under *MIFIDPRU* TP 2.7R(3) reflects how the previous requirements under the *UK CRR* or *GENPRU* would otherwise apply to the *firm* on an ongoing basis. The *firm* should therefore recalculate the alternative requirement under the *UK CRR* or *GENPRU* regularly. The *FCA* considers that it would be appropriate for the *firm* to carry out such calculations at least as frequently as it reports information on its *own funds requirement* to the *FCA* in accordance with *MIFIDPRU* 9.

Transitional for fixed overheads requirement and K-factor requirement for former exempt CAD firms

2.10 R (1) This *rule* applies to a *MIFIDPRU investment firm* that under the rules in force on [*Editor's note*: insert the date immediately before the day that MIFIDPRU begins to apply] was classified as an *exempt CAD firm*.

(2) A *firm* may substitute the alternative requirement in (3) in place of each of:

(a) its *fixed overheads requirement* under *MIFIDPRU* [4.5]; and

(b) to the extent applicable, its *K-factor requirement* under *MIFIDPRU* 4.6.

(3) The alternative requirement is:

(a) from [*Editor's note*: insert the date that MIFIDPRU begins to apply] to [*Editor's note*: insert the date one year after MIFIDPRU begins to apply minus one day], an amount equal to the *firm's permanent minimum capital requirement* after any transitional relief that may apply under *MIFIDPRU* TP 2.12R has been taken into account; and

(b) from [*Editor's note*: insert the date one year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date five years after MIFIDPRU begins to apply minus one day]:

(i) in relation to the *firm's fixed overheads requirement*, the relevant percentage specified in (4) of the *firm's fixed overheads requirement* (as that requirement would be determined if the substitution in (2)(a) did not apply); and

(ii) in relation to the *firm's K-factor requirement*, the relevant percentage specified in (4) of the *firm's K-factor requirement* (as that requirement would be determined if the substitution in (2)(b) did not apply).

(4) The relevant percentage is:

(a) from [*Editor's note*: insert the date one year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date two years after MIFIDPRU begins to apply minus one day]: 10%;

(b) from [*Editor's note*: insert the date two years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date three years after MIFIDPRU begins to apply minus one day]: 25%;

(c) from [*Editor's note*: insert the date three year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date four years after MIFIDPRU begins to apply minus one day]: 45%; and

(d) from [*Editor's note*: insert the date four years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date five years after MIFIDPRU begins to apply minus one day]: 70%.

Transitional for K-factor requirement for firms not in existence before [*Editor's note*: insert the date on which MIFIDPRU begins to apply]

2.11 R (1) This *rule* applies to a *MIFIDPRU investment firm* that immediately before [*Editor's note*: insert the date on which MIFIDPRU begins to apply]:

(a) was not in existence; or

(b) did not have a *Part 4A permission* that permitted the *firm* to carry on any *investment services and/or activities*.

(2) A *firm* may substitute the alternative requirement in (3) in place of its *K-factor requirement* under *MIFIDPRU* 4.6 (to the extent that such a requirement applies).

(3) The alternative requirement is an amount equal to twice the *fixed overheads requirement* of the *firm*, as calculated in accordance with *MIFIDPRU* [4.5] from time to time.

[**Note:** article 57(3)(b) of the *IFR*.]

Transitional for permanent minimum capital requirement: former exempt CAD firms

2.12 R (1) This *rule* applies to a *MIFIDPRU investment firm* that under the *rules* in force on [*Editor's note*: insert the date immediately before the day on which MIFIDPRU begins to apply] was classified as an *exempt CAD firm*.

(2) A *firm* may substitute the alternative requirement in (3) in place of its *permanent minimum capital requirement* under *MIFIDPRU* 4.4.

(3) The alternative requirement is as follows:

(a) from [*Editor's note*: insert the date on which MIFIDPRU begins to apply] to [*Editor's note*: insert the date one year after MIFIDPRU begins to apply minus one day]: £50,000;

(b) from [*Editor's note*: insert the date one year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date two years after MIFIDPRU begins to apply minus one day]: £55,000;

(c) from [*Editor's note*: insert the date two years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date three years after MIFIDPRU begins to apply minus one day]: £60,000;

(d) from [*Editor's note*: insert the date three year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date four years after MIFIDPRU begins to apply minus one day]: £65,000; and

(e) from [*Editor's note*: insert the date four years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date five years after MIFIDPRU begins to apply minus one day]: £70,000.

(4) This *rule* is subject to *MIFIDPRU* TP 2.19R.

Transitional for permanent minimum capital requirement: former IFPRU investment firms

2.13 R (1) Subject to (2), this *rule* applies to a *MIFIDPRU investment firm* that under the *rules* in force on [*Editor's note*: insert the date immediately before the day on which MIFIDPRU begins to apply] was classified as an *IFPRU 50K firm*.

(2) This *rule* does not apply to a *firm* to which *MIFIDPRU* TP 2.18R applies.

(3) A *firm* may substitute the alternative requirement in (4) in place of its *permanent minimum capital requirement* under *MIFIDPRU* 4.4.

(4) The alternative requirement is as follows:

(a) from [*Editor's note*: insert the date on which MIFIDPRU begins to apply] to [*Editor's note*: insert the date one year after MIFIDPRU begins to apply minus one day]: £50,000;

(b) from [*Editor's note*: insert the date one year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date two years after MIFIDPRU begins to apply minus one day]: £55,000;

(c) from [*Editor's note*: insert the date two years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date three years after MIFIDPRU begins to apply minus one day]: £60,000;

(d) from [*Editor's note*: insert the date three year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date four years after MIFIDPRU begins to apply minus one day]: £65,000; and

(e) from [*Editor's note*: insert the date four years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date five years after MIFIDPRU begins to apply minus one day]: £70,000.

(5) This *rule* is subject to *MIFIDPRU* TP 2.19R.

[**Note:** article 57(4)(b) of the *IFR*.]

2.14 R (1) Subject to (2), this *rule* applies to a *MIFIDPRU investment firm* that under the *rules* in force on [*Editor's note*: insert the date immediately before the day on which MIFIDPRU begins to apply] was classified as an *IFPRU 125K firm*.

(2) This *rule* does not apply to a *firm* to which *MIFIDPRU* TP 2.18R applies.

(3) A *firm* may substitute the alternative requirement in (4) in place of its *permanent minimum capital requirement* under *MIFIDPRU* 4.4.

(4) The alternative requirement is as follows:

(a) from [*Editor's note*: insert the date on which MIFIDPRU begins to apply] to [*Editor's note*: insert the date one year after MIFIDPRU begins to apply minus one day]: £125,000;

(b) from [*Editor's note*: insert the date one year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date two years after MIFIDPRU begins to apply minus one day]: £130,000;

(c) from [*Editor's note*: insert the date two years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date three years after MIFIDPRU begins to apply minus one day]: £135,000;

(d) from [*Editor's note*: insert the date three year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date four years after MIFIDPRU begins to apply minus one day]: £140,000; and

(e) from [*Editor's note*: insert the date four years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date five years after MIFIDPRU begins to apply minus one day]: £145,000.

(5) This *rule* is subject to *MIFIDPRU* TP 2.19R.

[**Note:** article 57(4)(b) of the *IFR*.]

2.15 R (1) This *rule* applies to a *MIFIDPRU investment firm* that under the *rules* in force on [*Editor's note*: insert the date immediately before the day on which MIFIDPRU begins to apply] was classified as an *IFPRU 730K firm*.

(2) A *firm* may substitute the alternative requirement in (3) in place of its *permanent minimum capital requirement* under *MIFIDPRU* 4.4.

(3) The alternative requirement is as follows:

(a) from [*Editor's note*: insert the date on which MIFIDPRU begins to apply] to [*Editor's note*: insert the date one year after MIFIDPRU begins to apply minus one day]: £730,000;

(b) from [*Editor's note*: insert the date one year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date two years after MIFIDPRU begins to apply minus one day]: £735,000;

(c) from [*Editor's note*: insert the date two years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date three years after MIFIDPRU begins to apply minus one day]: £740,000;

(d) from [*Editor's note*: insert the date three year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date four years after MIFIDPRU begins to apply minus one day]: £745,000; and

(e) from [*Editor's note*: insert the date four years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date five years after MIFIDPRU begins to apply minus one day]: £750,000.

(4) This *rule* is subject to *MIFIDPRU* TP 2.19R.

[**Note:** article 57(4)(b) of the *IFR*.]

Transitional for permanent minimum capital requirement: former BIPRU firms

2.16 R (1) This *rule* applies to a *MIFIDPRU investment firm* that under the *rules* in force on [*Editor's note*: insert the date immediately before the day on which MIFIDPRU begins to apply] was classified as a *BIPRU firm* (other than an *exempt BIPRU commodities firm* or a *collective portfolio management investment firm*).

(2) This *rule* does not apply to a *firm* to which *MIFIDPRU* TP 2.18R applies.

(3) A *firm* may substitute the alternative requirement in (4) in place of its *permanent minimum capital requirement* under *MIFIDPRU* 4.4.

(4) The alternative requirement is as follows:

(a) from [*Editor's note*: insert the date on which MIFIDPRU begins to apply] to [*Editor's note*: insert the date one year after MIFIDPRU begins to apply minus one day]: £50,000;

(b) from [*Editor's note*: insert the date one year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date two years after MIFIDPRU begins to apply minus one day]: £55,000;

(c) from [*Editor's note*: insert the date two years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date three years after MIFIDPRU begins to apply minus one day]: £60,000;

(d) from [*Editor's note*: insert the date three year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date four years after MIFIDPRU begins to apply minus one day]: £65,000; and

(e) from [*Editor's note*: insert the date four years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date five years after MIFIDPRU begins to apply minus one day]: £70,000.

(5) This *rule* is subject to *MIFIDPRU* TP 2.19R.

[**Note:** article 57(4)(c) of the *IFR*.]

2.17 G (1) The transitional arrangements in *MIFIDPRU* TP 2.13R to 2.16R permit the relevant *MIFIDPRU investment firms* to substitute an alternative requirement for their *permanent minimum capital requirement*. Those provisions do not affect the *fixed overheads requirement* or, where applicable, the *K-factor requirement* for such *firms.*

(2) The effect of (1) is that where the *fixed overheads requirement* or the *K-factor requirement* of the relevant *MIFIDPRU investment firm* (in each case, as modified by any other relevant transitional arrangements in this section) is higher than the alternative requirement substituted for the *firm's permanent minimum capital requirement*, the *firm's own funds requirement* under *MIFIDPRU* 4.3 will still be the higher of those other two requirements.

Transitional for permanent minimum capital requirement: former IFPRU and BIPRU firms that relied on IFPRU 1.1.12R or BIPRU 1.1.23R (former "matched principal" firms)

2.18 R (1) This *rule* applies to a *firm* that, under the *rules* in force on [*Editor's note*: insert the date immediately before the day on which MIFIDPRU begins to apply], was classified as one of the following:

(a) an *IFPRU 50K firm*, due to the application of *IFPRU* 1.1.12R (Meaning of dealing on own account);

(b) an *IFPRU 125K firm*, due to the application of *IFPRU* 1.1.12R (Meaning of dealing on own account); or

(c) a *BIPRU firm*, due to the application of *BIPRU* 1.1.23R (Meaning of dealing on own account).

(2) A *firm* may substitute the alternative requirement in (3) in place of its *permanent minimum capital requirement* under *MIFIDPRU* 4.4.

(3) The alternative requirement is as follows:

(a) from [*Editor's note*: insert the date on which MIFIDPRU begins to apply] to [*Editor's note*: insert the date one year after MIFIDPRU begins to apply minus one day]:

(i) for a former *BIPRU firm* or a former *IFPRU 50K firm*: £50,000;

(ii) for a former *IFPRU 125K firm*: £125,000;

(b) from [*Editor's note*: insert the date one year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date two years after MIFIDPRU begins to apply minus one day]: £190,000;

(c) from [*Editor's note*: insert the date two years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date three years after MIFIDPRU begins to apply minus one day]: £330,000;

(d) from [*Editor's note*: insert the date three year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date four years after MIFIDPRU begins to apply minus one day]: £470,000; and

(e) from [*Editor's note*: insert the date four years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date five years after MIFIDPRU begins to apply minus one day]: £610,000.

Disapplication of permanent minimum capital requirement transitional provisions due to changes in permission

2.19 R The transitional arrangements in *MIFIDPRU* TP 2.12R to 2.16R cease to apply where there is a change in the *permissions* of the relevant *MIFIDPRU investment firm* on or after [*Editor's note*: insert the date on which MIFIDPRU begins to apply] that results in an increase in the *permanent minimum capital requirement* that would apply to the *firm* under *MIFIDPRU* 4.4.

[**Note:** article 57(5) of the *IFR*.]

Transitional for own funds requirement: former local firms

2.20 R (1) This *rule* applies to a *MIFIDPRU investment firm* that:

(a) was in existence before 25 December 2019; and

(b) under the *rules* in force on [*Editor's note*: insert the date immediately before the day on which MIFIDPRU begins to apply], was classified as a *local firm*.

(2) A *firm* may substitute the alternative requirement in (3) in place of its *own funds requirement* under *MIFIDPRU* 4.3.

(3) The alternative requirement is as follows:

(a) from [*Editor's note*: insert the date on which MIFIDPRU begins to apply] to [*Editor's note*: insert the date one year after MIFIDPRU begins to apply minus one day]: £250,000;

(b) from [*Editor's note*: insert the date one year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date two years after MIFIDPRU begins to apply minus one day]: £350,000;

(c) from [*Editor's note*: insert the date two years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date three years after MIFIDPRU begins to apply minus one day]: £450,000;

(d) from [*Editor's note*: insert the date three year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date four years after MIFIDPRU begins to apply minus one day]: £550,000; and

(e) from [*Editor's note*: insert the date four years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date five years after MIFIDPRU begins to apply minus one day]: £650,000.

[**Note:** article 57(6) of the *IFR*.]

Transitional for fixed overheads and K-factor requirements: exempt commodities firms

2.21 R (1) This *rule* applies to a *MIFIDPRU investment firm* that, under the *rules* in force on [*Editor's note*: insert the date immediately before the day on which MIFIDPRU begins to apply], was classified as:

(a) an *exempt IFPRU commodities firm*; or

(b) an *exempt BIPRU commodities firm*.

(2) A *firm* may substitute the alternative requirement in (3) in place of each of:

(a) its *fixed overheads requirement* under *MIFIDPRU* [4.5]; and

(b) to the extent applicable, its *K-factor requirement* under *MIFIDPRU* 4.6.

(3) Subject to (5), the alternative requirement is:

(a) from [*Editor's note*: insert the date on which MIFIDPRU begins to apply] to [*Editor's note*: insert the date one year after MIFIDPRU begins to apply minus one day]: an amount equal to the *firm's permanent minimum capital requirement*;

(b) from [*Editor's note*: insert the date one year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date five years after MIFIDPRU begins to apply minus one day]:

(i) in relation to the *firm's fixed overheads requirement*, the relevant percentage specified in (4) of the *firm's fixed overhead requirement* (as that requirement would be determined if the substitution in (2)(a) did not apply); and

(ii) in relation to the *firm's K-factor requirement*, the relevant percentage specified in (4) of the *firm's K-factor requirement* (as that requirement would be determined if the substitution in (2)(b) did not apply).

(4) The relevant percentage is:

(a) from [*Editor's note*: insert the date one year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date two years after MIFIDPRU begins to apply minus one day]: 10%;

(b) from [*Editor's note*: insert the date two years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date three years after MIFIDPRU begins to apply minus one day]: 25%;

(c) from [*Editor's note*: insert the date three year after MIFIDPRU begins to apply] to [*Editor's note*: insert the date four years after MIFIDPRU begins to apply minus one day]: 45%; and

(d) from [*Editor's note*: insert the date four years after MIFIDPRU begins to apply] to [*Editor's note*: insert the date five years after MIFIDPRU begins to apply minus one day]: 70%.

(5) If the *firm* was subject to *IPRU(INV)* 3 on [*Editor's note*: insert the date immediately before the day on which MIFIDPRU begins to apply], the alternative requirement can never be lower than the amount of the financial resources requirement that would apply to the *firm* if it had continued to be subject to *IPRU(INV)* 3 in the form in which that chapter stood on that date.

2.22 G *MIFIDPRU* TP 2.21R(5) means that the alternative *fixed overheads requirement* and alternative *K-factor requirement* of an *exempt IFPRU commodities firm* or an *exempt BIPRU commodities firm* under the transitional arrangements are subject to a floor if the *firm* was previously subject to *IPRU(INV)* 3. *Firms* are reminded that the base requirement under *IPRU(INV)* 3-71R (in the form in which it stood on [*Editor's note*: insert the date immediately before the day on which MIFIDPRU begins to apply]) is calculated by reference to the highest of an absolute minimum requirement, an expenditure requirement and a volume of business requirement.

Transitional for consolidated own funds requirement

2.23 R (1) This *rule* applies to a *UK parent entity* that is required to apply prudential consolidation to an *investment firm group* in accordance with *MIFIDPRU* 2.5.

(2) A *UK parent entity* may substitute the alternative requirements in (3) in place of the following, as they result from applying *MIFIDPRU* 4 to its *consolidated situation*:

(a) the consolidated *fixed overheads requirement*; and

(b) the consolidated *K-factor requirement.*

(3) Subject to (8), the alternative requirement is:

(a) in relation to the *fixed overheads requirement*, an amount calculated in accordance with the formula in (4); and

(b) in relation to the *K-factor requirement*, an amount calculated in accordance with the formula in (6).

(4) The formula for calculating the alternative requirement for the consolidated *fixed overheads requirement* is:

A = B - C

where:

A = the alternative requirement for the consolidated *fixed overheads requirement*.

B = the consolidated *fixed overheads requirement* that results from applying *MIFIDPRU* 4 to the *consolidated situation* in accordance with *MIFIDPRU* 2.5 without applying *MIFIDPRU* TP 2.

C = the transitional credit, determined in accordance with (5).

(5) For the purposes of (4), the transitional credit (C) is the sum of the output of the following formula as applied to each *MIFIDPRU investment firm* in the *investment firm group*:

C = D - E

where:

D = the individual *fixed overheads requirement* that would apply to the *MIFIDPRU investment firm* under *MIFIDPRU* 4, ignoring any transitional relief under *MIFIDPRU* TP 2.

E = the alternative requirement that applies to the *MIFIDPRU investment firm* under *MIFIDPRU* TP 2 in place of the individual *fixed overheads requirement*. If no alternative requirement applies to the *firm* in place of its individual *fixed overheads requirement*, the value of E is equal to D.

(6) The formula for calculating the alternative requirement for the consolidated *K-factor requirement* is:

F = G - H

where:

F = the alternative requirement for the consolidated *K-factor requirement*.

G = the consolidated *K-factor requirement* that results from applying *MIFIDPRU* 4 to the *consolidated* *situation* in accordance with *MIFIDPRU* 2.5 without applying *MIFIDPRU* TP 2.

H = the transitional credit, determined in accordance with (7).

(7) For the purposes of (6), the transitional credit (H) is the sum of the output of the following formula as applied to each *MIFIDPRU investment firm* in the *investment firm group*:

$$H = J - K$$

where:

J = the *K-factor requirement* that would apply to the individual *MIFIDPRU investment firm* under *MIFIDPRU* 4, ignoring any transitional relief under *MIFIDPRU* TP 2.

K = the alternative requirement that applies to the *MIFIDPRU investment firm* under *MIFIDPRU* TP 2 in place of the individual *K-factor requirement*. If no alternative requirement applies to the *firm* in place of its individual *K-factor requirement*, the value of K is equal to J.

(8) The alternative requirement can never be lower than the following:

(a) in relation to the consolidated *fixed overheads requirement*, the sum of the following in relation to the *investment firm group*:

(i) for each *MIFIDPRU investment firm* that is subject to an alternative requirement under *MIFIDPRU* TP 2 in place of its individual *fixed overheads requirement*, that alternative requirement; and

(ii) for every other *MIFIDPRU investment firm*, the *firm's* individual *fixed overheads requirement*;

(b) in relation to the consolidated *K-factor requirement*, the sum of the following in relation to the *MIFIDPRU investment firms* in the *investment firm group*:

(i) for each *MIFIDPRU investment firm* that is subject to an alternative requirement under *MIFIDPRU* TP 2 in place of its individual *K-factor requirement*, that alternative requirement; and

(ii) for other *MIFIDPRU investment firms*, the individual *K-factor requirement*.

TP 3 Group capital test: transitional arrangements

Application

3.1 R *MIFIDPRU* TP 3 applies to the following:

(1) a *MIFIDPRU investment firm*;

(2) a *UK parent entity*; and

(3) a *relevant financial undertaking* that is a *parent undertaking* in an *investment firm group*.

Purpose

3.2 G *MIFIDPRU* TP 3 contains transitional provisions which allow an *investment firm group* to apply the *group capital test* on a temporary basis before the *FCA* has determined an application made in accordance with *MIFIDPRU* 2.4.17R, provided that certain conditions are met.

Temporary application of the group capital test

3.3 R (1) This *rule* applies in relation to an *investment firm group* where:

(a) the *UK parent entity* or a *MIFIDPRU investment* within that *investment firm group* has submitted an application to the *FCA* in accordance with *MIFIDPRU* 2.4.17R by no later than [*Editor's note*: insert date one month after the date that the MIFIDPRU sourcebook begins to apply]; and

(b) the *management body* of the *UK parent entity* or *MIFIDPRU investment firm* in (1) has determined that there is a reasonable basis to conclude that the *investment firm group* satisfies the requirements in *MIFIDPRU* 2.4.17R(2)(a) and (b).

(2) This *rule* applies from [*Editor's note*: insert date that the MIFIDPRU sourcebook begins to apply] until the earlier of the following:

(a) [*Editor's note*: insert date two years after the MIFIDPRU sourcebook begins to apply]; or

(b) such earlier date as may be specified in the notification to the *UK parent entity* or *MIFIDPRU* *investment firm* of the *FCA's* decision in relation to the application in (1)(a).

(3) Where this *rule* applies, the *undertakings* in *MIFIDPRU* TP 3.1 may apply the *group capital test* in accordance with *MIFIDPRU* 2.6, notwithstanding that the *FCA* has not granted permission to use the *group capital test* in accordance with *MIFIDPRU* 2.4.17R.

3.4 G Under *MIFIDPRU* 2.4.18R(2)(g), an application submitted under *MIFIDPRU* 2.4.17R must contain an explanation of how the *investment firm group* would comply with the consolidated requirements under *MIFIDPRU* 2.5 if the *FCA* did not grant permission to apply the *group capital test*. The application must also contain an explanation of the timeframe in which the *investment firm group* would expect to achieve compliance with those consolidated requirements. The *FCA* will have regard to these explanations when considering any date that it may specify under *MIFIDPRU* TP 3.3R(2)(b) for the transitional arrangements to cease, if the *FCA* has decided not to grant the relevant application.

TP 4 K-factor metric calculations: transitional

Application

4.1 R *MIFIDPRU* TP 4 applies to a *MIFIDPRU investment firm* where:

(1) immediately before [*Editor's note*: insert the date on which MIFIDPRU begins to apply], the *firm* was carrying on *investment services and/or activities*; and

(2) the *investment services and/or activities* in (1) result in *K-factor metrics* that are relevant to the calculation of the following on or after [*Editor's note*: insert the date on which MIFIDPRU begins to apply]:

(i) the *firm's K-factor requirement*; or

(ii) an alternative requirement in *MIFIDPRU* TP 2 that is calculated by reference to the *K-factor requirement*.

4.2 R *MIFIDPRU* TP 4.11 applies to a *UK parent entity* where the following conditions are met:

(1) the *UK parent entity* is required to apply *MIFIDPRU* 4 on a *consolidated basis* in accordance with *MIFIDPRU* 2.5.7R; and

(2) the *consolidated situation* of the *UK parent entity* includes one or more the following:

(a) a *MIFIDPRU investment firm* to which *MIFIDPRU* TP 4.1R applies; or

(b) a *third country* entity to which *MIFIDPRU* TP 4.1R would apply if it were established in the *UK*.

Purpose

4.3 G (1) The standard *rules* in *MIFIDPRU* 4 require a *MIFIDPRU investment firm* to collect data on the *K-factor metrics* that are relevant to the *investment services and/or activities* that the *firm* carries on. Certain *K-factor metric* calculations are based on average values and require a minimum level of historical data.

(2) *MIFIDPRU* TP 4 contains transitional rules for the calculation of a *firm's K-factor requirement* where a *firm* was carrying on *investment services and/or activities* immediately before *MIFIDPRU* began to apply, but does not have the historical data necessary to calculate the relevant *K-factor metric*.

(3) *MIFIDPRU* TP 4 is not relevant to the calculation of the following elements of the *K-factor requirement*, as they do not use historical data:

(1) the *K-NPR requirement*;

(2) the *K-TCD requirement*; and

(3) the *K-CON requirement*.

(4) *MIFIDPRU* TP 4 does not apply to the extent that a *firm* modifies its *permissions* on or after [*Editor's note*: insert the date on which MIFIDPRU begins to apply] to carry on new *investment services and/or activities*. In that case, to the extent relevant to the new activity, the *rules* in *MIFIDPRU 4* specify that the *firm* should use the information in the business projections submitted with its application for a variation of *permission* to calculate the relevant *K-factor metric* until historical data becomes available.

Duration

4.4 G The duration of the transitional arrangements in *MIFIDPRU* TP 4 depends on the relevant *K-factor metric*. Under *MIFIDPRU* TP 4.5.R(3), the transitional arrangements cease to apply once a *firm* has (or should have) collected sufficient historical information to perform the necessary calculations in accordance with the standard calculation *rules* for the relevant *K-factor metric* in *MIFIDPRU* 4.

Missing historical data for K-factor calculations: transitional for individual MIFIDPRU firms

4.5	R	(1)	This *rule* applies to the extent that a *MIFIDPRU investment firm* does not have the necessary historical data to calculate the *K-factor metric* required for any of the following in accordance with the relevant *rules* in *MIFIDPRU* 4: (a) its *K-AUM requirement*; (b) its *K-CMH requirement*; (c) its *K-ASA requirement*; (d) its *K-COH requirement*; (e) its *K-DTF requirement*; or (d) its *K-CMG requirement*.
		(2)	Subject to *MIFIDPRU* TP 4.13R(2)(a), where this *rule* applies, a *firm* may either: (a) use reasonable estimates to fill any missing historical data points in the calculation of the relevant *K-factor metric*; or (b) by way of derogation from the standard calculation *rules* in *MIFIDPRU 4*, use the modified calculation in *MIFIDPRU* TP 4.11R to calculate the relevant *K-factor metric*.
		(3)	This *rule* ceases to apply in relation to a *K-factor metric* on the earlier of the following: (a) the date on which the *firm* has collected sufficient historical information to calculate the *K-factor metric* in accordance with the standard calculation *rules* in *MIFIDPRU* 4; or (b) the date that falls *n months* after the date on which *MIFIDPRU* first began to apply, where *n* is the number of *months'* worth of data points required to calculate that *K-factor metric* in accordance with the standard calculation *rules* in *MIFIDPRU* 4.
4.6	G	(1)	*MIFIDPRU* TP 4.5R(3) specifies the date on which the transitional arrangements for calculating a *K-factor metric* will cease to apply and the *firm* will therefore need to use the standard calculation *rules* in *MIFIDPRU* 4 in relation to that *K-factor metric*. This date may vary depending on the position of the individual *firm*.

(2) Under *MIFIDPRU* TP 4.5R(3)(a), once a *firm* has sufficient historical information to perform the calculation in the standard way, it is no longer permitted to use either reasonable estimates for missing data points or to use the modified calculation in *MIFIDPRU* 4.11R. For example, on the date on which *MIFIDPRU* begins to apply, Firm A already has historical data on its *AUM* covering the previous 10 *months*. The standard calculation of *AUM* in *MIFIDPRU* 4 requires 15 *months* of historical data. Since the *firm* must begin collecting *AUM* data no later than the date that *MIFIDPRU* begins to apply, the *firm* will have sufficient data to perform the standard calculation 5 *months* later. At that point, the transitional arrangements under *MIFIDPRU* TP 4 will no longer apply to the *firm's* calculation of *AUM*.

(3) *MIFIDPRU* TP 4.5R(3)(b) acts as a "long-stop" date for the transitional arrangements under *MIFIDPRU* TP 4. Since a *firm* must begin collecting data on its *K-factor metrics* no later than the date that *MIFIDPRU* begins to apply, all *MIFIDPRU investment firms* should have sufficient historical data to perform the standard calculation of a *K-factor metric* once sufficient *months* have elapsed to cover at least the standard calculation period for that *K-factor metric*. For example, the standard calculation for *CMH* requires 9 *months* of historical data. For the purposes of *MIFIDPRU* TP 4.5.R(3)(b), the value of *n* is therefore 9, and the transitional arrangements under *MIFIDPRU* TP 4 will cease to apply in relation to the calculation of *CMH* 9 *months* after *MIFIDPRU* first begins to apply.

4.7 R (1) A *firm* must apply its chosen approach under *MIFIDPRU* TP 4.5R(2) consistently in relation to a specific *K-factor metric*.

(2) A *firm* may apply different approaches under *MIFIDPRU* TP 4.5R(2) in relation to different *K-factor metrics*.

4.8 G *MIFIDPRU* TP 4.7R prevents a *firm* from changing its approach to missing historical data points in relation to a particular *K-factor*. For example, if a *firm* is missing the necessary historical data points and chooses to apply the modified calculation in *MIFIDPRU* TP 4.11R to determine *AUM*, it cannot subsequently decide to estimate the missing values for *AUM* instead. However, a *firm* may choose, for example, to use reasonable estimates for missing values for *AUM*, but to apply the modified calculation in *MIFIDPRU* TP 4.11R for the purposes of missing values for *COH*. In the example, this could reflect the fact that the *firm* has a reasonable basis on which to estimate *AUM*, but is unable to produce reasonable estimates for *COH*.

4.9 R A *firm* that uses reasonable estimates in accordance with *MIFIDPRU* TP 4.5R(2)(a) must, upon request, provide a reasonable explanation to the *FCA* of how it has determined the relevant estimates.

4.10 G If a *firm* does not have a reasonable basis on which to estimate missing historical data points in relation to a *K-factor metric*, it should apply the modified calculation in *MIFIDPRU* TP 4.11R.

4.11 R (1) A *firm* that is using the modified calculation for determining a *K-factor metric*, other than in relation to the *K-CMG requirement*, must apply the following requirements:

(a) the *firm* must calculate the arithmetic mean of the daily values (or in the case of *AUM*, monthly values) for the *K-factor metric* over the previous *n months*, excluding the most recent *y months*;

(b) *n* is the number of *months* that have elapsed since *MIFIDPRU* began to apply (with the *month* during which *MIFIDPRU* begins to apply being counted as month 1);

(c) *y* is the greater of the following:

(i) zero; or

(ii) *n* minus *x*; and

(d) *x* is a fixed value, being:

(i) 12 in the case of *AUM*;

(ii) 6 in the case of *CMH*, *ASA* or *DTF*; and

(iii) 3 in the case of *COH*.

(2) A *firm* that is using the modified calculation for determining the level of margin for the purposes of the *K-CMG requirement* must apply the following requirements:

(a) the *firm* must calculate the third highest amount of total margin as calculated under *MIFIDPRU* 4.13.5R required from the *firm* on a daily basis over the preceding *n months*; and

(b) *n* is the number of *months* that have elapsed since *MIFIDPRU* began to apply (with the *month* during which *MIFIDPRU* begins to apply being counted as month 1).

4.12 G (1) The following are worked examples of the modified calculation in *MIFIDPRU* TP 4.11R.

(2) Firm A has chosen to apply the modified calculation in relation to *AUM*. *MIFIDPRU* has been in force for 6 *months*. Firm A would calculate its *AUM* as follows:

(i) The value of *n* is 6, being the length of time that *MIFIDPRU* has been in force.

(ii) The value of *y* is zero, as zero is greater than *n* minus *x* (i.e. 6 minus 12). This means that Firm A must not exclude any of the most recent *months* of daily figures.

(iii) When calculating *AUM* for present purposes, Firm A must therefore calculate the arithmetic mean of the previous 6 *months* of daily values for *AUM*.

(3) Firm B applies the modified calculation in relation to *COH*, as it is unable to generate reasonable estimates for missing data points for *COH*. *MIFIDPRU* has been in force for 4 *months*. Firm B would calculate its *COH* as follows:

(i) The value of *n* is 4, being the length of time that *MIFIDPRU* has been in force.

(ii) The value of *y* is 1, as *n* minus *x* (i.e. 4 minus 3) is greater than zero.

(iii) When calculating *COH* for present purposes, Firm B must therefore calculate the arithmetic mean of the previous 4 *months* of daily values for *COH*, excluding the values for the most recent *month*.

(4) *MIFIDPRU* has been in force for 10 *months*. Although Firm C would like to apply the modified calculation in relation to *CMH*, under *MIFIDPRU* TP 4.5R(3)(b), this is not permitted. This is because the standard calculation of *CMH* under *MIFIDPRU* 4 requires only 9 *months* of daily values. Firm C should therefore have collected sufficient data by that time to be able to apply the standard calculation.

Missing historical data for K-factor calculations: transitional for investment firm groups to which consolidation applies

4.13 R (1) If the conditions in (2) are met, a *UK parent entity* may apply the transitional arrangements in *MIFIDPRU* TP 4.5R to 4.11R, as modified by *MIFIDPRU* TP 4.14R, when calculating *K-factor metrics* on a *consolidated basis*.

(2) The conditions are as follows:

(a) to the extent that it is relying on the transitional arrangements in *MIFIDPRU* TP 4, each *MIFIDPRU investment firm* in the *investment firm group* must apply the same approach under *MIFIDPRU* TP 4.5R(2) in relation to calculating a specific *K-factor metric* on an individual basis; and

(b) the *UK parent entity* must apply the same approach under *MIFIDPRU* TP 4.5R(2) in relation to calculating a specific *K-factor metric* on a *consolidated basis* as the *firms* in (a) have applied on an individual basis.

4.14 R Where a *UK parent entity* is applying *MIFIDPRU* TP 4.5R to 4.11R in accordance with *MIFIDPRU* TP 4.13R, the following modifications apply:

(1) references to a "*K-factor metric*" shall be read as references to that *K-factor metric* as it applies on a *consolidated basis*;

(2) references to the "*K-AUM requirement*", "*K-COH requirement*", "*K-ASA requirement*", "*K-CMH requirement*", "*K-DTF requirement*" or *"K-CMG requirement*" shall be read as references to those requirements as they apply on a *consolidated basis*;

(3) references to *MIFIDPRU* 4 shall be read as references to that chapter as it applies on a *consolidated basis* in accordance with *MIFIDPRU* 2.5; and

(4) references to a "*firm*" should be read as references to the *UK parent entity*.

4.15 G (1) Under *MIFIDPRU* 2.5, *third country* entities that would be *MIFIDPRU investment firms* if they were established in the *UK* may contribute towards a consolidated *K-factor metric*. A *UK parent entity* may rely on the transitional arrangements in *MIFIDPRU* TP 4 in relation to missing data points relating to such entities that the *UK parent entity* requires to calculate the consolidated *K-factor requirement*.

(2) However, *UK parent entities* are reminded that under *MIFIDPRU* 2.5.9R, they are responsible for ensuring that any *subsidiaries* that are not subject to *MIFIDPRU* (including *third country* entities) implement the necessary arrangements to ensure that the *UK parent entity* can comply with consolidated requirements. As a result, the guidance in *MIFIDPRU* TP 4.6G(2) is equally applicable in relation to *third country* entities within the *investment firm group*, which must ensure that they begin to collect the necessary data once *MIFIDPRU* begins to apply.

Part 2: Come into force on [*Editor's note*: insert date one month before the application date specified for Part 1]

TP 5 Advance data collection

Application

5.1 R *MIFIDPRU* TP 5 applies to:

(1) a *MIFIDPRU investment firm*; and

(2) a *UK parent entity*.

Duration

5.2 R *MIFIDPRU* TP 5 applies from [*Editor's note*: insert date one month before the date on which MIFIDPRU applies in full] until [*Editor's note*: insert date on which MIFIDPRU applies in full] (the "relevant period").

Purpose

5.3 G (1) *MIFIDPRU* TP 5 requires *MIFIDPRU investment firms* and *UK parent entities* to begin collecting data on *K-factor metrics* one *month* before the *MIFIDPRU* sourcebook begins to apply in full.

(2) If *firms* and *parent undertakings* will be using the alternative calculation in *MIFIDPRU* TP 4 after *MIFIDPRU* begins to apply in full, the data covering the relevant period will allow them to calculate their *K-factor requirement* during the first *month*.

(3) If *firms* and *parent undertakings* will be using the reasonable estimates approach in *MIFIDPRU* TP 4 after *MIFIDPRU* begins to apply in full, the data covering the relevant period will provide at least one *month's* observed historical data which must be used in the relevant calculations. The observed data may also be helpful for verifying whether any remaining estimated historical data points are reasonable.

Requirement to collect data on K-factor metrics

5.4 R (1) A *MIFIDPRU investment firm* or *UK parent entity* must collect the required information in (2) throughout the relevant period.

(2) The required information is:

(a) in the case of a *MIFIDPRU investment firm*, data on the *K-factor metrics* that the *firm* would be required to collect to calculate its individual *K-factor requirement* if *MIFIDPRU* applied in full; and

(b) in the case of a *UK parent entity*, data on the *K-factor metrics* that the *investment firm group* would be required to collect to calculate its *K-factor requirement* on a *consolidated basis* if *MIFIDPRU* applied in full.

5.5 G *MIFIDPRU* TP 5.4R only requires a *firm* or *parent undertaking* to collect data on *K-factor metrics* that are relevant to the *investment services/and or activities* that it undertakes (or in the case of a *parent undertaking*, that relevant entities within its *investment firm group* undertake).

Annex B

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

ASA	*assets safeguarded and administered*
assets safeguarded and administered	[*Editor's note*: This definition will be published in a subsequent CP.]
assets under management	[*Editor's note*: This definition will be published in a subsequent CP.]
AUM	*assets under management*
cash trade	(in *MIFIDPRU*) means an order relating to the purchase or sale of a *financial instrument* that is: (1) referred to in paragraphs 1 to 3 of Part 1 of Schedule 2 to the *Regulated Activities Order*; or (2) an exchange-traded option.
clearing margin given	the total margin required by a *clearing member* or *CCP*, where the execution and settlement of transactions of a *MIFIDPRU investment firm's dealing on own account* take place under the responsibility of a *clearing member* or *CCP*.
client money held	the *MIFID client money* that a *MIFIDPRU investment firm* holds, taking into account the legal arrangements in relation to asset segregation and irrespective of the accounting regime applicable to *client money* held by the *MIFIDPRU investment firm*.
client orders handled	the value of orders that a *MIFIDPRU investment firm* handles for *clients* through: (1) the reception and transmission of *client* orders; and (2) the *execution of orders on behalf of clients* in the name of the *client*.
CMG	*clearing margin given*
CMH	*client money held*

CMV	*current market value*
COH	*client orders handled*
commodity and emission allowance dealer	a *MIFIDPRU investment firm* the main business of which consists exclusively of the provision of *investment services and/or activities* in relation to: (1) *commodity derivatives* or commodity derivative contracts referred to in paragraphs 5, 6, 7, 9 and 10 of Part 1 of Schedule 2 to the *Regulated Activities Order*; (2) derivatives of *emission allowances* referred to in paragraph 4 of Part 1 of Schedule 2 to the *Regulated Activities Order*; or (3) *emission allowances* referred to in paragraph 11 of Part 1 of Schedule 2 to the *Regulated Activities Order*.
CON own funds requirement	the own funds requirement calculated in accordance with *MIFIDPRU* 5.7.2R that relates to a concentrated exposure to a *client* or *group of connected clients*.
concentration risk	the risks arising from the strength or extent of a *firm's* relationships with, or direct exposure to, a single *client* or *group of connected clients*.
concentration risk soft limit	the limit specified in *MIFIDPRU* 5.5.1R on the *exposure value* a *firm* has to a *client* or a *group of connected clients*, above which a *firm* is required to calculate the *K-CON requirement*.
connected undertaking	has the meaning in *MIFIDPRU* 2.4.6R.
daily trading flow	the daily value of transactions that a *MIFIDPRU investment firm* enters through: (1) *dealing on own account*; or (2) the *execution of orders on behalf of clients* in the *firm's* own name.
derivatives trade	(in *MIFIDPRU*) means an order relating to the purchase or sale of a *financial instrument* that is not a *cash trade*.
DTF	*daily trading flow*
EV	(in *MIFIDPRU* 5) the *exposure value*
EVE	(in *MIFIDPRU* 5) the *exposure value excess*

exposure value	(in *MIFIDPRU* 5) the value of a *firm's* exposure to a *client* or *group of connected clients*, calculated in accordance with *MIFIDPRU* 5.4.
exposure value excess	(in *MIFIDPRU* 5) the value by which a *firm's* exposure to a *client* or *group of connected clients* exceeds the *concentration risk soft limit*, calculated in accordance with *MIFIDPRU* 5.5.3R.
group capital test	the requirement in *MIFIDPRU* 2.6.5R.
ICARA process	[*Editor's note*: This definition will be published in a subsequent CP.][17]
investment advice of an ongoing nature	the recurring provision of *investment advice* as well as the continuous or periodic assessment and monitoring or review of a *client* portfolio of *financial instruments*, including of the *investments* undertaken by the *client* on the basis of a contractual arrangement.
investment firm group	(1) (in *MIFIDPRU* 2.4, and in any other provision which refers to a group to which *MIFIDPRU* 2.5 applies) a group of *undertakings* which: (a) consists of a *parent undertaking* (including an *undertaking* that is deemed to be a *parent undertaking* for the purposes of *MIFIDPRU* 2.5) and: (i) the *subsidiaries* and *connected undertakings* of that *parent undertaking*; and (ii) the *connected undertakings* of the *subsidiaries* of that *parent undertaking*; (b) includes at least one *MIFIDPRU investment firm*; and (c) does not include a *subsidiary* which is a *UK credit institution.* (2) (in any provision which refers to a group to which *MIFIDPRU* 2.6 applies) a group of *undertakings* which: (a) consists of a *parent undertaking* and its *subsidiaries*; (b) includes at least one *MIFIDPRU investment firm*; and

[17] The FCA will consult on detailed proposals for the individual capital adequacy and risk assessment (ICARA) process in a subsequent consultation paper.

	(c) does not include a *UK credit institution.*
investment holding company	a *financial institution* which meets all of the following conditions: (1) its *subsidiaries* are exclusively or mainly *investment firms* or *financial institutions*; (2) at least one of its *subsidiaries* is a *MIFIDPRU investment firm*; and (3) its *subsidiaries* do not include a *UK credit institution*. For the purposes of this definition, the *subsidiaries* of a *financial institution* are "mainly" *investment firms* or *financial institutions* where: (a) more than 50% of the *financial institution's* equity, consolidated assets, capital deployed, revenues, expenses, personnel or *customers* are associated with *subsidiaries* that are *investment firms* or *financial institutions*; or (b) the *group* containing the *financial institution* and its *subsidiaries* has been structured in an artificial manner to avoid exceeding the threshold in (a).
K-ASA requirement	the part of the *K-factor requirement* calculated on the basis of the *ASA* of a *MIFIDPRU investment firm* in accordance with *MIFIDPRU* [4.9].
K-AUM requirement	the part of the *K-factor requirement* calculated on the basis of the *AUM* of a *MIFIDPRU investment firm* in accordance with *MIFIDPRU* [4.7].
K-CMG permission	a permission granted to a *MIFIDPRU investment firm* in accordance with *MIFIDPRU* 4.13.9R permitting the *firm* to calculate a *K-CMG requirement* in respect of a *portfolio*.
K-CMG requirement	the part of the *K-factor requirement* calculated in accordance with *MIFIDPRU* 4.13 in relation to *portfolios* for which the firm has been granted a *K-CMG permission*.
K-CMH requirement	the part of the *K-factor requirement* calculated on the basis of the *CMH* of a *MIFIDPRU investment firm* in accordance with *MIFIDPRU* [4.8].
K-COH requirement	the part of the *K-factor requirement* calculated on the basis of the *COH* of a *MIFIDPRU investment firm* in accordance with *MIFIDPRU* [4.10].

K-CON requirement	the part of the *K-factor requirement* that accounts for *concentration risk* in the *trading book* of a *MIFIDPRU investment firm*, calculated in accordance with *MIFIDPRU* 5.7.
K-DTF requirement	the part of the *K-factor requirement* calculated on the basis of the *DTF* of a *MIFIDPRU investment firm* in accordance with *MIFIDPRU* 4.15.
K-NPR requirement	the part of the *K-factor requirement* calculated on the basis of the *NPR* of a *MIFIDPRU investment firm* in accordance with *MIFIDPRU* 4.12 where the *firm* is *dealing on own account* (whether on its own behalf or on behalf of its *clients*) and the relevant positions do not form part of a *portfolio* for which the *firm* has been granted a *K-CMG permission*.
K-TCD requirement	the part of the *K-factor requirement* calculated in accordance with *MIFIDPRU* 4.14 that is based on the transactions listed in *MIFIDPRU* 4.14.3R and not otherwise excluded by *MIFIDPRU* 4.14.5R or *MIFIDPRU* 4.14.6R, where those transactions are: (1) recorded in the *trading book* of a *firm dealing on own account* (whether or itself or on behalf of a *client*); or (2) in the case of transactions specified in *MIFIDPRU* 4.14.3R(7), undertaken by a *firm* that has the necessary *permissions* to *deal on own account*.
K-factor metric	any of the following: (1) *ASA*; (2) *AUM*; (3) *CMG*; (4) *CMH*; (5) *COH*; (6) *CON*; (7) *DTF*; (8) *NPR*; and (9) *TCD*.
K-factor requirement	the part of the *own funds requirement* calculated in accordance with *MIFIDPRU* 4.6.

liquid assets	[*Editor's note*: The *FCA* will consult on this definition in a subsequent consultation paper.]
majority common management	a relationship between an *undertaking* ("A") and another *undertaking* ("B") where: (1) A and B are not connected by virtue of being a *parent undertaking* and *subsidiary undertaking* in accordance with section 1162 (read together with Schedule 7) of the Companies Act 2006; and (2) the administrative, management or supervisory bodies of A and B consist, for the major part, of the same *persons* in office during the financial year in respect of which it is being decided whether such a relationship exists.
Market Risk Model Extensions and Changes RTS	Part 1 (FCA) of the *UK* version of Regulation (EU) No 529/2014 of 12 March 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for assessing the materiality of extensions and changes of the Internal Ratings Based Approach and the Advanced Measurement Approach, which is part of *UK* law by virtue of the *EUWA*.
MIFID client money	(in *MIFIDPRU*) *money* that a *MIFIDPRU investment firm* receives from, or holds for or on behalf of, a *client* in the course of, or in connection with, its *MIFID business*. For the purposes of *MIFIDPRU*, this includes: (1) where such *money* has been deposited into a *client bank account* in accordance with *CASS* 7.13.3R; (2) where a *MIFIDPRU investment firm* has placed such *money* in a *qualifying money market fund* in accordance with *CASS* 7.13.3R(4); and (3) any amount of such *money* which a *MIFIDPRU investment firm* has allowed a third party to hold in accordance with *CASS* 7.14.][18]
MIFIDPRU	the Prudential sourcebook for MiFID Investment Firms.
MIFIDPRU-eligible institution	(in *MIFIDPRU* 5) means (1) a *MIFIDPRU investment firm*; (2) a *UK credit institution*;

[18] The FCA will consult on the rules relating to the calculation of K-CMH and the definition of "client money held" and "MiFID client money" for these purposes in a subsequent consultation. This draft definition is provided here for context in this consultation paper.

	(3) a *UK designated investment firm*;
	(4) a *MIFIDPRU-eligible third country investment firm*; or
	(5) a *MIFIDPRU-eligible third country credit institution*.
MIFIDPRU-eligible third country investment firm	an *investment firm* which satisfies the following conditions:
	(1) its registered office or, if it has no registered office, its head office is outside the *UK*;
	(2) it is authorised by a *third country competent authority* in the state or territory in which the *investment firm's* head office is located; and
	(3) the *investment firm* is subject to prudential supervisory and regulatory requirements in that state or territory which are comparable to those applied in the *UK*.
MIFIDPRU-eligible third country credit institution	a *credit institution* which satisfies the following conditions:
	(1) its registered office or, if it has no registered office, its head office is outside the *UK*;
	(2) it is authorised by a *third country competent authority* in the state or territory in which the *credit institution's* head office is located; and
	(3) the *credit institution* is subject to prudential supervisory and regulatory requirements in that state or territory which are comparable to those applied in the *UK*.
MIFIDPRU investment firm	an FCA investment firm as defined in [section 143A of the *Act*].[19]
	In summary, this an *investment firm* that meets the following conditions:
	(1) it is an *authorised person*;
	(2) it is not a *designated investment firm*;
	(3) it has its registered office or, if it has no registered office, its head office in the *UK*;
	(4) it is not a *person* who is excluded from the definition of an "investment firm" in article 3(1) of the *Regulated Activities Order* by paragraphs (a) or (b) of that definition; and

[19] *Editor's note*: This definition is based on the definition in the Financial Services Bill, as introduced in the House of Commons on 20 October 2020. This definition may change if the Bill is amended during the parliamentary process.

	(5) it is not an *investment firm* that has a *Part 4A permission* to carry on regulated activities as an exempt investment firm within the meaning of regulation 8 of the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017.
net position risk	the value of the following positions of a *MIFIDPRU investment firm*: (1) *trading book* positions; and (2) positions other than *trading book* positions where such positions give rise to foreign exchange risk or commodity risk.
non-financial sector entity	an entity which is not a *financial sector entity*.
non-segregated account	(in *MIFIDPRU*) any account that is not a *segregated account*.
non-SNI MIFIDPRU investment firm	a *MIFIDPRU investment firm* that is not an *SNI MIFIDPRU investment firm*.
NPR	*net position risk*
OFR	(in *MIFIDPRU* 5) the own funds requirement for exposures to a *client* or *group of connected clients* calculated in accordance with *MIFIDPRU* 5.7.3R(2).
OFRE	(in *MIFIDPRU* 5) the own funds requirement for the excess calculated in accordance with *MIFIDPRU* 5.7.3R(1).
own funds requirement	the requirement for a *MIFIDPRU investment firm* to maintain a minimum level of *own funds* specified in *MIFIDPRU* 4.3.[20]
permanent minimum capital requirement	the part of the *own funds requirement* calculated in accordance with *MIFIDPRU* 4.4.
portfolio	(in relation to the *K-CMG requirement* or a *K-CMG permission*) either: (1) all the *trading book* positions attributable to a specific *trading desk* within the *firm*; or

[20] *Editor's note*: It is the FCA's intention that MIFIDPRU 4.3 will contain the draft rules specifying the basic own finds requirement for a MIFIDPRU investment firm. This will be the higher of the fixed overheads requirement and the permanent minimum capital requirement for an SNI investment firm, and the highest of the fixed overheads requirement, permanent minimum capital requirement and K-factor requirement for a non-SNI firm. These draft rules will be published in a subsequent consultation paper.

	(2)	a subset of the positions in (1) that share identified common characteristics and risks.
positions held with trading intent	any of the following:	
	(a)	proprietary positions and positions arising from client servicing and market making;
	(b)	positions intended to be resold in the short term;
	(c)	positions intended to benefit from actual or expected short-term price differences between buying and selling prices or from other price or interest rate variations.
relevant financial undertaking	any of the following:	
	(1)	an *investment firm*;
	(2)	a *financial institution*;
	(3)	an *ancillary services undertaking*; or
	(4)	a *tied agent*.
responsible UK parent	(for the purposes of the *group capital test*) an *undertaking* ("A") in relation to which all of the following conditions are satisfied:	
	(1)	A is incorporated in the *UK* or has its registered office (or, if it has no registered office, its head office) in the *UK*;
	(2)	A is part of an *investment firm group*;
	(3)	A is the *parent undertaking* of an *undertaking* established in a *third country* ("B");
	(4)	B:
		(a) is a *parent undertaking*; and
		(b) would be a *relevant financial undertaking* if B were established in the *UK*; and
	(5)	A does not have a *subsidiary* which:
		(a) is incorporated in the *UK* or has its registered office (or, if it has no registered office, its head office) in the *UK*; and
		(b) is a *parent undertaking* of B.

segregated account	[*Editor's note*: the *FCA* will consult on this definition in a subsequent consultation.]
SNI MIFIDPRU investment firm	a *MIFIDPRU investment firm* that is classified as an *SNI MIFIDPRU investment firm* in accordance with *MIFIDPRU* 1.2.
TCD	*trading counterparty default*
TCD own funds requirement	the own funds requirement calculated in accordance with *MIFIDPRU* 4.14.17R which applies to the transactions specified in *MIFIDPRU* 4.14.1R(2).
trading counterparty default	the exposures in the *trading book* of a *MIFIDPRU investment firm* in instruments and transactions specified in *MIFIDPRU* 4.14.3R, and not otherwise excluded by *MIFIDPRU* 4.14.5R or *MIFIDPRU* 4.14.6R, giving rise to the risk of trading counterparty default.
trading desk	an identified group of *individuals* established by a *firm* for the joint management of one or more portfolios of *trading book* positions in accordance with a well-defined and consistent business strategy, operating under the same risk management structure.
UK credit institution	a *credit institution* that meets the definition of "CRR firm" under article 4(1)(2A) of the *UK CRR*.
UK investment holding company	an *investment holding company* that is incorporated in the *United Kingdom* or that has its registered office (or, if it has no registered office, its head office) in the *United Kingdom*.
UK mixed-activity holding company	a *mixed-activity holding company* that is incorporated in the *United Kingdom* or that has its registered office (or, if it has no registered office, its head office) in the *United Kingdom*.
UK mixed financial holding company	a *mixed financial holding company* that is incorporated in the *United Kingdom* or that has its registered office (or, if it has no registered office, its head office) in the *United Kingdom*.
UK parent entity	any of the following: (1) a *UK parent investment firm*; (2) a *UK parent investment holding company*; or (3) a *UK mixed financial holding company*.
UK parent investment firm	a *MIFIDPRU investment firm* which: (1) is part of an *investment firm group*; (2) either holds a *participation* in or has as a *subsidiary*:

(a) a *MIFIDPRU investment firm*;

(b) a *designated investment firm*; or

(c) a *financial institution*; and

(3) is not a *subsidiary* of:

(a) a *MIFIDPRU investment firm*; or

(b) an *investment holding company* or *mixed financial holding company* that is incorporated in the *UK* or that has its registered office (or, if it has no registered office, its head office) in the *UK*.

UK parent investment holding company	an *investment holding company* incorporated in the *UK* or that has its registered office (or, if it has no registered office, its head office) in the *UK* which: (1) is part of an *investment firm group*; and (2) is not a *subsidiary* of: (a) a *MIFIDPRU investment firm*; or (b) an *investment holding company* or *mixed financial holding company* that is incorporated in the *UK* or that has its registered office (or, if it has no registered office, its head office) in the *UK*.
UK parent mixed financial holding company	a *mixed financial holding company* incorporated in the *UK* or that has its registered office (or, if it has no registered office, its head office) in the *UK* which: (1) is part of an *investment firm group*; and (2) is not a *subsidiary* of: (a) a *MIFIDPRU investment firm*; or (b) an *investment holding company* or *mixed financial holding company* that is incorporated in the *UK* or that has its registered office (or, if it has no registered office, its head office) in the *UK*.

Amend the following definitions as shown.

additional tier 1 capital	<u>(1)</u>	<u>(in *MIFIDPRU*) as defined in article 61 of the *UK CRR*, as applied and modified by the requirements in *MIFIDPRU* 3.4.</u>

	(2)	(except in *MIFIDPRU*) as defined in article 61 of the *UK CRR*.
additional tier 1 instrument	(1)	(in relation to an instrument issued by a *MIFIDPRU investment firm*) a capital instrument that qualifies as an additional tier 1 capital instrument under article 52 of the *UK CRR* as applied and modified by the requirements in *MIFIDPRU* 3.4.
	(2)	(in any other case) a capital instrument that qualifies as an additional tier 1 capital instrument under article 52 of the *UK CRR*.
central counterparty	~~(for the purpose of *BIPRU* 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions))~~ an entity that legally interposes itself between counterparties to contracts traded within one or more financial markets, becoming the buyer to every seller and the seller to every buyer.	
	…	
client	…	…

(B) in the *FCA Handbook*:

(1) (except in *PROF*, in *MIFIDPRU* 5, in relation to a *credit-related regulated activity*, in relation to a *home finance transaction* and in relation to *insurance risk transformation* and activities directly arising from *insurance risk transformation*) has the meaning given in *COBS* 3.2, that is (in summary and without prejudice to the detailed effect of *COBS* 3.2) a *person* to whom a *firm* provides, intends to provide or has provided a service in the course of carrying on a *regulated activity*, or in the case of *MiFID or equivalent third country business*, an *ancillary service*:

…

(2A) (in *MIFIDPRU* 5) means any counterparty of the *investment firm*.

…

client money …

	(2A)	(in *MIFIDPRU*, *FEES*, *CASS* 6, *CASS* 7, *CASS* 7A and *CASS* 10 and, in so far as it relates to matters covered by *CASS* 6, *CASS* 7, *COBS* or *GENPRU* and *IPRU(INV)* 11) subject to the *client money rules*, *money* of any currency:
		…
common equity tier 1 capital	(1)	(in *MIFIDPRU*) as defined in article 50 of the *UK CRR*, as applied and modified by the requirements in *MIFIDPRU* 3.3.
	(2)	(except in *MIFIDPRU*) as defined in article 50 of the *UK CRR*.
consolidated basis	~~has the meaning in article 4(1)(48) of the *UK CRR*.~~ means on the basis of the *consolidated situation*.	
consolidated situation	~~has the meaning in article 4(1)(47) of the *UK CRR*.~~ the situation that results from applying the requirements in *MIFIDPRU* 3, 4, 5, [8] and 9[21] in accordance with *MIFIDPRU* 2.5 to a *UK parent entity* as if that *undertaking* formed, together with all the *investment firms*, *financial institutions*, *ancillary services undertakings* and *tied agents* in the *investment firm group*, a single *MIFIDPRU investment firm*. For the purpose of this definition, the terms *investment firm*, *financial institution*, *ancillary services undertaking* and *tied agent* shall also apply to *undertakings* established in other countries, which, were they established in the *UK*, would fulfil the definitions of those terms.	
control	(1)	(except in ~~(2) and (2A)~~ (2), (2A) and (2B))
	…	
	(2B)	(in *MIFIDPRU* 5) the relationship between a parent undertaking and a subsidiary undertaking, as defined in section 1162 of the Companies Act 2006, or the accounting standards to which an undertaking is subject under section 403(1) of the Companies Act 2006, or a similar relationship between a natural or legal *person* and an undertaking.
	(3)	(except in ~~(2) and (2A)~~ (2), (2A) and (2B)) …
		…
	(4)	(except in ~~(2) and (2A)~~ (2), (2A) and (2B)) …

[21] The FCA will consult on any remaining content of MIFIDPRU 4 and 9 and on the content of MIFIDPRU 8 in a subsequent consultation.

…

(5) (except in ~~(2) and (2A)~~ <u>(2), (2A) and (2B)</u>) …

…

convertible	(for the purposes of ~~*BIPRU* and *IFPRU*~~ <u>*MIFIDPRU*</u>) a *security* which gives the investor the right to convert the *security* into a *share* at an agreed price or on an agreed basis.
current market value	~~(for the purpose of *BIPRU* 13.5 (CCR standardised method)) the net market value of the portfolio of transactions within the *netting set* with the counterparty; both positive and negative market values are used in computing *current market value*.~~ the net market value of the portfolio of transactions or securities legs subject to netting in accordance with *MIFIDPRU* 4.14.28R (Netting), where both positive and negative market values are used in computing *CMV*.
data element	A discrete fact or individual piece of information relating to a particular field within a *data item* required to be submitted to the *appropriate regulator* by a *firm*<u>,</u> ~~or~~ other regulated entity <u>or *parent undertaking*</u>.
data items	One or more related *data elements* that are grouped together into a prescribed format and required to be submitted by<u>:</u> <u>(1)</u> a *firm* or other regulated entity under *SUP* 16 or provisions referred to in *SUP* 16<u>; or</u> <u>(2)</u> <u>a *MIFIDPRU investment firm* or a *parent undertaking* under *MIFIDPRU* 9</u>.
financial holding company	~~a *financial institution* that fulfils the following conditions:~~ ~~(1)~~ ~~(except in (2))~~ has the meaning in article 4(1)(20) of the *UK CRR*. ~~(2)~~ ~~(in *GENPRU* (except *GENPRU* 3) and *BIPRU* (except *BIPRU* 12) a *financial institution* that fulfils the following conditions:~~ ~~(a)~~ ~~its *subsidiary undertakings* are exclusively or mainly *CAD investment firms* or *financial institutions*;~~ ~~(b)~~ ~~at least one of those *subsidiary undertakings* is a *CAD investment firm*; and~~ ~~(b)~~ ~~it is not a *mixed financial holding company*.~~
financial institution	…

	(5)	(for the purposes of *MIFIDPRU*) an *undertaking* that fulfils the following conditions:
		(a) it is a *financial holding company*, a *mixed financial holding company*, an *investment holding company*, an *authorised payment institution* or an *asset management company*, or any other *undertaking* the principal activity of which is to acquire holdings or to pursue one or more of the *Annex 1 activities*; and
		(b) it is not one of the following:
		(i) a *UK credit institution*;
		(ii) a *MIFIDPRU investment firm*;
		(iii) a pure industrial holding company; or
		(iv) an insurance holding company or mixed-activity insurance holding company, as defined in the *PRA Rulebook*.
fixed overheads requirement	(1)	~~(except in *IPRU(INV)* and for the purposes of *GENPRU* (except *GENPRU* 3 and *BIPRU* (except *BIPRU* 12)) the part of the *capital resources requirement* calculated in accordance with *GENPRU* 2.1.53R (Calculation of the fixed overheads requirement).~~ [deleted]
	(2)	(in *IPRU(INV)*) the part of the own funds requirement calculated in accordance with *IPRU(INV)* 11.3.3R (Fixed overheads requirement).
	(3)	(in *MIFIDPRU*) the part of the *own funds requirement* calculated in accordance with *MIFIDPRU* [4.5].
group of connected clients		~~has the meaning given to it in article 4.1(39) of the *UK CRR*.~~ (in *MIFIDPRU* 5) has the meaning in *MIFIDPRU* 5.1.12R to 5.1.16R.
initial capital		…
	(4)	~~(in the case of a *BIPRU firm*) *capital resources* included in stage A (Core tier one capital) of the *capital resources table* plus *capital resources* included in stage B of the *capital resources table* (Perpetual non-cumulative preference shares).~~ [deleted]
	(5)	[deleted]

	(6)	~~(for the purposes of the definition of *dealing on own account* in *BIPRU* and in the case of an *undertaking* not falling within (3) or (4)) *capital resources* calculated in accordance with (3) and paragraphs (3) and (4) of the definition of *capital resources*.~~ [deleted]
	(7)	(in *IPRU(INV)* 13) the initial capital of a *firm* calculated in accordance with *IPRU(INV)* 13.1A.6R.
	(8)	~~(for an *IFPRU investment firm*) the amount of *own funds* referred to in article 26(1)(a) to (e) of the *UK CRR* and calculated in accordance with Part Two of those Regulations (Own funds).~~ ~~[Note: article 28(1) of *CRD*]~~ [deleted]
	(9)	~~(for the purpose of the definition of dealing on own account in *IFPRU*) the amount of *own funds* referred to in article 26(1)(a) to (e) of the *UK CRR* and calculated in accordance with Part Two of those Regulations (Own funds).~~ [deleted]
	(10)	(for a *MIFIDPRU investment firm*) the amount of *own funds* that is required for *authorisation* as a *MIFIDPRU investment firm* in accordance with *MIFIDPRU* 4.2.1R).
institution	(1)	has the meaning in article 4(1)(3) of the *UK CRR*.
	(2)	(for the purposes of ~~*GENPRU* and *BIPRU*~~ *MIFIDPRU*) ~~includes a *CAD investment firm*~~ a *UK credit institution* or a *designated investment firm*.
long settlement transaction	a transaction where a counterparty undertakes to deliver a security, a *commodity*, or a *foreign currency* amount against cash, other ~~*CRD*~~ *financial instruments*, or *commodities*, or vice versa, at a settlement or delivery date ~~that is contractually specified as more than the lower of~~ specified by contract that is later than the market standard for this particular type of transaction ~~and~~ or five *business days* after the date on which the *person* enters into the transaction, whichever is earlier. ~~[Note: Part 1 of Annex III of the *Banking Consolidation Directive* (Definitions)]~~	
margin lending transaction	~~for the purpose of *BIPRU* 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) transactions in which a person extends credit in connection with the purchase, sale, carrying or trading of securities; the definition does not include other loans that happen to be secured by securities collateral.~~	

~~[Note: Part 1 of Annex III of the *Banking Consolidation Directive* (Definitions)]~~

has the meaning in point (10) of article 3 of the *SFTR*.

mixed-activity holding company

(1) (in *IFPRU* 11, *SUP* 16 and *SYSC* 12) has the meaning given to the definition of "mixed activity holding company" in article 4(1)(22) of the *UK CRR*~~.~~;

(2) (in *MIFIDPRU*) a *parent undertaking* that meets the following conditions:

(a) its *subsidiaries* include at least one *MIFIDPRU investment firm*; and

(b) it is not a *financial holding company*, an *investment holding company*, a *credit institution*, an *investment firm* or a *mixed financial holding company*.

netting set

~~(for the purpose of *BIPRU* 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) a group of transactions with a single counterparty that are subject to a legally enforceable bilateral netting arrangement and for which netting is recognised under *BIPRU* 13.7 (Contractual netting), *BIPRU* 5 (Credit risk mitigation) and, if applicable, *BIPRU* 4.10 (The IRB approach: Credit risk mitigation); each transaction that is not subject to a legally enforceable bilateral netting arrangement, which is recognised under *BIPRU* 13.7 must be interpreted as its own netting set for the purpose of *BIPRU* 13. Under the method set out at *BIPRU* 13.6, all *netting sets* with a single counterparty may be treated as a single *netting set* if negative simulated market values of the individual sets are set to zero in the estimation of *expected exposure* (EE).~~

~~[Note: Part 1 of Annex III of the *Banking Consolidation Directive* (Definitions) and Annex III, Part 1, point 5 of the *Banking Consolidation Directive*]~~

(in *MIFIDPRU*) a group of transactions with a single counterparty that meet the conditions in *MIFIDPRU* 14.14.28R.

own funds

(1) ~~(in *GENPRU* (except *GENPRU* 3 (Cross sector groups) and *BIPRU* (except *BIPRU* 12 (Liquidity standards)) own funds as described in articles 56 to 67 of the *Banking Consolidation Directive*.~~ [deleted]

…

~~(3A)~~ ~~(in *IPRU(INV)* 13) the own funds of a firm calculated in accordance with *IPRU(INV)* 13.1A.14R (Own funds) for~~

~~a *personal investment firm* that is an *exempt CAD firm*~~ [deleted]

…

(5) (except in (1) to (4)) has the meaning in ~~article 4(1)(118) of the *CRR*~~ *MIFIDPRU* 3.2.1R.

own funds instruments

(1) (in relation to an instrument issued by a *MIFIDPRU investment firm*) capital instruments that qualify as *common equity tier 1 instruments*, *additional tier 1 instruments* or *tier 2 instruments*.

(2) (in relation to a *parent undertaking* to which the *group capital test* applies) as defined in *MIFIDPRU* 2.6.2R.

(3) (in any other case) has the meaning in article 4(1)(119) of the *UK CRR*.

parent undertaking …

(3) (for the purposes of *GENPRU* 3, *BIPRU* 12, ~~*IFPRU*,~~ *SYSC* 19A (IFPRU Remuneration Code) and *SYSC* 19D (Dual-regulated firms Remuneration Code)) has the meaning in article 4(1)(15) of the *UK CRR* but so that article 4(1)(15)(b) applies for the purpose of *GENPRU* 3.

[Note: article 2(9) of the Financial Groups Directive]

(4) (for the purposes of *MIFIDPRU*, [*SYSC* 19G (MIFIDPRU Remuneration Code)] and otherwise in relation to an *investment firm group*):

(a) an *undertaking* which is a parent undertaking under section 1162 of the Companies Act 2006, taken with Schedule 7 to that Act; or

(b) (for the purposes of *MIFIDPRU* 2.5):

(i) an *undertaking* referred to in (a); and

(ii) an *undertaking* that is deemed to be a *parent undertaking* in accordance with *MIFIDPRU* 2.4.

participation

~~(1) (for the purposes of *GENPRU* (except *GENPRU* 3) and for the purposes of *BIPRU* (except *BIPRU* 12) as they apply on a consolidated basis):~~

~~(a) a participating interest may be defined according to:~~

(i) ~~section 421A of the *Act* where applicable; or~~

(ii) ~~paragraph 11(1) of Schedule 10 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) where applicable; or~~

(iii) ~~paragraph 8 of Schedule 7 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409) where applicable; or~~

(iv) ~~paragraph 8 of Schedule 4 to the Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913) where applicable; or~~

(v) ~~paragraph 8 of Schedule 5 to the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912) where applicable; or~~

~~(b)~~ ~~(otherwise) the direct or indirect ownership of 20% or more of the voting rights or capital of an *undertaking*;~~

~~but excluding the interest of a *parent undertaking* in its *subsidiary undertaking*.~~ [deleted]

(2) ~~(except in (1)~~ has the meaning in article 4(1)(35) of the *UK CRR*.

repurchase transaction ~~(for the purposes of *BIPRU*) any agreement in which an *undertaking* or its counterparty transfers securities or *commodities* or guaranteed rights relating to title to securities or *commodities* where that guarantee is issued by a *designated investment exchange* or *recognised investment exchange* which holds the rights to the securities or *commodities* and the agreement does not allow an *undertaking* to transfer or pledge a particular security or *commodity* to more than one counterparty at one time, subject to a commitment to repurchase them or substituted securities or *commodities* of the same description at a specified price on a future date specified, or to be specified, by the transferor, being a *repurchase agreement* for the *undertaking* selling the securities or *commodities* and a *reverse repurchase agreement* for the *undertaking* buying them.~~

~~[Note: article 3(1)(m) of the *Capital Adequacy Directive* and Article 4(33) of the *Banking Consolidation Directive* (Definitions)]~~

has the meaning in article 3(9) of the *SFTR*.

securities or commodities lending or borrowing transaction

~~(for the purposes of *BIPRU*) any transaction in which an *undertaking* or its counterparty transfers securities or commodities against appropriate collateral subject to a commitment that the borrower will return equivalent securities or *commodities* at some future date or when requested to do so by the transferor, that transaction being *securities or commodities lending* for the *undertaking* transferring the securities or *commodities* and being *securities or commodities borrowing* for the *undertaking* to which they are transferred.~~

~~[Note: article 4(34) of the Banking Consolidation Directive and Article 3(1)(n) of the Capital Adequacy Directive (Definitions)]~~

a transaction that falls within the definition in article 3(7) of the *SFTR*.

securities financing transaction

…

(1B) (in *CASS* and *MIFIDPRU*) a securities financing transaction as defined in article 3(11) of the *SFTR*.

…

subsidiary

…

(2) (in relation to *MiFID business*, other than for the purposes of *MIFIDPRU*, [*SYSC* 19G (MIFIDPRU Remuneration Code)] and the definition of an *investment firm group*) a subsidiary undertaking within the meaning of article 2(10) and article 22 of the *Accounting Directive*, including any subsidiary of a subsidiary undertaking of an ultimate *parent undertaking*.

(3) ~~(for the purpose of *IFPRU*) has the meaning in article 4(1)(16) of the *UK CRR*.~~ (for the purposes of *MIFIDPRU*, [*SYSC* 19G (MIFIDPRU Remuneration Code)] and in the definition of an *investment firm group*) an *undertaking* which is a subsidiary undertaking under section 1162 of the Companies Act 2006, read with Schedule 7 to that Act.

…

tier 2 capital

(1) (in *MIFIDPRU*) as defined in article 71 of the *UK CRR*, as applied and modified by the requirements in *MIFIDPRU* 3.5.

	(2)	(except in *MIFIDPRU*) as defined in article 71 of the *UK CRR*.
trading book	(1)	[deleted]
	(2)	~~(in *BIPRU* and *GENPRU* in relation to a *BIPRU firm*) has the meaning in *BIPRU* 1.2 (Definition of the trading book) which is in summary, all that *firm's positions* in *CRD financial instruments* and *commodities* held either with trading intent or in order to hedge other elements of the *trading book*, and which are either free of any restrictive covenants on their tradability or able to be hedged.~~ [deleted]
	(3)	~~(in *BIPRU* and *GENPRU* and in relation to a *person* other than a *BIPRU firm*) has the meaning in (2) with references to a *firm* replaced by ones to a *person*.~~ [deleted]
	(4)	~~(in *IFPRU* and in relation to an *IFPRU investment firm*) has the meaning in article 4(1)(86) of the *UK CRR*.~~ [deleted]
	(5)	(in *DTR*) has the meaning in article 4.1(86) of *UK CRR*.
	(6)	(in *MIFIDPRU*) all positions in *financial instruments* and commodities held by a *MIFIDPRU investment firm* that are: (a) *positions held with trading intent*; or (b) held in order to hedge *positions held with trading intent*.
UK CRR	(1)	the *UK* version of Regulation of the European Parliament and the Council on prudential requirements for credit institutions and investment firms (Regulation (EU) No 575/2013) and amending Regulation (EU) No 648/2012, which is part of *UK* law by virtue of the *EUWA*.
	(2)	(in *MIFIDPRU* TP 2) has the meaning in *MIFIDPRU* TP 2.5R.

Delete the following definitions. The text is not shown struck through.

deal on own account[22]	(1)	(for the purposes of *GENPRU* and *BIPRU*) has the meaning in *BIPRU* 1.1.23 R (Meaning of dealing on own account) which is in summary the service referred to in paragraph 3 of Part 3 of Schedule 2 to the *Regulated Activities Order*, subject to the adjustments in *BIPRU* 1.1.23R(2) and *BIPRU* 1.1.23R(3).
	(2)	(2) (other than in *GENPRU* and *BIPRU*) has the meaning in *IFPRU* 1.1.12 R (Meaning of dealing on own account) which is, in summary, the service referred to in paragraph 3 of Part 3 of Schedule 2 to the *Regulated Activities Order,* subject to the adjustments in *IFPRU* 1.1.12R(2) and *IFPRU* 1.1.12R(3).
own funds requirements	as defined in article 92 (Own funds requirements) of the *UK CRR.*	

[22] *Editor's note*: There are currently two separate definitions in the Handbook Glossary. One is defined as "deal on own account" and is used for the purposes of referring to the "matched principal" prudential treatment in BIPRU 1.1.23R and IFPRU 1.1.12R. This definition will no longer be necessary under IFPR and is being deleted in this draft instrument. The separate definition of "dealing on own account" refers to the general MiFID activity of trading against proprietary capital resulting in the conclusion of transactions in one or more financial instruments. That definition is being retained. References in the draft rules in this instrument to "deal(s) on own account" should therefore be read as references to carrying on that general MiFID activity, in accordance with the guidance on related expressions in GEN 2.2.7R(2) and GEN 2.2.8G.

Annex C

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

16 Reporting requirements

16.1 Application

…

16.1.3 R Application of different sections of SUP 16 (excluding SUP 16.13, SUP 16.15, SUP 16.16, SUP 16.17, SUP 16.22 and SUP 16.26)

(1) Section(s)	(2) Categories of firm to which section applies	(3) Applicable rules and guidance
…		
SUP 16.18	A *full-scope UK AIFM* and a *small authorised UK AIFM*	*SUP* 16.8.3R
SUP 16.20	~~An *IFPRU 730k firm*~~ A *firm* to which *MIFIDPRU* 4.4.1R applies and a *qualifying parent undertaking* that is required to send a *recovery plan*, a *group recovery plan* or information for a resolution plan to the *FCA*	Entire Section
…		

…

16.3 General provisions on reporting

…

~~Notifications regarding financial information reporting under the UK CRR~~

~~Underwriting agents: submission to the Society of Lloyd's~~

Service of Notices Regulations

16.3.22 G The *Financial Services and Markets Act 2000 (Service of Notices) Regulations 2001* (SI 2001/1420) contain provisions relating to the service of documents on the *FCA*. They do not apply to reports required under *SUP* 16, because of the specific *rules* in this section.

…

16.3.26 G Examples of reports covering a *group* are:

(1) the compliance reports required from *banks* under *SUP* 16.6.4R;

(2) annual controllers reports required under *SUP* 16.4.5R;

(3) annual close links reports required under *SUP* 16.5.4R

(4) consolidated financial reports required from *banks* under *SUP* 16.12.5R;

(5) consolidated reporting statements required from *securities and futures firms* under *SUP* 16.12.11R~~;~~.

~~(6) reporting in relation to *defined liquidity groups* under *SUP* 16.12.~~

…

16.7A Annual report and accounts

…

Requirement to submit annual report and accounts

16.7A.3 R A *firm* in the *RAG* in column (1) and which is a type of *firm* in column (2) must submit its *annual report and accounts* to the *FCA* annually on a single entity basis.

(1)	(2)
RAG	Firm type
1	*UK bank*
	Dormant account operator
	A *non-UK bank*
2.2	The *Society*
3	~~*IFPRU investment firms*~~ *MIFIDPRU investment firms*

	~~*BIPRU firms*~~	
	~~*Exempt CAD firms* subject to *IPRU (INV)* Chapter 13~~	
	All other *firms* subject to the following chapters in *IPRU(INV)*:	
	(1)	Chapter 3
	(2)	Chapter 5
	(3)	Chapter 9
4	~~*IFPRU investment firms*~~ <u>*MIFIDPRU investment firms*</u>	
	~~*BIPRU firms*~~	
	~~*Exempt CAD firms* subject to *IPRU (INV)* Chapter 13~~	
	Collective portfolio management firm	
	All other *firms* subject to the following chapters in *IPRU(INV)*:	
	(1)	Chapter 3
	(2)	Chapter 5
	(3)	Chapter 9
	~~(5)~~<u>(4)</u>	Chapter 12
5	All *firms*	
6	All *firms* other than *firms* subject to *IPRU (INV)* Chapter 13 ~~that are not *exempt CAD firms*~~	
7	~~*IFPRU investment firms*~~ <u>*MIFIDPRU investment firms*</u>	
	~~*BIPRU firms*~~	
	~~*Exempt CAD firms* subject to *IPRU (INV)* Chapter 13~~	
8	All *firms* other than *firms* subject to *IPRU (INV)* Chapter 13 ~~that are not *exempt CAD firms*~~	

…

Requirement to submit annual report and accounts for mixed activity holding companies

16.7A.5 R A *firm* in the *RAG* group in column (1), which is a type of firm in column (2) and whose ultimate parent is a *mixed activity holding company* must:

(1) submit the *annual report and accounts* of the *mixed activity holding company* to the *FCA* annually; and

(2) notify the *FCA* that it is covered by this reporting requirement by email using the email address specified in *SUP* 16.3.10G(3), by its *accounting reference date*.

(1)	(2)
RAG	Firm type
1	*UK bank*
3	~~*IFPRU investment firm*~~ <u>*MIFIDPRU investment firm*</u>
	~~*BIPRU firm*~~
4	~~*IFPRU investment firm*~~ <u>*MIFIDPRU investment firm*</u>
	~~*BIPRU firm*~~
7	~~*IFPRU investment firm*~~ <u>*MIFIDPRU investment firm*</u>
	~~*BIPRU firm*~~

…

Time period for firms submitting annual report and accounts for mixed activity holding companies

16.7A.9 R *Firms* must submit the *annual report and accounts* of a *mixed activity holding company* in accordance with *SUP* 16.7A.5R within 7 months of their *accounting reference date*.

…

16.12 Integrated Regulatory Reporting

…

Purpose

16.12.2 G (1) *Principle* 4 requires *firms* to maintain adequate financial resources. ~~The Interim Prudential sourcebooks, *BIPRU*, *GENPRU* and *IFPRU*~~ The prudential sourcebooks, which are contained in the Prudential Standards block in the *Handbook*, set out the *FCA's* detailed capital adequacy requirements. By submitting regular data, *firms* enable the *FCA* to monitor their compliance with *Principle* 4 and their prudential requirements.

…

16.12.3-A G ~~(1)~~ ~~*Investment firms* subject to the *UK CRR* should refer to any relevant technical standards to determine their specific reporting obligations, as those obligations may extend beyond those specified in this chapter.~~

~~(2)~~ ~~Where a *firm* submits a *data item* pursuant any applicable provision of the *UK CRR* any *data item* with the same name and purpose does not have to be submitted again regardless of *RAG*.~~ [deleted]

16.12.3-B G ~~In relation to an *investment firm* subject to the *UK CRR*, where an expression appearing in italics in this chapter is also used in the *UK CRR*, the italicised expression:~~

~~(1)~~ ~~has the same meaning as the corresponding expression used in the *UK CRR*; or~~

~~(2)~~ ~~is interpreted in the context of the risk or requirement in the *UK CRR* that corresponds to the risk or requirement referred to in the italicised expression.~~ [deleted]

16.12.3B G *Firms'* attention is drawn to *SUP* 16.3.25G regarding a single submission for all *firms* in the group.

16.12.4 R Table of applicable ~~rules~~ *rules* containing *data items*, frequency and submission periods

(1)		**(2)**	**(3)**	**(4)**
***RAG* number**	***Regulated Activities***	**Provisions containing:**		
		applicable *data items*	**reporting frequency / period**	**due date**

RAG 1	• accepting deposits • *meeting of repayment claims* • *managing dormant account funds (including the investment of such funds)*	*RAG* 1 *firms* should complete their prudential reporting requirements as set out in the *PRA Rulebook*.		
…	…			
RAG 3	• dealing in investment as principal • dealing in investments as agent • advising on investments (except P2P agreements) (excluding retail investment activities) • arranging (bringing about) deals in investments (excluding retail investment activities) • advising on P2P agreements (when carried on exclusively with or for professional clients)	*SUP* 16.12.10R *SUP* 16.12.11R ~~except FSA001 and FSA002 on *consolidated basis* for *FINREP firms*~~	*SUP* 16.12.10R *SUP* 16.12.12R	*SUP* 16.12.10R *SUP* 16.12.13R
RAG 4	• managing investments • establishing,	*SUP* 16.12.14R *SUP* 16.12.15R~~,~~	*SUP* 16.12.14R	*SUP* 16.12.14R

	operating or winding up a collective investment scheme • establishing, operating or winding up a stakeholder pension scheme • establishing, operating or winding up a personal pension scheme • managing an *AIF* • *managing a UK UCITS* • *operating an electronic system in relation to lending* (*FCA-authorised persons* only)	~~except FSA001 and FSA002 on *consolidated basis* for *FINREP firms*~~	*SUP* 16.12.16R	*SUP* 16.12.17R
…	…	…	…	…
RAG 7	• retail investment activities • advising on P2P agreements (except when carried on exclusively with or for professional clients) • advising on pensions transfers & opt-outs • arranging (bringing about deals) in retail	*SUP* 16.12.22AR ~~except FSA001 and FSA002 on *consolidated basis* for *FINREP firms*~~	*SUP* 16.12.23AR	*SUP* 16.12.24AR

	investments			
RAG 8	• making arrangements with a view to transactions in investments • operating a multilateral trading facility • operating an organised trading facility	*SUP* 16.12.25AR ~~or *SUP* 16.12.25CR for *UK designated investment firms* except FSA001 and FSA002 on *consolidated basis for FINREP firms*~~	*SUP* 16.12.26R	*SUP* 16.12.27R
…	…	…	…	…

~~Group liquidity reporting~~

16.12.4B G ~~Reporting at group level for liquidity purposes by *firms* falling within BIPRU 12 (Liquidity) is by reference to *defined liquidity groups*. *Guidance* about the different types of *defined liquidity groups* and related material is set out in *SUP* 16 Annex 26 (Guidance on designated liquidity groups in *SUP* 16.12).~~ [deleted]

Investment firm group reporting

16.12.4C G *Investment firm groups* are reminded that *MIFIDPRU* 9 contains reporting requirements for:

(1) *UK parent entities* of *investment firm groups* that are subject to consolidation under *MIFIDPRU* 2.5; and

(2) *parent undertakings* that are subject to the *group capital test*.

Those reporting requirements apply irrespective of whether the *UK parent entity* or *parent undertaking* is an *authorised person*.

~~Regulated Activity Group 1~~

Regulated Activity Group 2.2

16.12.9 R The applicable *data items* referred to in *SUP* 16.12.4R are set out according to type of *firm* in the table below.

The applicable reporting frequencies for submission of *data items* and periods referred to in *SUP* 16.12.4R are set out in the table below and are calculated from a *firm's accounting reference date*, unless indicated otherwise.

The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period.

	Member's adviser		the *Society* (note 1)		
Description of *data item*	Frequency	Submission deadline	Description of *data item*	Frequency	Submission deadline
…	…	…	…	…	…
Balance Sheet					
FSA001 (~~notes 15,~~ note 20) or	Quarterly or half yearly	(note 14)			
…	…	…			
Large Exposures					
FSA008 (~~Notes~~ note 20~~, 21~~)	Quarterly	20 *business days* (note 19)			
…	…	…			
Note 1	The *Society* must prepare its reports in the format specified in *IPRU(INS)* Appendix 9.11, unless Note 2 applies.				
…	…				
Note 14	~~*BIPRU firms* report half yearly on 30 *business days* submission.~~ All UK *consolidation group* reports report half yearly on 45				

	business days submission. All other *firms* report monthly on 20 *business days* submission.
Note 15	~~This *data item* only applies to *BIPRU firms*.~~ [deleted]
…	…
Note 21	~~This will not be applicable to *BIPRU firms*.~~ [deleted]

16.12.9A G A *member's adviser* that is also ~~an *IFPRU investment firm*~~ a *MIFIDPRU investment firm* will also fall under one of the higher number *RAGs* that apply to ~~*IFPRU investment firms*~~ *MIFIDPRU investment firms*. That means it will have to report *data items* in addition to those that it has to supply under *RAG* 2.2.

Regulated Activity Group 3

…

16.12.11 R The applicable *data items* referred to in *SUP* 16.12.4R are set out according to *firm* type in the table below:

[*Editor's note*: The existing table in SUP 16.12.11R is deleted in its entirety. The deleted text is not shown. The following table is inserted to replace the deleted text.]

Description of *data item*	*Firms'* prudential category and applicable *data items* (note 1)				
	MIFIDPRU investment firms	Firms other than *MIFIDPRU investment firms*			
		IPRU(INV) Chapter 3	*IPRU(INV)* Chapter 5	*IPRU(INV)* Chapter 9	*IPRU(INV)* Chapter 13
Solvency statement	No standard format (note 4)	No standard format (note 6)	No standard format (note 4)		

Balance sheet	FSA029 (note 2)	FSA029 (note 5)	FSA029	FSA029	Section A RMAR
Income statement	FSA030 (note 2)	FSA030 (note 5)	FSA030	FSA030	Section B RMAR
Capital adequacy	MIF001 (notes 2 and 3)	FSA033 (note 5)	FSA034 or FSA035 or FIN071 (note 7)	FSA031	Section D1 RMAR
[Pillar 2 questionnaire]	[*Editor's note*: The FCA will consult on the form of Pillar 2 reporting in a subsequent CP]				
Threshold conditions					Section F RMAR
Client money and client assets	FSA039	FSA039	FSA039	FSA039	Section C RMAR
CFTC	FSA040 (note 8)	FSA040 (note 8)	FSA040 (note 8)	FSA040 (note 8)	FSA040 (note 8)
[Securitisations]	[*Editor's note*: The FCA will consult on potential securitisation reporting requirements in a subsequent CP]				
Liquidity	MIF002				

	(notes 2, 3 and 10)				
Metrics reporting	MIF003 (notes 2 and 3)				
Concentration risk (non-*K-CON*)	MIF004 (notes 2, 3 and 11)				
Concentration risk (*K-CON*)	MIF005 (notes 2, 3 and 11)				
Group capital test	MIF006 (notes 3 and 12)				
Liquidity Questionnaire	MLA-M (note 9)	MLA-M (note 9)	MLA-M (note 9)	MLA-M (note 9)	MLA-M (note 9)
Note 1	All *firms* (except *MIFIDPRU investment firms* in relation to items reported under *MIFIDPRU* 9) must, when submitting the completed *data item* required, use the format of the *data item* set out in *SUP* 16 Annex 24R. Guidance notes for completion of the *data items* are contained in *SUP* 16 Annex 25G.				
Note 2	A *UK parent entity* of an *investment firm group* to which consolidation applies under *MIFIDPRU* 2.5 must also submit this report on the basis of the *consolidated situation*.				
Note 3	Data items MIF001 – MIF006 must be reported in accordance with the *rules* in *MIFIDPRU* 9.				
Note 4	Only applicable to a *firm* that is a *sole trader* or *partnership*. Where the *firm* is a *partnership*, this report must be submitted by each *partner*.				

Note 5	Except if the *firm* is an *adviser* (as referred to in *IPRU(INV)* 3-60(4)R).
Note 6	Only required in the case of an *adviser* (as referred to in *IPRU(INV)* 3-60(4)R) that is a *sole trader*.
Note 7	FSA034 must be completed by a *firm* not subject to the exemption in *IPRU(INV)* 5.4.2R, unless it is a *firm* whose permitted business includes *establishing, operating or winding up a personal pension scheme*, in which case FIN071 must be completed. FSA035 must be completed by a *firm* subject to the exemption in *IPRU(INV)* 5.4.2R.
Note 8	Only applicable to *firms* granted a *Part 30 exemption order* and operating an arrangement to cover forward profits on the London Metals Exchange.
Note 9	Only applicable to RAG 3 *firms* carrying on *home financing* or *home finance administration* connected to *regulated mortgage contracts*, unless as at 26 April 2014 the *firm's Part 4A permission* was and remains subject to a restriction preventing it from undertaking new *home financing* or *home finance administration* connected to *regulated mortgage contracts*.
Note 10	Does not apply to an *SNI MIFIDPRU investment firm* which has been granted an exemption from the liquidity requirements in *MIFIDPRU* [6].
Note 11	Only applicable to a *non-SNI MIFIDPRU investment firm*.
Note 12	Only applicable to a *parent undertaking* to which the *group capital test* applies.

~~16.12.11A~~	~~G~~	~~The column in the table in *SUP* 16.12.11R that deals with *IFPRU firms* covers some liquidity items that only have to be reported by an *ILAS BIPRU firm* (please see notes 28 and 33).~~
16.12.12	R	The applicable reporting frequencies for *data items* referred to in *SUP* 16.12.4R are set out in the table below according to *firm* type. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

[*Editor's note*: The existing table in SUP 16.12.12R is deleted in its entirety. The deleted text is not shown. The following table is inserted to replace the deleted text.]

Data item	*Non-SNI MIFIDPRU investment firm*	*SNI MIFIDPRU investment firm*	*Investment firm group*	*Firm* other than a *MIFIDPRU investment firm*
Solvency statement	Annually	Annually		Annually
FSA029	Quarterly	Quarterly	Quarterly	Quarterly
FSA030	Quarterly	Quarterly	Quarterly	Quarterly
FSA031				Quarterly
FSA033				Quarterly
FSA034				Quarterly
FSA035				Quarterly
FSA039	Half yearly	Half yearly		Half yearly

FSA040	Quarterly	Quarterly		Quarterly
FIN071				Quarterly
MIF001	Quarterly (note 3)	Quarterly (note 3)	Quarterly (note 3)	
MIF002	Quarterly (note 3)	Quarterly (note 3)	Quarterly (note 3)	
MIF003	Quarterly (note 3)	Quarterly (note 3)	Quarterly (note 3)	
MIF004	Quarterly (note 3)		Quarterly (note 3)	
MIF005	Quarterly (note 3)		Quarterly (note 3)	
MIF006	Quarterly (note 3)	Quarterly (note 3)		
Section A RMAR				Half yearly (note 1) Quarterly (note 2)
Section B RMAR				Half yearly (note 1) Quarterly (note 2)

Section C RMAR				Half yearly (note 1) Quarterly (note 2)
Section D1 RMAR				Half yearly (note 1) Quarterly (note 2)
Section F RMAR				Half yearly
MLA-M	Quarterly	Quarterly	Quarterly	Quarterly
Note 1	Annual regulated business revenue up to and including £5 million.			
Note 2	Annual regulated business revenue over £5 million.			
Note 3	Reporting frequencies and reporting periods for this *data item* are calculated on a calendar year basis and not by reference to the *firm's accounting reference date*. The relevant quarters end on the last *business day* of March, June, September and December.			

16.12.13 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.12R, unless indicated otherwise.

[*Editor's note*: The existing table in SUP 16.12.13R is deleted in its entirety. The deleted text is not shown. The following table is inserted to replace the deleted text.]

Data item	Quarterly	Half yearly	Annual
Solvency statement			3 months
FSA029	20 *business days* (note 1) 30 *business days* (note 2)		
FSA030	20 *business days* (note 1) 30 *business days* (note 2)		
FSA031	20 *business days*		
FSA033	20 *business days*		
FSA034	20 *business days*		
FSA035	20 *business days*		
FSA039		30 *business days*	
FSA040	15 *business days*		
FIN071	20 *business days*		
MIF001	20 *business days* (note 1) 30 *business days* (note 2)		
MIF002	20 *business days* (note 1) 30 *business days* (note 2)		
MIF003	20 *business days*		

	(note 1) 30 *business days* (note 2)		
MIF004	20 *business days* (note 1) 30 *business days* (note 2)		
MIF005	20 *business days* (note 1) 30 *business days* (note 2)		
MIF006	20 *business days*		
Section A RMAR	30 *business days*	30 *business days*	
Section B RMAR	30 *business days*	30 *business days*	
Section C RMAR	30 *business days*	30 *business days*	
Section D1 RMAR	30 *business days*	30 *business days*	
Section F RMAR		30 *business days*	
MLA-M	20 *business days*		
Note 1	For reports relating to the position of an individual *firm*.		
Note 2	For reports relating to the *consolidated situation* of an *investment firm group*.		

Regulated Activity Group 4

…

16.12.15 R The applicable *data items* referred to in *SUP* 16.12.4R are set out according to *firm* type in the table below:

[*Editor's note*: The existing table in SUP 16.12.15R is deleted in its entirety. The deleted text is not shown. The following table is inserted to replace the deleted text.]

Description of *data item*	*Firms'* prudential category and applicable *data items* (note 1)						
	MIFIDPRU investment firms	*Firms* other than *MIFIDPRU investment firms*					
		IPRU(INV) Chapter 3	*IPRU(INV)* Chapter 5	*IPRU(INV)* Chapter 9	*IPRU(INV)* Chapter 11 (*collective portfolio management firms* only)	*IPRU(INV)* Chapter 12	*IPRU(INV)* Chapter 13
Solvency statement (note 2)	No standard format		No standard format		No standard format		
Balance sheet	FSA029 (note 3)	FSA029	FSA029	FSA029	FSA029	FSA029	Section A RMAR
Income statement	FSA030 (note 3)	FSA030	FSA030	FSA030	FSA030	FSA030	Section B RMAR

Capital adequacy	MIF001 (note 3 and 4)	FSA033	FSA034 or FSA035 or FIN071 (note 5)	FSA031	FIN066	FIN069	Section D1 RMAR
[Pillar 2 questionnaire]	[*Editor's note*: The FCA will consult on the form of Pillar 2 reporting in a subsequent CP]						
Threshold conditions							Section F RMAR
Volumes and types of business		FSA038	FSA038	FSA038	FSA038		FSA038
Client money and client assets	FSA039	FSA039	FSA039	FSA039	FSA039	FSA039	Section C RMAR
[Securitisations]	[*Editor's note*: The FCA will consult on potential securitis						

	ation reporting requirements in a subsequent CP]						
Liquidity	MIF002 (notes 3, 4 and 6)						
Metrics monitoring	MIF003 (notes 3 and 4)						
Concentration risk (non-*K-CON*)	MIF004 (notes 3, 4 and 7)						
Concentration risk (*K-CON*)	MIF005 (notes 3, 4 and 7)						
Group capital test	MIF006 (notes 4 and 8)						
Information on *P2P agreements*						FIN070	
Note 1	All *firms*, except *MIFIDPRU investment firms* in relation to items reported under *MIFIDPRU* 9, must, when submitting the completed *data*						

	item required, use the format of the *data item* set out in *SUP* 16 Annex 24. Guidance notes for completion of the *data items* are contained in SUP 16 Annex 25.
Note 2	Only applicable to a *firm* that is a *sole trader* or *partnership*. Where the *firm* is a *partnership*, this report must be submitted by each *partner*.
Note 3	A *UK parent entity* of an *investment firm group* to which consolidation applies under *MIFIDPRU* 2.5 must also submit this report on the basis of the *consolidated situation*.
Note 4	Data items MIF001 – MIF006 must be reported in accordance with the *rules* in *MIFIDPRU* 9.
Note 5	FSA034 must be completed by a *firm* not subject to the exemption in *IPRU(INV)* 5.4.2R, unless it is a *firm* whose permitted business includes *establishing, operating or winding up a personal pension scheme*, in which case FIN071 must be completed. FSA035 must be completed by a *firm* subject to the exemption in *IPRU(INV)* 5.4.2R.
Note 6	Does not apply to an *SNI MIFIDPRU investment firm* which has been granted an exemption from the liquidity requirements in *MIFIDPRU* [6].
Note 7	Only applicable to a *non-SNI MIFIDPRU investment firm*.
Note 8	Only applicable to a *parent undertaking* to which the *group capital test* applies.

16.12.15A G ~~The column in the table in *SUP* 16.12.15R that deals with *IFPRU firms* covers some liquidity items that only have to be reported by an *ILAS BIPRU firm* (please see notes 25 and 30).~~ [deleted]

16.12.16 R The applicable reporting frequencies for *data items* referred to in *SUP* 16.12.15R are set out in the table below according to *firm* type.

Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

[*Editor's note*: The existing table in SUP 16.12.16R is deleted in its entirety. The deleted text is not shown. The following table is inserted to replace the deleted text.]

Data item	*Non-SNI MIFIDPRU investment firm*	*SNI MIFIDPRU investment firm*	*Investment firm group*	*Firm* other than a *MIFIDPRU investment firm*
Solvency statement	Annually	Annually		Annually
FSA029	Quarterly	Quarterly	Quarterly	Quarterly
FSA030	Quarterly	Quarterly	Quarterly	Quarterly
FSA031				Quarterly
FSA033				Quarterly
FSA034				Quarterly
FSA035				Quarterly
FSA039	Half yearly	Half yearly		Half yearly
FIN071				Quarterly
MIF001	Quarterly (note 3)	Quarterly (note 3)	Quarterly (note 3)	

MIF002	Quarterly (note 3)	Quarterly (note 3)	Quarterly (note 3)	
MIF003	Quarterly (note 3)	Quarterly (note 3)	Quarterly (note 3)	
MIF004	Quarterly (note 3)		Quarterly (note 3)	
MIF005	Quarterly (note 3)		Quarterly (note 3)	
MIF006	Quarterly (note 3)	Quarterly (note 3)		
Section A RMAR				Half yearly (note 1) Quarterly (note 2)
Section B RMAR				Half yearly (note 1) Quarterly (note 2)
Section C RMAR				Half yearly (note 1) Quarterly (note 2)
Section D1 RMAR				Half yearly (note 1)

				Quarterly (note 2)
Section F RMAR				Half yearly (note 1) Quarterly (note 2)
Note 1	Annual regulated business revenue up to and including £5 million.			
Note 2	Annual regulated business revenue over £5 million.			
Note 3	Reporting frequencies and reporting periods for this *data item* are calculated on a calendar year basis and not by reference to the *firm's accounting reference date*. The relevant quarters end on the last *business day* of March, June, September and December.			

16.12.17 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.16R, unless indicated otherwise.

[*Editor's note*: The existing table in SUP 16.12.17R is deleted in its entirety. The deleted text is not shown. The following table is inserted to replace the deleted text.]

Data item	Quarterly	Half yearly	Annual
Solvency statement			3 months
FSA029	20 *business days* (note 1) 30 *business days* (note 2)		

FSA030	20 *business days*		
FSA031	20 *business days*		
FSA033	20 *business days*		
FSA034	20 *business days*		
FSA035	20 *business days*		
FSA039		30 *business days*	
FIN071	20 *business days*		
MIF001	20 *business days* (note 1) 30 *business days* (note 2)		
MIF002	20 *business days* (note 1) 30 *business days* (note 2)		
MIF003	20 *business days* (note 1) 30 *business days* (note 2)		
MIF004	20 *business days* (note 1) 30 *business days* (note 2)		
MIF005	20 *business days* (note 1) 30 *business days*		

	(note 2)		
MIF006	20 *business days*		
Section A RMAR	30 *business days*	30 *business days*	
Section B RMAR	30 *business days*	30 *business days*	
Section C RMAR	30 *business days*	30 *business days*	
Section D1 RMAR	30 *business days*	30 *business days*	
Section F RMAR		30 *business days*	
MLA-M	20 *business days*		
Note 1	For reports relating to the position of an individual *firm*.		
Note 2	For reports relating to the *consolidated situation* of an *investment firm group*.		

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Regulated Activity Group 6

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16.12.19A R The applicable *data items* referred to in *SUP* 16.12.4R are set out according to type of *firm* in the table below:

Description of *data item*	*Firms'* prudential category and applicable *data items* (note 1)			
	IPRU(INV) Chapter 3	*IPRU(INV)* Chapter 5	*IPRU(INV)* Chapter 9	*IPRU(INV)* Chapter 13
Solvency statement (note 6)		No standard format		

Balance sheet	FSA029	FSA029	FSA029	~~FSA029 or~~ Section A RMAR ~~(note 7)~~
Income statement	FSA030	FSA030	FSA030	~~FSA030 or~~ Section B RMAR ~~(note 7)~~
Capital adequacy	FSA033	FSA034 or FSA035 or FIN071 or FIN072 (note 4)	FSA031	~~FSA032 or~~ Section D1 RMAR ~~(notes 5 and 7)~~
Threshold conditions				Section F RMAR ~~(Note 7)~~
Client money and assets	FSA039	FSA039	FSA039	Section C RMAR ~~(note 7) or FSA039~~
Pillar 2 questionnaire		FSA019 (note 8)		
Note 1	When submitting the completed *data item* required, a *firm* must use the format of the *data item* set out in *SUP* 16 Annex 24. Guidance notes for completion of the data items are contained in *SUP* 16 Annex 25.			
Note 2	[deleted]			
Note 3	[deleted]			
Note 4	FSA034 must be completed by a *firm* not subject to the exemption in *IPRU(INV)* 5.4.2R, unless it is a *firm* whose permitted business includes *establishing, operating or winding up a personal pension scheme*, in which case FIN071 must be completed.			

	FSA035 must be completed by a *firm* subject to the exemption in *IPRU(INV)* 5.4.2R, unless the *firm* is the depositary of a *UCITS scheme* in which case, FIN072 must be completed.
Note 5	~~FSA032 must be completed by a *firm* subject to *IPRU(INV)* Chapter 13 which is an *exempt CAD firm*.~~ [deleted]
Note 6	Only applicable to a firm that is a *partnership*, when the report must be submitted by each *partner*.
Note 7	~~FSA029, FSA030, FSA032 and FSA039 only apply to a *firm* subject to *IPRU(INV)* Chapter 13 which is an *exempt CAD firm*. Sections A, B, C, D1, and F RMAR only apply to a *firm* subject to *IPRU(INV)* Chapter 13 which is not an *exempt CAD firm*.~~ [deleted]
Note 8	Only applicable to a *firm* that is the *depositary* of a *UCITS scheme*.

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Regulated Activity Group 7

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16.12.22A R The applicable *data items* referred to in *SUP* 16.12.4R are set out according to type of *firm* in the table below:

[*Editor's note*: The existing table in SUP 16.12.22AR is deleted in its entirety. The deleted text is not shown. The following table is inserted to replace the deleted text.]

Description of *data item*	*Firms'* prudential category and applicable *data item* (note 1)		
	MIFIDPRU investment firms	*Firms* subject to *IPRU(INV)* Chapter 13	*Firms* that are also in one or more of *RAGs* 2 to 6 and not subject to *IPRU(INV)* Chapter 13

Solvency statement	No standard format (note 2)		
Balance sheet	FSA029 (note 3)	Section A RMAR	
Income statement	FSA030 (note 3)	Section B RMAR	
Capital adequacy	MIF001 (notes 3 and 6)	Section D1 RMAR (note 9)	
Liquidity	MIF002 (notes 3, 4 and 6)		
Metrics monitoring	MIF003 (notes 3 and 6)		
Concentration risk (non-*K-CON*)	MIF004 (notes 3, 5 and 6)		
Concentration risk (*K-CON*)	MIF005 (notes 3, 5 and 6)		
Group capital test	MIF006 (notes 6 and 8)		
[Pillar 2 questionnaire]	[*Editor's note*: The FCA will consult on the form of Pillar 2 reporting in a subsequent CP]		

[Securitisations]	[*Editor's note*: The FCA will consult on the form of securitisation reporting in a subsequent CP]		
Professional indemnity insurance (note 15)	Section E RMAR	Section E RMAR	Section E RMAR
Threshold conditions		Section F RMAR	
Training and competence	Section G RMAR	Section G RMAR	Section G RMAR
COBS data	Section H RMAR	Section H RMAR	Section H RMAR
Client money and client assets	Section C RMAR	Section C RMAR	
Fees and levies	Section J RMAR	Section J RMAR	
Adviser charges	Section K RMAR (note 7)	Section K RMAR (note 7)	Section K RMAR (note 7)
Note 1	When submitting the completed *data item* required, a *firm* (except a *MIFIDPRU investment firm* in relation to an item reported under *MIFIDPRU* 9) must use the format of the data item set out in *SUP* 16 Annex 24R, or *SUP* 16 Annex 18AR in the case of the *RMAR*. Guidance notes for completion of the *data items* are contained in *SUP* 16 Annex 25, or *SUP* 16 Annex 18BG in the case of the *RMAR*.		
Note 2	Only applicable to a *firm* that is a *sole trader* or *partnership*. Where the *firm* is a *partnership*, this report must be submitted by each *partner*.		

Note 3	A *UK parent entity* of an *investment firm group* to which consolidation applies under *MIFIDPRU* 2.5 must also submit this report on the basis of the *consolidated situation*.
Note 4	Does not apply to an *SNI MIFIDPRU investment firm* which has been granted an exemption from the liquidity requirements in *MIFIDPRU* [6].
Note 5	Only applicable to a *non-SNI MIFIDPRU investment firm*.
Note 6	Data items MIF001 – MIF006 must be reported in accordance with the *rules* in *MIFIDPRU* 9.
Note 7	This item only applies to *firms* that provide advice on *retail investment products* and *P2P agreements*.
Note 8	Only applicable to a *parent undertaking* to which the *group capital test* applies.
Note 9	Where a *firm* submits *data items* for both RAG 7 and RAG 9, the *firm* must complete Section D1.

16.12.22B	G	~~The column in the table in *SUP* 16.12.22AR that deals with *IFPRU firms* covers some liquidity items that only have to be reported by an *ILAS BIPRU firm* (see notes 18 and 24).~~ [deleted]
16.12.23A	R	The applicable reporting frequencies for *data items* referred to in *SUP* 16.12.22AR are set out in the table below. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

[*Editor's note*: The existing table in SUP 16.12.23AR is deleted in its entirety. The deleted text is not shown. The following table is inserted to replace the deleted text.]

Data item	Frequency				
	Non-SNI MIFIDPRU investment firm	*SNI MIFIDPRU investment firm*	*Investment firm group*	Annual regulated business revenue up to and including £5 million	Annual regulated business revenue over £5 million
Solvency statement	Annually	Annually			
FSA029	Quarterly	Quarterly	Quarterly		
FSA030	Quarterly	Quarterly	Quarterly		
MIF001	Quarterly (note 1)	Quarterly (note 1)	Quarterly (note 1)		
MIF002	Quarterly (note 1)	Quarterly (note 1)	Quarterly (note 1)		
MIF003	Quarterly (note 1)	Quarterly (note 1)	Quarterly (note 1)		
MIF004	Quarterly (note 1)		Quarterly (note 1)		
MIF005	Quarterly (note 1)		Quarterly (note 1)		
MIF006	Quarterly	Quarterly			

	(note 1)	(note 1)			
Section A RMAR				Half yearly	Quarterly
Section B RMAR				Half yearly	Quarterly
Section C RMAR				Half yearly	Quarterly
Section D1 RMAR				Half yearly	Quarterly
Section E RMAR	Half yearly	Half yearly	Half yearly	Half yearly	Quarterly
Section F RMAR	Half yearly	Half yearly	Half yearly	Half yearly	Half yearly
Section G RMAR	Half yearly	Half yearly	Half yearly	Half yearly	Half yearly
Section H RMAR	Half yearly	Half yearly	Half yearly	Half yearly	Half yearly
Section J RMAR	Annually	Annually	Annually	Annually	Annually
Section K RMAR	Annually	Annually	Annually	Annually	Annually
Note 1	Reporting frequencies and reporting periods for this *data item* are calculated on a calendar year basis and not by reference to the *firm's*				

	accounting reference date. The relevant quarters end on the last *business day* of March, June, September and December.

16.12.24A R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.23AR, unless indicated otherwise.

[*Editor's note*: The existing table in SUP 16.12.24AR is deleted in its entirety. The deleted text is not shown. The following table is inserted to replace the deleted text.]

Data item	Quarterly	Half yearly	Annual
Solvency statement			3 months
FSA029	20 *business days* (note 1) 30 *business days* (note 2)		
FSA030	20 *business days* (note 1) 30 *business days* (note 2)		
MIF001	20 *business days* (note 1) 30 *business days* (note 2)		
MIF002	20 *business days* (note 1) 30 *business days* (note 2)		

MIF003	20 *business days* (note 1) 30 *business days* (note 2)		
MIF004	20 *business days* (note 1) 30 *business days* (note 2)		
MIF005	20 *business days* (note 1) 30 *business days* (note 2)		
MIF006	20 *business days*		
Section A RMAR	30 *business days*	30 *business days*	
Section B RMAR	30 *business days*	30 *business days*	
Section C RMAR	30 *business days*	30 *business days*	
Section D1 RMAR	30 *business days*	30 *business days*	
Section E RMAR	30 *business days*	30 *business days*	
Section F RMAR		30 *business days*	
Section G RMAR		30 *business days*	
Section H RMAR		30 *business days*	
Section J RMAR			30 *business days*
Section K RMAR		30 *business days*	
Note 1	For reports relating to the position of an individual *firm*.		

Note 2	For reports relating to the *consolidated situation* of an *investment firm group*.

Regulated Activity Group 8

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16.12.25A R The applicable *data items* referred to in *SUP* 16.12.4R are set out according to type of *firm* in the table below:

[*Editor's note*: The existing table in SUP 16.12.25AR is deleted in its entirety. The deleted text is not shown. The following table is inserted to replace the deleted text.]

Description of *data item*	*Firms'* prudential category and applicable *data items* (note 1)				
	MIFIDPRU investment firms	Firms other than *MIFIDPRU investment firms*			
		IPRU(INV) Chapter 3	*IPRU(INV)* Chapter 5	*IPRU(INV)* Chapter 9	*IPRU(INV)* Chapter 13
Solvency statement (note 2)	No standard format				
Balance sheet	FSA029 (note 3)	FSA029	FSA029	FSA029	Section A RMAR
Income statement	FSA030 (note 3)	FSA030	FSA030	FSA030	Section B RMAR
Capital adequacy	MIF001 (notes 3 and 5)	FSA033	FSA034 or FSA035 or FIN071 (note 4)	FSA031	Section D1 RMAR

Liquidity	MIF002 (notes 3 and 5)				
Metrics monitoring	MIF003 (notes 3 and 5)				
Concentration risk (non-*K-CON*)	MIF004 (notes 3, 5 and 7)				
Concentration risk (*K-CON*)	MIF005 (notes 3, 5 and 7)				
Group capital test	MIF006 (notes 5 and 6)				
[Pillar 2 questionnaire]	[*Editor's note*: The FCA will consult on the form of Pillar 2 reporting in a subsequent CP]				
[Securitisations]	[*Editor's note*: The FCA will consult on the form of securitisation reporting in a subsequent CP]				
Threshold conditions					Section F RMAR (note 17)
Client money and client assets	FSA039	FSA039	FSA039	FSA039	Section C RMAR

					(note 13) or FSA039
Note 1	All *firms* (except *MIFIDPRU investment firms* in relation to items reported under *MIFIDPRU* 9) when submitting the completed *data item* required, must use the format of the *data item* set out in *SUP* 16 Annex 24. Guidance notes for completion of the *data items* are contained in *SUP* 16 Annex 25.				
Note 2	Only applicable to a *firm* that is a *sole trader* or *partnership*. Where the *firm* is a *partnership*, this report must be submitted by each *partner*.				
Note 3	A *UK parent entity* of an *investment firm group* to which consolidation applies under *MIFIDPRU* 2.5 must also submit this report on the basis of the *consolidated situation*.				
Note 4	FSA034 must be completed by a *firm* not subject to the exemption in *IPRU(INV)* 5.4.2R, unless it is a *firm* whose permitted business includes *establishing, operating or winding up a personal pension scheme*, in which case FIN071 must be completed. FSA035 must be completed by a *firm* subject to the exemption in *IPRU(INV)* 5.4.2R.				
Note 5	Data items MIF001 – MIF006 must be reported in accordance with the *rules* in *MIFIDPRU* 9.				
Note 6	Only applicable to a *parent undertaking* to which the *group capital test* applies.				
Note 7	Only applicable to a *non-SNI MIFIDPRU investment firm*.				

16.12.25B	G	~~The column in the table in *SUP* 16.12.25AR that deals with *IFPRU firms* cover some liquidity items that only have to be reported by an *ILAS BIPRU firm* (see notes 23 and 28).~~ [deleted]
16.12.26	R	The applicable reporting frequencies for *data items* referred to in *SUP* 16.12.25AR are set out according to the type of *firm* in the table below. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

[*Editor's note*: The existing table in SUP 16.12.26R is deleted in its entirety. The deleted text is not shown. The following table is inserted to replace the deleted text.]

Data item	*Non-SNI MIFIDPRU investment firm*	*SNI MIFIDPRU investment firm*	*Investment firm group*	*Firm* other than a *MIFIDPRU investment firm*
Solvency statement	Annually	Annually		Annually
FSA029	Quarterly	Quarterly	Quarterly	Quarterly
FSA030	Quarterly	Quarterly	Quarterly	Quarterly
FSA031				Quarterly
FSA033				Quarterly
FSA034				Quarterly
FSA035				Quarterly
FSA039	Half yearly	Half yearly		Half yearly
FIN071				Quarterly

MIF001	Quarterly (note 3)	Quarterly (note 3)	Quarterly (note 3)	
MIF002	Quarterly (note 3)	Quarterly (note 3)	Quarterly (note 3)	
MIF003	Quarterly (note 3)	Quarterly (note 3)	Quarterly (note 3)	
MIF004	Quarterly (note 3)		Quarterly (note 3)	
MIF005	Quarterly (note 3)		Quarterly (note 3)	
MIF006	Quarterly	Quarterly		
Section A RMAR				Half yearly (note 1) Quarterly (note 2)
Section B RMAR				Half yearly (note 1) Quarterly (note 2)
Section C RMAR				Half yearly (note 1) Quarterly (note 2)

Section D1 RMAR				Half yearly (note 1) Quarterly (note 2)
Section F RMAR				Half yearly
Note 1	Annual regulated business revenue up to and including £5 million.			
Note 2	Annual regulated business revenue over £5 million.			
Note 3	Reporting frequencies and reporting periods for this *data item* are calculated on a calendar year basis and not by reference to the *firm's accounting reference date*. The relevant quarters end on the last *business day* of March, June, September and December.			

16.12.27 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.26R, unless indicated otherwise.

[*Editor's note*: The existing table in SUP 16.12.27R is deleted in its entirety. The deleted text is not shown. The following table is inserted to replace the deleted text.]

Data item	Quarterly	Half yearly	Annual
Solvency statement			3 months
FSA029	20 *business days* (note 1) 30 *business days* (note 2)		

FSA030	20 *business days* (note 1) 30 *business days* (note 2)		
FSA031	20 *business days*		
FSA033	20 *business days*		
FSA034	20 *business days*		
FSA035	20 *business days*		
FSA039		30 *business days*	
FIN071	20 *business days*		
MIF001	20 *business days* (note 1) 30 *business days* (note 2)		
MIF002	20 *business days* (note 1) 30 *business days* (note 2)		
MIF003	20 *business days* (note 1) 30 *business days* (note 2)		
MIF004	20 *business days* (note 1) 30 *business days* (note 2)		

MIF005	20 *business days* (note 1) 30 *business days* (note 2)		
MIF006	20 *business days*		
Section A RMAR	30 *business days*	30 *business days*	
Section B RMAR	30 *business days*	30 *business days*	
Section C RMAR	30 *business days*	30 *business days*	
Section D1 RMAR	30 *business days*	30 *business days*	
Section F RMAR	30 *business days*	30 *business days*	
Note 1	For reports relating to the position of an individual *firm*.		
Note 2	For reports relating to the *consolidated situation* of an *investment firm group*.		

Regulated Activity Group 9

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16.12.28A R The applicable *data items*, reporting frequencies and submission deadlines referred to in *SUP* 16.12.4R are set out in the table below. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period.

Description of *data item*	*Data item* (note 1)	Frequency		Submission deadline
		Annual regulated business revenue up to and including £5 million	Annual regulated business revenue over £5 million	
…	…	…	…	…
Professional indemnity insurance (note 2)	Section E RMAR	Half yearly	Quarterly	30 *business days*
…	…	…	…	…
Note 1	…			
Note 2	This item only applies to *firms* that may be subject to an *FCA* requirement to hold professional indemnity insurance and are not ~~*exempt CAD firms*~~ *MIFIDPRU investment firms*.			

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FINANCIAL
CONDUCT
AUTHORITY

12 Endeavour Square London E20 1JN
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk