Prudential sourcebook for MiFID Investment Firms

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Chapter 1

Application

1.1 Application and purpose

Application

1.1.1 G There is no overall application provision for *MIFIDPRU*. Each chapter or section has its own application statement. However, *MIFIDPRU* broadly applies to the following:

(1) *MIFIDPRU investment firms*;

(2) *UK parent entities*; and

(3) *parent undertakings* in an *investment firm group* that are incorporated in, or have their principal place of business in, the *United Kingdom*.

1.1.2 G (1) The definition of a *MIFIDPRU investment firm* includes a *collective portfolio management investment firm*. This means that a *collective portfolio management investment firm* must comply with the *rules* in *MIFIDPRU*, except to the extent that a provision of *MIFIDPRU* otherwise provides.

(2) A *collective portfolio management investment firm* is also subject to the prudential requirements in ■ IPRU-INV 11 (Collective Portfolio Management Firms and Collective Portfolio Management Investment Firms). These *firms* should refer to ■ IPRU-INV 11.6 for further *guidance* on how the requirements in *MIFIDPRU* interact with the requirements in ■ IPRU-INV 11.

(3) As explained in ■ MIFIDPRU 1.1.5G, many requirements in *MIFIDPRU* apply only in relation to the *MiFID business* of a *firm* and therefore will not apply to the collective portfolio management activities carried on by a *collective portfolio management investment firm*. However, some requirements in *MIFIDPRU* apply to the *firm* as a whole.

Application to overseas firms

1.1.3 G *MIFIDPRU* does not directly apply to an *undertaking* which is not incorporated in, and does not have its principal place of business in, the *United Kingdom*. However, *MIFIDPRU* imposes some obligations on *UK parent entities* and *responsible UK parents* relating to *undertakings* established in a *third country* that form part of the same *investment firm group*. ■ MIFIDPRU 2 (Levels of application) contains additional *guidance* on the application of *MIFIDPRU* to *investment firm groups*.

1.1.4 G

(1) This *guidance* provision applies to a *third country MIFIDPRU investment firm*. It is without prejudice to the *FCA's* general approach to authorising *overseas firms*.

(2) The *FCA* will not normally give a *Part 4A permission* to a *third country MIFIDPRU investment firm* unless the *FCA* is satisfied that the applicant will be subject to prudential regulation by a *regulatory body* in its home jurisdiction and the regulatory requirements are broadly equivalent to the requirements that would apply under *MIFIDPRU*.

(3) When conducting the assessment in (2), the *FCA* will take into account the following non-exhaustive list of factors:

(a) whether the requirements of the jurisdiction are likely to achieve similar prudential outcomes to *MIFIDPRU*;

(b) how the overseas *regulatory body* supervises and enforces those requirements in practice;

(c) the broader legal framework applicable to the applicant in the jurisdiction; and

(d) whether there are adequate arrangements in place between the *FCA* and the overseas *regulatory body* to facilitate any necessary supervisory cooperation.

(4) The *FCA* considers that the approach described in (2) and (3) is consistent with the following:

(a) The requirements in the *threshold conditions* including, in particular, the effective supervision *threshold condition* described in ■ COND 2.3, the appropriate resources *threshold condition* described in ■ COND 2.4 and the suitability *threshold condition* described in ■ COND 2.5.

(b) The need for the *FCA* to be able to apply effective supervision to a *third country MIFIDPRU investment firm* to ensure appropriate protection for *consumers* or potential *consumers*. This relies on cooperation between the *FCA* and the overseas *regulatory body* that supervises that *third country MIFIDPRU investment firm* and on the *FCA* being able to place appropriate reliance on the supervision applied by that overseas *regulatory body*.

(5) If a *third country MIFIDPRU investment firm* is not subject to prudential regulation by a *regulatory body* in its home jurisdiction which is broadly equivalent to the requirements that would apply under *MIFIDPRU*, the *FCA* will normally expect it to establish a *subsidiary* in the *United Kingdom*. That *subsidiary* would need to be authorised as a *MIFIDPRU investment firm* and would then be directly subject to the requirements in *MIFIDPRU*. The *subsidiary* would need to demonstrate that it meets the *threshold conditions* to obtain *authorisation*.

(6) Although a *third country MIFIDPRU investment firm* that is granted a *Part 4A permission* is not subject to *MIFIDPRU*, it must still comply with the requirements in the *threshold conditions* and *Principles* on an ongoing basis. This includes the obligation under *Principle* 11 (Relations with regulators) to inform the *FCA* of anything of which the *FCA* would reasonably expect notice, which may include interactions between the *firm* and its overseas *regulatory body*.

Purpose

1.1.5 G The purpose of *MIFIDPRU* is to set out the detailed prudential requirements that apply to a *MIFIDPRU investment firm*. *MIFIDPRU* does not apply to a *designated investment firm*, which is subject to prudential regulation by the *PRA*. Generally, the *rules* in *MIFIDPRU* are intended to cover the *MiFID business* undertaken by a *firm*, but certain requirements apply to a *firm* as a whole.

1.1.6 G The requirements in *MIFIDPRU* expand upon the basic requirements under the appropriate resources *threshold condition* referred to in ■ COND 2.4 and the requirement in *Principle* 4 for a *firm* to maintain adequate financial resources.

Tied agents

1.1.7 G (1) Certain provisions of *MIFIDPRU* refer to, or apply in relation to, *tied agents*. The definition of a *tied agent* refers to a *person* who, on behalf of an *investment firm* (including a *third country investment firm*):

(a) promotes *investment services* or *ancillary services* to *clients* or prospective *clients*;

(b) receives and transmits instructions or orders from the *client* in respect of *investment services* or *financial instruments*;

(c) places *financial instruments*; or

(d) provides advice to *clients* or prospective *clients* in respect of *investment services* or *financial instruments*.

(2) The references in *MIFIDPRU* to *tied agents* do not include *appointed representatives* that do not meet the definition of a *tied agent* (for example, because the relevant *appointed representative* does not carry on its activities in relation to the *MiFID business* of its principal *firm*). However, a *firm's* potential responsibility for *appointed representatives* (whether or not they are also *tied agents*) will be a relevant factor for a *firm's ICARA process* under ■ MIFIDPRU 7 (Governance and risk management).

Voluntary application of stricter requirements

1.1.8 R No provision in *MIFIDPRU* prevents a *firm* from:

(1) holding *own funds* (or components of *own funds*) or *liquid assets* that exceed those required by *MIFIDPRU*; or

(2) applying other measures that are stricter than those required by *MIFIDPRU*.

1.1.9 G (1) If a *firm* applies stricter measures than those required under *MIFIDPRU* in accordance with ■ MIFIDPRU 1.1.8R, the *firm* must still ensure that it meets the basic requirements of *MIFIDPRU*. This is illustrated by the following two examples:

(a) Example 1: A *firm* decides to hold *own funds* of 0.03% of its *average AUM*, rather than 0.02% as required under

■ MIFIDPRU 4.7.5R. This would be a stricter measure that still met the basic requirements of *MIFIDPRU* and therefore would be permitted under ■ MIFIDPRU 1.1.8R.

(b) Example 2: A *firm* decides to hold a significant amount of additional *own funds* instead of applying the deductions from its *common equity tier 1 capital* required under ■ MIFIDPRU 3.3.6R. This is on the basis that the additional *own funds* far exceed the estimated value of the required deductions and the *firm* considers that the deduction calculations are too onerous. While the *firm* may consider that holding these additional *own funds* is a stricter measure, this approach would not meet the basic requirements of *MIFIDPRU*, which require the *firm* to calculate and apply the deductions. In addition, the failure to apply the correct deductions to *common equity tier 1 capital* may result in the *firm* incorrectly applying the *concentration risk* requirements and limits in ■ MIFIDPRU 5. This approach would therefore not be permitted under ■ MIFIDPRU 1.1.8R because it does not meet the basic requirements of *MIFIDPRU*.

(2) If a *firm* wishes to apply a stricter measure but is unsure of whether that measure would meet the basic requirements of *MIFIDPRU*, it should discuss the proposal with the *FCA* before applying the measure.

Notifications and applications under MIFIDPRU for which there is no dedicated form

1.1.10 R This *rule* applies where:

a notification or an application for permission is required under a provision in (2); and

the provisions in *MIFIDPRU* do not specify that a particular notification or application form must be used for that purpose.

The relevant provisions in (1) are:

a *rule* in *MIFIDPRU*;

a provision of the *UK CRR* that is applied by *MIFIDPRU*; or

a provision in binding technical standards made for the purposes of the *UK CRR* where those binding technical standards are applied by *MIFIDPRU*.

Where this *rule* applies, a *firm*, *UK parent entity* or *GCT parent undertaking* that is subject to the relevant provision in (2) must:

where the provision requires a notification, complete the notification form in ■ MIFIDPRU 1 Annex 5R and submit it to the *FCA* using the *online notification and application system*; or

where the provision requires an application for permission, complete the application form in ■ MIFIDPRU 1 Annex 6R and submit it to the *FCA* using the *online notification and application system*.

1.2 SNI MIFIDPRU investment firms

Basic conditions for classification 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 *average AUM*, as calculated in accordance with ■ MIFIDPRU 4.7.5R is less than £1.2 billion;

(2) its *average COH*, as calculated in accordance with ■ MIFIDPRU 4.10.19R is less than:

(a) £100 million per *day* for *cash trades*; and

(b) £1 billion per *day* for *derivatives trades*;

(3) its *average ASA*, as calculated in accordance with ■ MIFIDPRU 4.9.8R is zero;

(4) its *average CMH*, as calculated in accordance with ■ MIFIDPRU 4.8.13R is zero;

(5) it does not have *permission* for any of the following:

(a) dealing on own account; or

(b) underwriting of *financial instruments* and/or placing of *financial instruments* on a firm commitment basis;

(6) its on- and off-balance sheet total is less than £100 million;

(7) its total annual gross revenue from *investment services and/or activities* 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;

(8) it has not been classified as a *non-SNI MIFIDPRU investment firm* due to the effect of ■ MIFIDPRU 10.2 (Categorisation of clearing firms as non-SNI MIFIDPRU investment firms);

(9) its *average DTF*, as calculated in accordance with ■ MIFIDPRU 4.15.4R, is zero; and

(10) it is not appointed to act as a *depositary* in accordance with ■ FUND 3.11.10R(2) or ■ COLL 6.6A.8R(3)(b)(i).

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 (K-CMH requirement) and ■ 4.9 (K-ASA requirement).

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* must use the following for the purposes of the conditions in ■ MIFIDPRU 1.2.1R:

(1) end-of-day values to calculate:

(a) its *average AUM* under ■ MIFIDPRU 1.2.1R(1);

(b) its *average COH* under ■ MIFIDPRU 1.2.1R(2);

(c) its *average ASA* under ■ MIFIDPRU 1.2.1R(3);

(2) intra-day values to assess its *average CMH* under ■ MIFIDPRU 1.2.1R(4).

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 *average AUM* for the purposes of ■ MIFIDPRU 1.2.1R(1); and/or

(b) its *average COH* for the purposes of ■ MIFIDPRU 1.2.1R(2).

(2) The alternative approach is to apply the methodologies in ■ MIFIDPRU 4 for measuring *average AUM* and *average COH*, but with the following modifications:

(a) the measurement must be performed over the immediately preceding 12 *months*; and

(b) the exclusion of the 3 most recently monthly values does not apply.

(3) If a *firm* uses the derogation in (1), it must:

notify the *FCA* by submitting the form in ■ MIFIDPRU 1 Annex 1R via the *online notification and application system*; and

apply the alternative approach for a continuous period of at least 12 *months* from the date specified in the *firm's* notice in (a).

(4) If a *firm* ceases to apply the derogation in (1), it must notify the *FCA* by submitting the form in ■ MIFIDPRU 1 Annex 1R via the *online notification and application system*.

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*.

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It does not apply for the purpose of the *firm's* calculation of its *K-factor requirement* under ■ MIFIDPRU 4.

1.2.6 R

(1) Subject to (2), 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) The *firm* must use provisional accounts where its accounts have not been finalised and approved after 6 *months* from the end of the last financial year.

1.2.7 R

(1) A *firm* may use the end-of-day value for *average CMH* instead of the intra-day value under ■ MIFIDPRU 1.2.3R(2) if:

(a) there is an error in record-keeping or in the reconciliation of accounts that incorrectly indicates that the *firm* has 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) If a *firm* uses an end-of-day value under (1), it must notify the *FCA* immediately of:

the error;

the reasons that the error occurred; and

how the error has been corrected.

(3) The notification in (2) must be submitted via the *online notification and application system* using the form in ■ MIFIDPRU 1 Annex 2R.

1.2.8 G

(1) ■ MIFIDPRU 1.2.7R applies where a *firm* has incorrectly recorded an amount of *client money* as *CMH* and identifies the mistake before the end of the same *business day*. 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.

(2) ■ MIFIDPRU 1.2.7R does not apply where a *firm* mistakenly accepts an amount that satisfies 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 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) average ASA under ■ MIFIDPRU 1.2.1R(3);

(2) *average CMH* under ■ MIFIDPRU 1.2.1R(4);

(3) *average DTF* under ■ MIFIDPRU 1.2.1R(9);

(4) whether the *firm* has *permission* to *deal on own account*;

(5) whether the *firm* is a *clearing member* or an *indirect clearing firm*; and

(6) whether the *firm* is appointed to act as a *depositary* in accordance with ■ FUND 3.11.10R(2) or ■ COLL 6.6A.8R(3)(b)(i).

1.2.10 R 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 the *firm*:;

MIFIDPRU investment firms;

designated investment firms;

collective portfolio management investment firms; and

third country investment firms that carry on *investment services and/or activities* in the *UK*.

The relevant conditions are:

(a) where a *MIFIDPRU investment firm* has metrics for *AUM*, *average AUM* under ■ MIFIDPRU 1.2.1R(1);

(b) where a *MIFIDPRU investment firm* has metrics for *COH*, *average 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).

When measuring the combined total annual gross revenue under (2)(d), the *firm* may exclude any double counting that arises in respect of gross revenues generated within the *group*.

When calculating the contribution of the following to the combined position of the *group*, the *firm* must:

(a) for a *collective portfolio management investment firm*, include only amounts that are attributable to the *investment services and/or activities* that fall within ■ COLL 6.9.9R (4) to ■ COLL 6.9.9R (6) or ■ FUND 1.4.3R (3) to ■ FUND 1.4.3R (6); and

(b) for a *third country investment firm*:

(i) 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*; and

(ii) apply the definitions of *AUM* and *COH* as if the references to "*MiFID business*" in those definitions included the *investment services and/or activities* in (i).

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*

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group. The purpose of the *rule* is to prevent a *MIFIDPRU investment firm* from dividing its business between 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*.

(1A) (a) A *MIFIDPRU investment firm* that does not have metrics for *AUM* or *COH*, does not need to take into account the *AUM* or *COH* of other members of its group when calculating *average AUM* under ■ MIFIDPRU 1.2.1R(1) or *average COH* under ■ MIFIDPRU 1.2.1R(2). This is illustrated by the example in (b).

(b) Firm A (a *MIFIDPRU investment firm* providing services for the *execution of orders on behalf of clients*, with no *AUM* itself) is part of the same *group* as Firm B and Firm C (both *MIFIDPRU investment firms* providing portfolio management services, each with *AUM* of £0.8 billion). As Firm A does not have any *AUM*, it does not need to take into account the *average AUM* of Firms B and C when considering the *average AUM* threshold in ■ MIFIDPRU 1.2.1R(1), and Firm A is therefore not a *non-SNI investment firm* under this particular metric. Firms B and C would both be *non-SNI MIFIDPRU investment firms* because they do have metrics for *AUM* and because their combined *average AUM* is more than the threshold in ■ MIFIDPRU 1.2.1R(1).

(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 for classification 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 1.2.9R and 1.2.10R)	
Average AUM	End-of-day	Less than £1.2 billion	Combined	See Note 1
Average COH (cash trades)	End-of-day	Less than £100 million per day	Combined	See Note 1

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 1.2.9R and 1.2.10R)	
Average COH (derivatives)	End-of-day	Less than £1 billion per day	Combined	See Note 1
Average ASA	End-of-day	Zero	Individual	
Average CMH	Intra-day	Zero	Individual	See Note 2
Average DTF	End-of-day	Zero	Individual	
NPR	*Firm* must not have *permission* to *deal on own account*, so these measures must always be zero		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 given financial year	Combined	See Notes 3 and 4
Whether *firm* is a *clearing member* or *indirect clearing firm* under MIFIDPRU 10.2	*Firm* must not be a *clearing member* or *indirect clearing firm*		Individual	
Whether the *firm* has been appointed to act as a *depositary* in accordance with FUND 3.11.10R(2) or COLL 6.6A.8R(3)(b)(i)	*Firm* must not be appointed as a *depositary* under the relevant *FUND* and *COLL* provisions		Individual	

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 1.2.9R and 1.2.10R)
Notes			
Note 1:	Under MIFIDPRU 1.2.4R, the *firm* can choose to calculate the relevant values for these measures by applying the applicable methodologies in MIFIDPRU 4 to the most recent 12 *months* without excluding the three most recent monthly values.		
Note 2:	Under MIFIDPRU 1.2.7R, the *firm* may use the end-of-day value if there has been an error in record keeping or in reconciliation of accounts that incorrectly indicates the *firm* has breached the zero threshold for *average CMH*, provided that the error is corrected before the end of the *business day* to which it relates.		
Note 3:	Under MIFIDPRU 1.2.6R, the *firm* must use provisional accounts where the relevant accounts have not been finalised and approved after 6 *months* from the end of the last financial year.		
Note 4:	Under MIFIDPRU 1.2.10R, the *firm* may exclude any double counting that arises in respect of gross revenues generated within the *group*.		

Non-SNI MIFIDPRU investment firms that subsequently satisfy the conditions to be an SNI MIFIDPRU investment firm

1.2.13 R

(1) This *rule* applies to a *non-SNI MIFIDPRU investment firm* that 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 if:

(a) the *firm* satisfies the relevant conditions for a continuous period of at least 6 *months* (or any longer period that has elapsed before the *firm* submits the notification in (b)); and

(b) the *firm* notifies the *FCA* that it satisfies the conditions in (a).

(3) The notification in (2)(b) must be submitted via the *online notification and application system* using the form in ■ MIFIDPRU 1 Annex 3R.

Ceasing to meet the conditions to be an SNI MIFIDPRU investment firm

1.2.14 R

Where a *MIFIDPRU investment firm* no longer satisfies all the conditions set out in ■ MIFIDPRU 1.2.1R, it ceases to be an *SNI MIFIDPRU investment firm* with immediate effect, except where ■ MIFIDPRU 1.2.15R applies.

1.2.15 R

(1) Where a *MIFIDPRU investment firm* exceeds one or more of the thresholds in (2), but continues to satisfy all other conditions in ■ MIFIDPRU 1.2.1R, it ceases to be an *SNI MIFIDPRU investment firm* 3 *months* after the date on which it first exceeded the relevant threshold.

(2) The relevant thresholds are:

(a) the *average AUM* threshold in ■ MIFIDPRU 1.2.1R(1);

(b) either or both of the *average 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).

1.2.16 R

(1) If a *MIFIDPRU investment firm* ceases to satisfy one of the conditions in ■ MIFIDPRU 1.2.1R, it must promptly notify the *FCA*.

(2) The notification in (1) must be submitted via the *online notification and application system* using the form in ■ MIFIDPRU 1 Annex 4R.

1.2.17 G

Where a *firm* ceases to satisfy one of the conditions in ■ MIFIDPRU 1.2.15R, but subsequently satisfies that condition within the three-*month* period referred to in that *rule*, the *firm* will still be reclassified as a *non-SNI MIFIDPRU investment firm* 3 *months* after the date on which it first ceased to satisfy that condition. The *firm* will only be reclassified as an *SNI MIFIDPRU investment firm* if it satisfies the conditions in, and requirements of, ■ 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) ■ MIFIDPRU 7.3 (Risk, remuneration and nomination committees);

(b) the provisions in ■ SYSC 19G (MIFIDPRU Remuneration Code) which are not listed in ■ SYSC 19G.1.6R(2).

(2) Subject to (4) and (5), if a *non-SNI MIFIDPRU investment firm* satisfies the conditions in ■ MIFIDPRU 1.2.1R to be classified as an *SNI MIFIDPRU investment firm*, the provisions in (1) will cease to apply only:

(a) 6 *months* after the date on which the *firm* first satisfied those conditions (or after any longer period that has elapsed before the *firm* submits the notification in (b)(ii)); and

(b) provided that the *firm*:

(i) continued to satisfy the conditions throughout the period in (a); and

(ii) has notified the *FCA* under ■ MIFIDPRU 1.2.13R(2)(b).

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(3) Subject to (4) and (5), if an *SNI MIFIDPRU investment firm* no longer satisfies the conditions in ■ MIFIDPRU 1.2.1R to be classified as an *SNI MIFIDPRU investment firm*, it must:

(a) notify the *FCA* immediately in accordance with ■ MIFIDPRU 1.2.16R of the date on which it ceased to satisfy the conditions; and

(b) comply with the provisions in (1) within 12 *months* from the date on which the *firm* ceased to satisfy the conditions.

(4) ■ MIFIDPRU 7.3 (Risk, remuneration and nomination committees) does not apply to a *non-SNI MIFIDPRU investment firm* if the *firm* meets the conditions in ■ MIFIDPRU 7.1.4R.

(5) The provisions listed in ■ SYSC 19G.1.1R(4) do not apply to a *non-SNI MIFIDPRU investment firm* if the *firm* meets the conditions in ■ SYSC 19G.1.1R(2).

1.2.19 G Under the Capital Requirements (Country-by-Country Reporting) Regulations 2013 (SI 2013/3118) as amended, *non-SNI MIFIDPRU investment firms* may be required to disclose information relating to their branches or subsidiaries outside the *UK*. The Regulations also set out how the country-by-country reporting obligations apply when a *MIFIDPRU investment firm* is reclassified as an *SNI MIFIDPRU investment firm* or a *non-SNI MIFIDPRU investment firm*.

1.3 Actions for damages

1.3.1 R A contravention of any *rule* 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).

Notification under MIFIDPRU 1.2.4R in respect of the use of the alternative approach to measure AUM and/or COH for the purpose of determining if a firm can be classified as an SNI investment firm

[*Editor's note*: The form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 1 Annex 1R Notification under MIFIDPRU 1.2.4R .pdf

Notification under MIFIDPRU 1.2.7R(2) of the use of an end-of-day value for CMH as a result of a qualifying error

[*Editor's note*: The form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 1 Annex 2R Notification under MIFIDPRU 1.2.7R(2) of the use of an end-of-day value for CMH.pdf

Notification under MIFIDPRU 1.2.13R(2)(b) that a non-SNI investment firm qualifies to be reclassified as an SNI investment firm

[*Editor's note*: The form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 1 Annex 3R Notification under MIFIDPRU 1.2.13R(2)(b).pdf

Notification under MIFIDPRU 1.2.16R that a firm no longer qualifies to be classified as an SNI investment firm

MIFIDPRU 1 Annex 4R Notification under MIFIDPRU 1.2.16R that a firm.group no longer qualifies.pdf

Application for a permission under MIFIDPRU for which there is no dedicated application form

Editor's note: The form can be found at this address:https://www.handbook.fca.org.uk/form/mifidpru/MIFIDPRU1_Annex5R_20220101.pdf

Notification under MIFIDPRU for which there is no dedicated notification form

Editor's note: The form can be found at this address: https://www.handbook.fca.org.uk/form/mifidpru/MIFIDPRU1_Annex6R_20220101.pdf

Chapter 2

Level of application of requirements

2

2.1 Application and purpose

Application

2.1.1 R ■ MIFIDPRU 2 applies to:

a *MIFIDPRU investment firm*;

a *UK parent entity*;

a *UK investment holding company*, *UK mixed financial holding company* or *UK mixed-activity holding company*; and

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* in ■ 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 in which 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 cover:

(a) the definition of an *investment firm group*;

(b) the *undertakings* that are included within an *investment firm group*; and

(c) when and 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;

(4) *rules* and *guidance* in ■ MIFIDPRU 2.5 which cover the following:

(a) when requirements in this sourcebook apply 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 an *investment firm group* must apply obligations in this sourcebook on a *consolidated basis*;

(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:

(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

2.2 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.

2.3 Exemptions

2.3.1 R A *MIFIDPRU investment firm* will be exempt from ■ MIFIDPRU 8 (Disclosure) on an individual basis if:

(1) the *firm* has applied to the *FCA* in accordance with ■ MIFIDPRU 2.3.3R;

(2) the application in (1) demonstrates to the satisfaction of the *FCA* that:

(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) 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 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.

2.3.2 R A *MIFIDPRU investment firm* will be exempt from ■ MIFIDPRU 6 (Liquidity) on an individual basis where:

(1) the *firm* has applied to the *FCA* in accordance with ■ MIFIDPRU 2.3.3R;

(2) the application in (1) demonstrates to the satisfaction of the *FCA* that:

(a) the *firm*:

(i) is supervised on a *consolidated basis* in accordance with Chapter 2 of Title II of Part One of the *UK CRR*; or

(ii) is included in an *investment firm group* that is 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*;

(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 in (c); and

(3) the *PRA* does not object to the exemption if it is the consolidating supervisor of the group.

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 using the *online notification and application system*.

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 definition of an *investment firm group* covers a *parent undertaking* that is incorporated in the *UK* or has its principal place of business in the *UK*, 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* that are not *subsidiaries*, but which form part of the *investment firm group* by one of the relationships listed in ■ MIFIDPRU 2.4.6R.

(2) If the *subsidiaries* of the group include a *UK credit institution*, the group is not an *investment firm group*. However, if a *UK credit institution* is only a *connected undertaking* in relation to an *investment firm group*, the group is still an *investment firm group*. If the *investment firm group* includes a *subsidiary* or a *connected undertaking* that is *credit institution* established in a *third country*, the group is still 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 must 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* or that are *connected undertakings* in which it holds a *participation* in accordance with ■ MIFIDPRU 2.4.15R. The *group capital test* does not apply in relation to a *relevant financial undertaking* that is a *connected undertaking* of the *parent undertaking* otherwise than due to a *participation*.

(3) However, as explained in ■ MIFIDPRU 2.4.19G, where an *investment firm group* contains material *connected undertakings* (other than those connected by a *participation*), 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*. In that case, it is likely that the *UK parent entity* of the *investment firm group* will be subject to consolidation under ■ MIFIDPRU 2.5.

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) 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) 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 under 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 under 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 to the facts at the time when the relevant relationship is created. This means that a subsequent change in the *own funds requirement* of an entity or *investment firm group* does not change the deemed *parent undertaking*.

Connected undertakings: majority common management

2.4.8 R This *rule* applies where:

a *MIFIDPRU investment firm* is connected to a *relevant financial undertaking* by *majority common management*; or

a *relevant financial undertaking* that forms part of an *investment firm group* is connected to another *relevant financial undertaking* by *majority common management*.

If only one of the *undertakings* connected by *majority common management* forms part of an existing *investment firm group*, that *undertaking* is deemed to be the *parent undertaking* of the other *undertaking* when applying the requirements in ■ MIFIDPRU 2.5.

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*, is deemed to be the *parent undertaking* of the other *undertaking* when applying the requirements in ■ MIFIDPRU 2.5.

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* is deemed to be the *parent undertaking* of the other *MIFIDPRU investment firm* when applying the requirements in ■ MIFIDPRU 2.5.

If neither of the *undertakings* connected by *majority common management* forms part of an existing *investment firm group* and only one of the *undertakings* is a *MIFIDPRU investment firm*, the *MIFIDPRU investment firm* is deemed to be the *parent undertaking* of the other *undertaking* when applying the requirements in ■ MIFIDPRU 2.5.

2.4.9 G A *MIFIDPRU investment firm* may 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* on

the basis of *majority common management* for the purposes of ■ MIFIDPRU 2.5.

2

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 is deemed to be the *parent undertaking* of the *relevant financial undertaking* when applying ■ MIFIDPRU 2.5.

2.4.11 G

(1) To assess whether A exercises significant influence over a *relevant financial undertaking*, the *FCA* considers that the equivalent accounting position, as it would be assessed under the guidance in International Accounting Standard 28 (as amended in 2011) under IFRS or Financial Reporting Standard 102 (March 2018) under UK GAAP, will be relevant. In particular, a *firm* should consider whether A has the power to participate in the financial and operating policy decisions of the *relevant financial undertaking*, even though A does not have control or joint control of those policies. The indicators in (2) may be evidence of significant influence but are not conclusive. A *firm* should consider all relevant facts and circumstances.

(2) When applying ■ MIFIDPRU 2.4.10R(1)(a), the following circumstances may be indicators that A exercises significant influence over the *relevant financial undertaking*:

(a) A appoints or has the ability to appoint a representative in the *management body* of the *relevant financial undertaking*, either in the executive or in the supervisory function;

(b) A participates in the policy-making processes of the *relevant financial undertaking*, including participation in decisions about dividends and other distributions;

(c) the existence of material transactions between the two *undertakings*;

(d) the interchange of managerial personnel between the two *undertakings*;

(e) the provision of essential technical information or critical services from one entity to the other;

(f) A enjoys additional rights in the *relevant financial undertaking*, under a contract or a provision in the articles of association or other constitutional documents of the *relevant financial*

undertaking, that could affect the management or the decision-making of the *relevant financial undertaking*; and

(g) 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*.

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* is 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* is 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* is 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* is deemed to be the *parent undertaking* of the other undertaking when applying the requirements in MIFIDPRU 2.5.

2.4.13 G When applying ■ 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. Whether two or more *undertakings* are placed under single management for the purposes of ■ MIFIDPRU 2.4.12R depends on whether in practice there is effective coordination of the financial and operating policies of the relevant *undertakings*. A *firm* should consider all relevant facts and circumstances.

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 is deemed to be the *parent undertaking* of the *relevant financial undertaking* when applying the requirements in ■ MIFIDPRU 2.5 or the *group capital test* in ■ MIFIDPRU 2.6.

2.4.16 G (1) An *undertaking* ("A") holds a *participation* in a *relevant financial undertaking* where A has direct or indirect ownership of 20% or

more of the voting rights in, or capital of, a *relevant financial 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 ■ MIFIDPRU 2.6 applies, and ■ MIFIDPRU 2.5 does not apply, to an *investment firm group* 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 application in (1) demonstrates to the satisfaction of the *FCA* 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 require supervision on a *consolidated basis*.

2.4.18 R An application submitted under ■ MIFIDPRU 2.4.17R(1):

(1) must be made using the form in ■ MIFIDPRU 2 Annex 2R, and should be submitted using the *online notification and application system*;

(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 of 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 any relationship that 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 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 each of the following is a fair reflection of the consideration paid by the *parent undertaking*:

(i) a *subsidiary*, whether that *subsidiary* forms part of the *investment firm group* or not; and

(ii) an entity that is a *connected undertaking* due to a *participation* in accordance with ■ MIFIDPRU 2.4.15R.

(f) calculations that 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*:

(i) would comply with the systems requirement in ■ MIFIDPRU 2.6.9R; or

(ii) would comply with the systems requirement in ■ MIFIDPRU 2.5.8R if the *FCA* did not grant permission to apply the *group capital test*.

(3) must be submitted by a *UK parent entity* or a *MIFIDPRU investment firm* that has the necessary authority to make the application on behalf of all *undertakings* within the *investment firm group* that 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 that are *connected undertakings* (other than *connected undertakings* due to a *participation* in accordance with ■ MIFIDPRU 2.4.15R), that are material (either individually or in aggregate), it is unlikely that the *investment firm group* will be sufficiently simple to be able to apply the *group capital test*. This is because the relationship between the relevant member of the *investment firm group* and the *connected undertaking* is likely to be more complex and because the *group capital test* can only apply to holdings in instruments issued by, or claims on, an entity. Therefore, prudential consolidation under ■ MIFIDPRU 2.5 is likely to be more appropriate in such circumstances.

Notifications relating to membership of a consolidation group or financial conglomerate

2.4.20 R (1) A *MIFIDPRU investment firm* must notify the *FCA* immediately if the *firm* becomes aware that:

(a) it has become a member of an *investment firm group*;

(b) it has ceased to be a member of an *investment firm group*;

(c) there has been a change in the composition of an *investment firm group* of which that *firm* forms a part;

(d) it has become a member of a *financial conglomerate*; or

(e) it has ceased to be a member of a *financial conglomerate*.

(2) A *firm* must:

(a) notify the *FCA* under (1) using the form in ■ MIFIDPRU 2 Annex 8R and submit it using the *online notification and application system*; and

(b) as part of the notification in (a):

(i) identify any entity that is becoming a member of the *investment firm group* or *financial conglomerate*;

(ii) identify any existing members of the *investment firm group* or *financial conglomerate* that continue to be members of that *investment firm group* or *financial conglomerate*;

(iii) identify any entity that is ceasing to be a member of the *investment firm group* or *financial conglomerate*; and

(iv) where applicable, confirm that the *investment firm group* or *financial conglomerate* has ceased to exist.

(3) A *firm* ("X") is not required to notify the *FCA* under (1) if:

(a) another member of the relevant *investment firm group* or *financial conglomerate* ("Y") has notified the *FCA* under (1); and

(b) the notification submitted by Y includes information that accurately reflects X's relationship to the *investment firm group* or *financial conglomerate* and any other information required under (2)(b).

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 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 MIFIDPRU 2.5.12G	The main requirements in relation to prudential consolidation under MIFIDPRU 2.5
MIFIDPRU 2.5.13R to MIFIDPRU 2.5.16G	The default position requiring full consolidation and the availability of alternative methods of consolidation
MIFIDPRU 2.5.17R and MIFIDPRU 2.5.18G	Proportional consolidation
MIFIDPRU 2.5.19R and MIFIDPRU 2.5.20R	Exemption from consolidated liquidity requirements
MIFIDPRU 2.5.21R and MIFIDPRU 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*

Provisions of MIFIDPRU 2.5	Summary of content
MIFIDPRU 2.5.24G to MIFIDPRU 2.5.46R	Determining the consolidated *own funds requirement*
MIFIDPRU 2.5.47R and MIFIDPRU 2.5.48G	Consolidated liquidity requirements
[deleted]	[deleted]
MIFIDPRU 2.5.50G	Consolidated reporting requirements
MIFIDPRU 2.5.51	Consolidated governance requirements
MIFIDPRU 2.5.52	Application of the *ICARA process* on a group 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* (except where the *credit institution* is a *connected undertaking*). Where a *group* includes a *UK credit institution*, prudential consolidation applies in accordance with 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 this case, the *MIFIDPRU investment firm* would trigger prudential consolidation under this section and the *designated investment firm* would trigger consolidation under the *UK CRR*. Therefore, certain group structures may be subject to consolidation under both *MIFIDPRU* and the *UK CRR*, with the same entities included within the scope of consolidation of each. In this situation, the relevant *group* must comply with both sets of consolidated requirements, which are aimed at addressing different types of risks.

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 requirements in *MIFIDPRU* under ■ MIFIDPRU 2.5.7R and ■ MIFIDPRU 2.5.11R to a *UK parent entity*, as if it and the *relevant financial undertakings* in its *investment firm group*, form 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*" include *undertakings* established outside the *UK* that would satisfy those definitions if they were established in the *UK*.

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 applies whether the *tied agent* carries out *investment services and/or activities* or incurs relevant expenses on behalf of another entity within the *consolidated situation* or on behalf of a third party.

(2) The *guidance* in (1) relates to a *tied agent* that is included within the *consolidated situation*. There are separate requirements in:

(a) ■ MIFIDPRU 4.5.6R, 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 4.7.2R, ■ MIFIDPRU 4.8.3R, ■ MIFIDPRU 4.9.2R or ■ MIFIDPRU 4.10.2R, 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*. Where ■ MIFIDPRU 4 applies on a *consolidated basis*, those requirements will also be relevant to any activities carried on by *tied agents* on behalf of a *third country investment firm* included within the *consolidated situation*.

(3) Where the requirements in (2)(a) or (2)(b) apply in relation to a *MIFIDPRU investment firm* or a *third country investment firm* that is included within the *consolidated situation*, the relevant amounts that are added to the individual requirements of that *MIFIDPRU investment firm* or *third country 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 or carry on *investment services and/or activities* on behalf of a *MIFIDPRU investment firm* or *third country investment firm* ("B") where B is also included in the *consolidated situation*.

In this case, the contribution of A to the consolidated *fixed overheads requirement* and consolidated *K-factor requirement* may be adjusted to prevent double-counting of any amounts 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 following on the basis of its *consolidated situation*:

(1) ■ MIFIDPRU 3 (Own funds);

(2) ■ MIFIDPRU 4 (Own funds requirements);

(3) ■ MIFIDPRU 5 (Concentration risk);

(4) [deleted]

(5) ■ MIFIDPRU 9 (Reporting).

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 firm* in the same *investment firm group* must establish the following:

(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 firm* in the same *investment firm group* must each ensure that any of their *subsidiaries* that are not subject to *MIFIDPRU* implement the necessary arrangements, processes and mechanisms to ensure that the *UK parent entity* complies with the consolidated requirements under ■ MIFIDPRU 2.5.7R.

2.5.10 R (1) When applying ■ MIFIDPRU 3 on a *consolidated basis*, the requirements in Title II of Part Two of the *UK CRR* shall also apply with the modifications in this *rule*.

(2) A reference in Title II of Part Two of the *UK CRR* to an entity or person included within the "consolidation pursuant to Chapter 2 of Title II of Part One" is a reference to an entity or person included in the *consolidated situation* of the *investment firm group* under ■ MIFIDPRU 2.5.

(3) The relevant *subsidiaries* for the purposes of articles 81(1)(a) and 82(a) of the *UK CRR* are:

(a) a *MIFIDPRU investment firm*;

(b) a *designated investment firm*; and

(c) a *UK credit institution* that is included in the *consolidated situation* under ■ MIFIDPRU 2.5 because it is a *connected undertaking*.

(4) The modifications in (5) apply where the following provisions of the *UK CRR* apply to a *subsidiary* that is a *MIFIDPRU investment firm*:

(a) article 84(1)(a)(i);

(b) article 85(1)(a)(i); and

(c) article 87(1)(a)(i).

(5) The modifications referred to in (4) are as follows:

(a) the relevant amount of *common equity tier 1 capital* in article 84(1)(a)(i) is the sum of:

(i) the amount of *common equity tier 1 capital* required to meet the *firm's own funds threshold requirement*; and

(ii) any other requirements that apply to the *firm* under additional *third countries* local supervisory regulations in to the extent that those requirements must be met by *common equity tier 1 capital*;

(b) the relevant amount of *tier 1 capital* in article 85(1)(a)(i) is the sum of:

(i) the amount of *tier 1 capital* required to meet the *firm's own funds threshold requirement*; and

(ii) any other requirements that apply to the *firm* under additional local supervisory regulations in *third countries* to the extent that those requirements must be met by *tier 1 capital*; and

(c) the relevant amount of *own funds* in article 87(1)(a)(i) is the sum of:

(i) the amount of *own funds* required to meet the *firm's own funds threshold requirement*; and

(ii) any other requirements that apply to the *firm* under additional local supervisory regulations in *third countries* to the extent that those requirements must be met by *own funds*.

(6) The following provisions of the *UK CRR* are modified as follows:

(a) article 84(1)(a)(ii) applies as if it refers to the sum of:

(i) the amount of consolidated *common equity tier 1 capital* that relates to the *subsidiary* that is required on a *consolidated basis* to meet the requirement in ■ MIFIDPRU 2.5; and

(ii) any other requirements that apply to the *subsidiary* under additional local supervisory regulations in *third countries* to the extent that those requirements must be met by *common equity tier 1 capital*;

(b) article 85(1)(a)(ii) applies as if it refers to the sum of:

(i) the amount of consolidated *tier 1 capital* that relates to the *subsidiary* that is required on a *consolidated basis* to meet the requirement in ■ MIFIDPRU 2.5; and

(ii) any other requirements that apply to the *subsidiary* under additional local supervisory regulations in *third countries* to the extent that those requirements must be met by *tier 1 capital*; and

(c) article 87(1)(a)(ii) applies as if it refers to the sum of:

(i) the amount of consolidated *own funds* that relates to the *subsidiary* that is required on a *consolidated basis* to meet the requirement in ■ MIFIDPRU 2.5; and

(ii) any other requirements that apply to the *subsidiary* under additional local supervisory regulations in *third countries* to

the extent that those requirements must be met by *own funds*.

2.5.10A G ■ MIFIDPRU 3 Annex 7.57G and ■ MIFIDPRU 3 Annex 7.58R contain supplementary provisions that may be relevant when a *firm* is applying ■ MIFIDPRU 2.5.10R.

2.5.11 R A *UK parent entity* must comply with ■ MIFIDPRU 6 (Liquidity) on the basis of its *consolidated situation*.

2.5.12 G ■ MIFIDPRU 2.5.7R to ■ MIFIDPRU 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* 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* due to a *participation* in accordance with ■ MIFIDPRU 2.4.15R; and

(b) the conditions for proportional consolidation under ■ MIFIDPRU 2.5.17R are satisfied.

2.5.14 G A *UK parent entity* that is subject to ■ MIFIDPRU 2.5.13R(1) may apply to the *FCA* under section 138A of the Act to modify the application of ■ MIFIDPRU 2.5.13R(1) to require an alternative method of consolidation.

2.5.15 G When the *FCA* considers an application described in ■ MIFIDPRU 2.5.14G, it 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) through 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*.

2.5.16 G The *FCA* would generally expect that the alternative method of consolidation proposed in an application 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* due to 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 a legally binding and enforceable contract between A and all participating undertakings which:

(i) limits the liability of each party to the percentage of its 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) states that any change in the share of capital of a shareholder or member is subject to the explicit consent of all the shareholders or members;

(iv) states that if B is recapitalised, A will inform the *FCA* in a timely manner about the progress of the recapitalisation process and that each shareholder or member is 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 satisfactory;

(f) the *UK parent entity* has notified the *FCA* in advance that it intends to apply proportional consolidation in relation to B; and

(g) the notification in (f) has been made using the form in ■ MIFIDPRU 2 Annex 3R and submitted using the *online notification and application system*.

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* is 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) demonstrates 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*.

2.5.20 R A *UK parent entity* must make an application under ■ MIFIDPRU 2.5.19R(1) by completing the form in ■ MIFIDPRU 2 Annex 4R and submitting it using the *online notification and application system*.

Application of conditions for classification 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* should be treated as an *SNI MIFIDPRU investment firm* when applying the chapters of *MIFIDPRU* specified in ■ MIFIDPRU 2.5.7R and ■ MIFIDPRU 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* carried on by the *collective portfolio management investment firm*.

2.5.22 G (1) ■ 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) This is separate from the application of only certain metrics (*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) If any of the thresholds in ■ MIFIDPRU 1.2.1R are exceeded on a *consolidated basis*, the relevant chapters of *MIFIDPRU* specified in

■ MIFIDPRU 2.5.7R and ■ MIFIDPRU 2.5.11R apply to the *UK parent entity* as if it were a *non-SNI MIFIDPRU investment firm*. However, if none of the 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*.

(4) When calculating whether the thresholds in ■ MIFIDPRU 1.2.1R are exceeded on a *consolidated basis*, ■ MIFIDPRU 2.5.21R(5) permits a *UK parent entity* to exclude amounts that relate to its *non-MiFID business*. However, a *UK parent entity* should not apply this approach to the calculation of the consolidated on- and off-balance sheet total for the purposes of ■ MIFIDPRU 1.2.1R(6). This is because the *FCA* does not consider that it is reasonable to subdivide a *collective portfolio management investment firm's* balance sheet in this way. Therefore, a *UK parent entity* should include the full on- and off-balance sheet total of a *collective portfolio management investment firm* in the consolidated total for these purposes.

Prudential consolidation in practice: own funds

2.5.23 G

(1) Where ■ MIFIDPRU 3 applies on a *consolidated basis*, the total consolidated *own funds requirement* of an *investment firm group* must 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 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. Under section 165(6) and (7) of the *Act*, the *FCA* may require a *UK parent entity* to provide independent verification of the calculation of its consolidated *own funds*.

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) Where ■ MIFIDPRU 4 applies on a *consolidated basis*, the consolidated *own funds requirement* 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) the consolidated *K-factor requirement* if the *UK parent entity* is treated as a *non-SNI MIFIDPRU investment firm* in accordance with ■ MIFIDPRU 2.5.21R.

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*.

(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;

(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* that is fully consolidated within the *consolidated situation*; and

(iii) the relevant proportion of the individual fixed overheads of each *relevant financial undertaking* that is subject to proportional consolidation on a *consolidated basis*.

(c) Where the relevant figures under (2)(a) are available, but the consolidated *annual financial statements* include *undertakings* that are not members of the *investment firm group*, a *UK parent entity* may use the approach in (2)(b) to calculate its *fixed overheads requirement* on a *consolidated basis*.

(3) Where these 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 avoid double-counting of these 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 use its powers under section 55L or section 143K 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

2.5.27 R

(1) This *rule* applies for the purposes of a *UK parent entity's* calculation of the consolidated *permanent minimum capital requirement* when MIFIDPRU 4 applies on a *consolidated basis*.

(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* that would satisfy the 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) is the individual requirement that would apply if that entity were established in the *UK*.

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*, so 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* depend on the *investment services and/or activities* (or equivalent activities in the case of a *third country* entity) carried on by relevant entities within the *investment firm group*. The consolidated *K-factor requirement* should be calculated in accordance with ■ MIFIDPRU 4, 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* that are included within the *consolidated situation*.

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* of the following:

() the *K-AUM requirement*;

() the *K-COH requirement*; and

() the *K-DTF requirement*.

(2) Subject to (4), the consolidated *AUM*, *COH* or *DTF* for the purposes of (1) is the sum of the following:

(a) the full amount of the relevant individual *K-factor metrics* of each *MIFIDPRU investment firm* that is fully consolidated within the *consolidated situation*; and

(b) the relevant proportion of the relevant individual *K-factor metrics* of each *MIFIDPRU investment firm* that is subject to proportional consolidation on a *consolidated basis*.

(3) For the purposes of (2):

references to a *MIFIDPRU investment firm* include a *third country* entity within the *investment firm group* that would satisfy that definition if it were established in the *UK*; and

the relevant individual *K-factor metric* of any *third country* entity in (a) is the individual *K-factor metric* that would be attributable to that entity if that entity were established in the *UK*.

Where the consolidated *AUM*, *COH* or *DTF* under (2) includes amounts attributable to transactions or arrangements solely between two or more entities included within the *consolidated situation*, those amounts are excluded when calculating the consolidated *AUM*, *COH* or *DTF*.

2.5.29A G

(1) As the exclusion in ■ MIFIDPRU 2.5.29R(4) applies only to transactions or arrangements solely between two or more entities included within the *consolidated situation* of an *investment firm group*, it does not apply to transactions or arrangements involving counterparties or *clients* outside that *consolidated situation*. This is illustrated by the example in (2).

(2) Firm A and Firm B are part of the *consolidated situation* of an *investment firm group*. Firm A delegates management of assets to Firm B. If the assets delegated by Firm A are beneficially owned by a *client* outside the *consolidated situation*, such assets would not benefit from the exclusion under ■ MIFIDPRU 2.5.29R(4) for the purposes of the *UK parent entity's* calculation of consolidated *AUM*.

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 *rules* for calculating *CMH* and *ASA* in ■ MIFIDPRU 4.8 and ■ MIFIDPRU 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 whether, 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*, X holds:

(i) any *money* that was received from its *clients*; or

(ii) any assets belonging to its *clients*;

(b) subject to (3), applying the calculation *rules* in ■ MIFIDPRU 4.8 or ■ 4.9 to the amounts in (a) by treating:

(i) the amounts identified in (a)(i) as *CMH*;

(ii) the amounts identified in (a)(ii) as *ASA*;

(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 is a *segregated account* only if (ignoring ■ MIFIDPRU 4.8.9E, which does not apply for these purposes) it meets the requirements in ■ MIFIDPRU 4.8.8R.

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 the 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 requirements 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*.

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*.

(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 demonstrates to the satisfaction of the *FCA* that the conditions in article 325b of the *UK CRR* are met.

(4) An entity that applies for a permission under (3) must complete the form in ■ MIFIDPRU 2 Annex 5R and submit it using the *online notification and application system*.

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 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 ■ MIFIDPRU 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 those positions give rise to foreign exchange risk or commodity risk. These positions must be included within the calculation of the *consolidated K-NPR requirement*.

2.5.37 R When applying ■ MIFIDPRU 4 on a *consolidated basis*, a *UK parent entity* may calculate a consolidated *K-CMG requirement* in relation to portfolios that form part of its *consolidated situation* in accordance with ■ MIFIDPRU 2.5.38R to ■ MIFIDPRU 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 that *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 demonstrates to the satisfaction of the *FCA* that A satisfies 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 apply to the rules relating to the calculation of the *K-CMG requirement* in ■ MIFIDPRU 4.13:

(a) a reference to the "*MIFIDPRU investment firm*" or "*firm*" is a reference 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*;

(iii) a *MIFIDPRU investment firm*;

(iv) a *third country investment firm*;

(v) a *UK credit institution*; or

(vi) a *credit institution* established in a *third country*.

(c) the reference in ■ MIFIDPRU 4.13.12R to ■ MIFIDPRU 4.13.9R is 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 demonstrates to the satisfaction of the *FCA* that B satisfies 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 apply to the rules relating to the calculation of the *K-CMG requirement* in ■ MIFIDPRU 4.13:

(a) a reference to the "*MIFIDPRU investment firm*" or "*firm*" is a reference to B;

(b) the *clearing member* for the purposes of ■ MIFIDPRU 4.13.9R(2)(c) may be any of the following:

(i) an entity listed in ■ MIFIDPRU 4.13.9R(2)(c);

(ii) another entity that the application in (2)(a) demonstrates is subject to appropriate prudential regulation and supervision in the jurisdiction in which it operates; or

(iii) B itself, provided that the application demonstrates that B satisfies the conditions in (ii);

(c) a reference to the "*clearing member*" is a reference to the *clearing member* in (b);

(d) the reference in ■ MIFIDPRU 4.13.12R to:

(i) ■ MIFIDPRU 4.13.9R is a reference to ■ MIFIDPRU 4.13.9R as modified by this *rule*; and

(ii) both the *clearing member* and *client* of the *clearing member* being entities listed in ■ MIFIDPRU 4.13.9R(2)(c) is to both of those entities being entities listed in (b)(i) or (b)(ii);

(e) the obligation in ■ MIFIDPRU 4.13.13R(1)(b) does not apply, but B must ensure that its ongoing processes and systems for assessing the nature and level of risks to which it is, or might be, exposed incorporate the understanding of relevant *individuals* within B 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 B is exposed; and

(ii) the *K-CMG permission* remains appropriate in relation to the *portfolio(s)* in respect of which it was granted.

2.5.42 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 ■ MIFIDPRU 2 Annex 6R or ■ MIFIDPRU Annex 7R and submit it using the *online notification and application system*.

(2) A single application under (1) may be made in respect of multiple portfolios of multiple entities referenced in ■ MIFIDPRU 2.5.40R or ■ MIFIDPRU 2.5.41R, provided that the application demonstrates to the *FCA* how the relevant conditions in ■ MIFIDPRU 4.13.9R (as modified by ■ 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) A *UK parent entity* or *MIFIDPRU investment firm* that 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) When calculating the *K-TCD requirement* on a *consolidated basis*, transactions between counterparties included in the *consolidated situation* are disregarded. This applies 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*, 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:

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;

any references in that *rule* to the rights and obligations of the "*firm*" refer 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

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*; and

(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*, the provisions in ■ MIFIDPRU 5 apply, subject to the following:

(1) the *exposure value* with regard to an individual *client* or *group of connected clients* must 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 ■ MIFIDPRU 2.5.34R and consolidated *K-TCD requirement* in ■ MIFIDPRU 2.5.43G to ■ MIFIDPRU 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* are the consolidated *own funds* of the *investment firm group*, as explained in the *guidance* in ■ MIFIDPRU 2.5.23G.

Prudential consolidation in practice: liquidity

2.5.47 R

When applying ■ MIFIDPRU 6 on a *consolidated basis*, 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) Under ■ 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 (through the consolidated *fixed overheads requirement*), any *liquid assets* held by a *third country* entity do not count towards the *liquid assets* held by the *investment firm group* for the purposes of that *rule*.

(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 is exempt from the consolidated liquidity requirement if the conditions in ■ MIFIDPRU 2.5.19R are met.

2.5.49 G [deleted]

Prudential consolidation in practice: reporting by investment firms

2.5.50 G Under ■ MIFIDPRU 2.5.7R, a *UK parent entity* must 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. This does not apply to data item MIF007 (ICARA assessment questionnaire), which does not need to be submitted on a consolidated basis.

Prudential consolidation in practice: governance requirements

2.5.51 G (1) Under ■ MIFIDPRU 7.1.3R, a *UK parent entity* to which ■ MIFIDPRU 2.5.7R applies must comply with the general governance requirements in ■ MIFIDPRU 7.2 (Senior management and systems and controls) on a *consolidated basis*. In practice, this means that the *UK parent entity* must ensure that it has a proper organisational structure, effective processes and adequate internal controls covering the business of the *investment firm group*.

(2) The requirements in ■ MIFIDPRU 7.3 (Risk, remuneration and nomination committees) do not apply on a *consolidated basis*.

Prudential consolidation in practice: ICARA requirements

2.5.52 G As explained in ■ MIFIDPRU 7.9.4G, an *investment firm group* is not required to operate an *ICARA process* on a *consolidated basis*. However, ■ MIFIDPRU 7.9.5R permits an *investment firm group* to operate a single *group*

ICARA process covering the business carried on by that *investment firm group*, provided that certain requirements are met.

2.6 The group capital test

2.6.1 R This section applies to an *investment firm group* that has been granted permission by the *FCA* to apply the *group capital test* under ■ 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 ■ MIFIDPRU 3.3.6R(8), article 56(d), and article 66(d) of the *UK CRR*;

(2) the terms '*investment firm*', '*financial institution*', '*ancillary services undertaking*', '*tied agent*' and '*relevant financial undertaking*' include undertakings established in *third countries* that would satisfy the definitions of those terms if they were established in the *UK*.

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 those investments.

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 *GCT parent undertakings* in the *investment firm group* must hold own funds instruments sufficient to cover the sum of the following:

(1) the sum of the full book value of their holdings, subordinated claims and instruments referred to in ■ MIFIDPRU 3.3.6R(8), article 56(d), and article 66(d) of the *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*.

2.6.6 G

(1) Each *GCT parent undertaking* in the *investment firm group* must satisfy the *group capital test*. The *group capital test* can therefore apply at each level within the group structure. This mitigates the risk of leverage or capital gearing being introduced at levels underneath the *UK parent entity*.

(2) The requirement in ■ MIFIDPRU 2.6.5R only applies to *GCT parent undertakings*. However, ■ MIFIDPRU 2.6.7R imposes obligations on *GCT parent undertakings* in relation to their *subsidiaries* that are:

(a) parent undertakings established in a *third country*; or

(b) parent undertakings incorporated in, or with their principal place of business in, the *UK* that are not *GCT parent undertakings*.

(3) This prevents leverage and capital gearing being introduced into the *investment firm group* through:

(a) intermediate *parent undertakings* established in a *third country*; or

intermediate *parent undertakings* in the *UK* to which the *group capital test* does not directly apply.

2.6.7 R

(1) This *rule* applies where:

(a) an *investment firm group* has been granted permission to apply the group capital test under ■ MIFIDPRU 2.4.17R; and

(b) a *parent undertaking* in that *investment firm group* is a *relevant financial undertaking* and either:

(i) is established in a *third country*; or

(ii) is incorporated in, or has its principal place of business in, the *UK* and is not a *GCT parent undertaking*.

(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 the sum of the amounts in ■ MIFIDPRU 2.6.5R(1) and ■ (2) as they would apply to that *undertaking*; or

(b) hold own funds instruments sufficient to cover the sum of the amounts in ■ MIFIDPRU 2.6.5R(1) and ■ (2) that:

(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 is shown through the example below of a hypothetical *investment firm group* that contains the following *undertakings*:

a *UK parent entity* ("A");

an intermediate *investment holding company* ("B"), that is incorporated in the *UK* and is a direct *subsidiary* of A;

an *undertaking* established in a *third country* ("C") that would be an *investment holding company* if it were established in the *UK* and that is a direct *subsidiary* of B;

an *undertaking* established in a *third country* ("D") that would be a *MIFIDPRU investment firm* if it were established in the *UK* and that is a direct *subsidiary* of C;

a *MIFIDPRU investment firm* ("E") that is a direct *subsidiary* of D;

a *tied agent* ("F") that is established in the *UK* and that is a direct *subsidiary* of B;

an *undertaking* established in a *third country* ("G") that would be a *financial institution* if it were established in the *UK* and that is a direct *subsidiary* of C;

an intermediate holding company ("H") that is incorporated in the *UK* and is a direct *subsidiary* of A; and

an *authorised payment institution* ("I") that is incorporated in the UK and is a direct *subsidiary* of H.

(2) The *group capital test*:

(a) applies directly to A and B because they are both *GCT parent undertakings*;

(b) applies only indirectly to C and D, through the obligations imposed on the *responsible UK parent*, because C and D are *parent undertakings* established in a *third country*;

(c) applies only indirectly to H, through the obligations imposed on A in its capacity as the *responsible UK parent*, because H is not a *GCT parent undertaking*; and

(d) does not apply to E, F, G or I because they are not *parent undertakings*.

(3) In this example, B is a *responsible UK parent* because:

(a) B has two *subsidiaries* (a direct *subsidiary*, C, and an indirect *subsidiary*, D) that are both *parent undertakings* established in a *third country* and that would be *relevant financial undertakings* if they were established in the *UK*; and

(b) B does not have a subsidiary in the *UK* that 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 *parent undertaking* in the *UK* between B and either of C or D.

(4) A is not a *responsible UK parent* in relation to C and D. This is because A has a *subsidiary*, B, that is a *parent undertaking* of C and D and that is incorporated in the *UK*. B is therefore an intermediate *parent undertaking* in the *UK* between A on the one hand and C and D on the other.

(5) B is a *responsible UK parent* in relation to C and D. 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 that 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 in, and contingent liabilities in favour of, 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 in, and contingent liabilities in favour of, E.

(9) A is, however, a *responsible UK parent* in relation to H. This is because A is a *GCT parent undertaking* that is the *parent undertaking* of H. H is a *relevant financial undertaking* (being a holding company, and therefore a *financial institution*) and a *parent undertaking*. H is not a *GCT parent undertaking* because H is not an *authorised person* and does not have a *MIFIDPRU investment firm* as a *subsidiary*. There is also no intermediate *GCT parent undertaking* between A and H.

(10) In a similar way to B above, A therefore has a choice under MIFIDPRU 2.6.7R(2) of whether to:

(a) ensure that H complies with the requirements of the *group capital test* as if it applied directly to H; or

(b) hold own funds instruments that are sufficient to cover the sum of the requirements of the *group capital test* that apply to A and would apply to H.

(11) If A chooses the approach in (10)(a), A must:

(a) hold sufficient own funds instruments to cover the sum of A's holdings in, and contingent liabilities in favour of, B and H; and

(b) ensure that H holds sufficient own funds instruments to cover the sum of H's holdings in, and contingent liabilities in favour of, I.

(12) If A chooses the approach in (10)(b), A must hold sufficient own funds instruments to cover the sum of:

(a) A's holdings in, and contingent liabilities in favour of, B and H; and

(b) H's holdings in, and contingent liabilities in favour of, I.

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*.

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 *GCT parent undertakings* in the *investment firm group* must comply with the reporting requirements in (2).

Each *GCT parent undertaking* in (1) must:

(a) report in accordance with ■ MIFIDPRU 9 how that *GCT parent undertaking* meets the *group capital test*; and

(b) if the *GCT parent undertaking* is a *responsible UK parent*, also report in accordance with ■ MIFIDPRU 9 how:

(i) the *undertaking* in ■ MIFIDPRU 2.6.7R(1)(b) holds the required amount of own funds instruments referenced in ■ MIFIDPRU 2.6.7R(2)(a); or

(ii) the *GCT parent undertaking* holds at least the amount of own funds instruments to cover the amount applicable to the *undertaking* in ■ MIFIDPRU 2.6.7R(1)(b), as referenced in ■ MIFIDPRU 2.6.7R(2)(b).

2.6.11 R An *investment firm group* may designate:

(1) a *parent undertaking* in the *UK* that is part of the *investment firm group*; or

(2) a *MIFIDPRU investment firm* that is part of the *investment firm group* and that is not a *parent undertaking*;

to submit reports to the *FCA* under ■ MIFIDPRU 2.6.10R on behalf of the *GCT parent undertakings* in the *investment firm group*.

Inclusion of holding companies in supervision of compliance with the group capital test

2.6.12 G *UK investment holding companies* and *UK mixed financial holding companies* are included in the *FCA's* supervision of compliance with the *group capital test* where they are *GCT parent undertakings*.

2

2.7 Investment holding companies, mixed financial holding companies and mixed-activity holding companies

Qualifications of directors

2.7.1 G Under section 143R 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.

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 information that is relevant for the *FCA's* supervision of the *MIFIDPRU investment firm*.

(2) Under section 167 of the *Act*, 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) also apply to a *mixed-activity holding company*.

2.7.3 R (1) 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.

(2) The processes and mechanisms in (1) must include sound reporting and accounting procedures to identify, measure, monitor and control transactions between the *firm*, the *UK mixed-activity holding company* and its *subsidiaries*.

Sanctions

2.7.4 G Under section 143W of the *Act*, the *FCA* may impose disciplinary measures on the following, where they are not *authorised persons*, to end or mitigate breaches of a requirement under the *MIFIDPRU* sourcebook or sections 143K, 143R or 143S(6) of the *Act*:

(1) a *UK investment holding company*;

(2) a *UK mixed financial holding company*;

(3) a *UK mixed-activity holding company*; or

(4) a member of the *management body* of the entities in (1) to (3).

Application under MIFIDPRU 2.3.3R for an exemption from application of specific requirements on an individual basis

Part A – Permission under MIFIDPRU 2.3.1R to be exempt from disclosure requirements in MIFIDPRU 8 (Disclosure by investment firms) for SNI firms in consolidated insurance groups

MIFIDPRU 2 Annex 1R(A) Part A – Permission under MIFIDPRU 2.3.1R to be exempt from disclosure requirements.pdf

Part B – Individual exemption from liquidity requirements under MIFIDPRU 2.3.2R for MIFIDPRU investment firms in consolidated CRR or MIFIDPRU groups

MIFIDPRU 2 Annex 1R(B) Part B – Individual exemption from liquidity requirements under MIFIDPRU 2.3.2R.pdf

Application under MIFIDPRU 2.4.17R for permission to apply the group capital test

[*Editor's note*: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 2 Annex 2R Application under MIFIDPRU 2.4.17R for permission to apply the group capital test.pdf]

Notification under MIFIDPRU 2.5.17R of intended use of proportional consolidation in respect of a relevant financial undertaking

[Editor's note: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 2 Annex 3R Notification under MIFIDPRU 2.5.17R of the intended use of proportional consolidation.pdf]

Application under MIFIDPRU 2.5.19R for an exemption from liquidity requirements on a consolidated basis

[Editor's note: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 2 Annex 4R Application for exemption from liquidity requirements on a consolidated basis under MIFIDPRU 2.5.19R .pdf]

Application under MIFIDPRU 2.5.34R(2) for permission to use offsetting positions when calculating K-NPR on a consolidated basis

[Editor's note: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 2 Annex 5R Application under MIFIDPRU 2.5.34R for permission to use offsetting positions .pdf]

Application under MIFIDPRU 2.5.40R for permission to include a portfolio of a designated investment firm in consolidated K-CMG

[Editor's note: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 2 Annex 6R Application under MIFIDPRU 2.5.40R for permission to include a portfolio.pdf]

Application under MIFIDPRU 2.5.41R for permission to include portfolio of a third country entity in consolidated K-CMG

[Editor's note: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 2 Annex 7R Application under MIFIDPRU 2.5.41R for permission to include a portfolio of a third country entity .pdf]

Notification under MIFIDPRU 2.4.20R relating to membership of an investment firm group and/or a financial conglomerate

[Editor's note: the form can be found at this address: MIFIDPRU_2_Annex_8R_20233103.pdf]

Chapter 3

Own funds

3

3.1 Application and purpose

Application

3.1.1 R This chapter applies to:

(1) a *MIFIDPRU investment firm*; and

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) any reference to the "*UK CRR*" is to the *UK CRR* in the form in which it stood on 1 January 2022, read together with any CRR rules (as defined in section 144A of the *Act*) made by the *PRA* that applied on that date;

(2) where a term is not italicised but is defined in the *UK CRR*, the definition in the *UK CRR* applies;

(3) where this chapter applies to a parent undertaking that is not a *firm*, reference to a "*MIFIDPRU investment firm*" or a "*firm*" includes a reference to that *parent undertaking*; and

(4) where this chapter applies on the basis of the *consolidated situation* of an entity under ■ MIFIDPRU 3.1.1R(2), a reference in this chapter to a "*firm*" is a reference to the hypothetical single *MIFIDPRU investment firm* created under the *consolidated situation*.

Purpose

3.1.4 G This chapter contains requirements for the calculation of a *MIFIDPRU investment firm's own funds*. 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.

Supplementary provisions

3.1.5 G ■ MIFIDPRU 3 Annex 7R (Additional provisions relating to own funds) and ■ MIFIDPRU 3 Annex 8R (Prudent valuation and additional valuation adjustments) contain supplementary provisions that are relevant to certain *rules* in this chapter or certain requirements in the *UK CRR* that are cross-applied by *rules* in this chapter. A *firm*, *UK parent entity* or *GCT parent undertaking* that is applying a relevant *rule* in this chapter should therefore also refer to those annexes.

3

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.

3.2.2 R A *firm* must, at all times, have *own funds* that satisfy all 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 common equity tier 1 capital* and *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.

3.2.3 R A *firm's initial capital* must be made up of *own funds*.

3.2.4 G For the purposes of this chapter, the categorisation and the valuation of assets and off-balance sheet items should be carried out in accordance with the applicable accounting framework, unless 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.

3.3.1A R Article 34 of the *UK CRR* (Additional valuation adjustments) applies only in relation to positions held in a *firm's trading book*.

3.3.1B G (1) MIFIDPRU 3 Annex 7R contains supplementary provisions that may be relevant when a *firm* is calculating its *common equity tier 1 capital* under MIFIDPRU 3.3.1R.

(2) MIFIDPRU 3 Annex 8R contains supplementary provisions that apply when a *firm* is calculating any additional valuation adjustments under article 34 of the *UK CRR* (as applied by MIFIDPRU 3.3.1AR).

Prior permission to include interim profits or year-end profits in common equity tier 1 capital

3.3.2 R 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 in accordance with article 26(2) of the *UK CRR*, a *firm* must complete the form in MIFIDPRU 3 Annex 1R and submit it to the *FCA* using the *online notification and application system*.

Prior permission and notification of issuances of common equity tier 1 capital

3.3.3 R (1) To apply for permission to classify an issuance of capital instruments as *common equity tier 1 capital* in accordance with article 26(3) of the *UK CRR*, a *firm* must complete the form in MIFIDPRU 3 Annex 2R and submit it to the *FCA* using the *online notification and application system*.

(2) To notify the *FCA* in accordance with article 26(3) subparagraph two of the *UK CRR* about subsequent issuances of capital instruments for which it has already received the permission in (1), a *firm* must complete the form in MIFIDPRU 3 Annex 3R and submit it to the *FCA* using the *online notification and application system*.

3

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, 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 if:

(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* at least 20 *business days* before the *firm* intends to classify that issuance as *common equity tier 1 capital*.

Close correspondence between the value of a firm's covered bonds and the value of its assets

3.3.4A R

When determining whether there is a close correspondence between the value of a *firm's* covered bonds and the value of the *firm's* assets for the purposes of article 33(3)(c) of the *UK CRR*, the *Covered Bonds RTS* applies with the following modifications:

(1) any reference to an "institution" is a reference to the *firm*; and

(2) any reference to "Regulation (EU) No 575/2013" is a reference to the *UK CRR* as applied and modified by the *rules* in *MIFIDPRU*.

[**Note:** article 33(4) of the *UK CRR* and BTS 523/2014.]

Deductions from common equity tier 1 capital

3.3.5 R

For the purposes of *MIFIDPRU*:

(1) ■ MIFIDPRU 3.3.6R replaces article 36 of the *UK CRR*; and

(2) any reference to article 36 of the *UK CRR* or any part of that article in the following is a reference to ■ MIFIDPRU 3.3.6R (or the equivalent part of it):

(a) another provision of the *UK CRR* that is incorporated by reference into *MIFIDPRU*; or

(b) any technical standard that applies to a *MIFIDPRU investment firm* under a provision of the *UK CRR* to which (a) applies.

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) the value of any defined benefit pension fund assets on the balance sheet of the *firm* after deducting the amount of any associated deferred tax liability where that liability would be extinguished if the assets became impaired or were derecognised under the applicable accounting framework;

(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) 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) 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 under 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.

(11) where a *firm* is a *partnership* or a *limited liability partnership*, the amount by which the aggregate of any amounts withdrawn by its *partners* or members exceeds the profits of the *firm*, except to the extent that the amount:

(a) has already been deducted from the *firm's own funds* as a loss under (1);

(b) was repaid in accordance with ■ MIFIDPRU 3.3.16R(2) or ■ MIFIDPRU 3.3.17R(2); or

(c) is already reflected in a reduction of the *firm's own funds* that was permitted under articles 77 and 78 of the *UK CRR*, as applied in accordance with ■ MIFIDPRU 3.6 (General requirements for own funds instruments).

3

3.3.7 R

(1) For the purposes of ■ MIFIDPRU 3.3.6R and ■ MIFIDPRU 3.3.15R, holdings in a *fund* are to be treated as holdings in a *non-financial sector entity*.

(2) The requirement in (1) does not affect the meaning of the terms "*financial sector entity*" or "*non-financial sector entity*" when used in any other context in the *Handbook*.

Deferred tax assets that rely on future profitability

3.3.8 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).

Defined benefit pension fund assets on the firm's balance sheet

3.3.9 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).

Holdings of common equity tier 1 instruments of financial sector entities

3.3.10 R

(1) This *rule* applies to a *firm's* holdings of capital instruments that are not held in its *trading book*.

(2) Subject to ■ MIFIDPRU 3.3.14R, 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).

3.3.11 R

The following provisions do not apply 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*.

3.3.12 R

Subject to ■ MIFIDPRU 3.3.14R, 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).

3.3.13 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.

Holdings of common equity tier 1 instruments issued by a financial sector entity within an investment firm group

3.3.14 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 if 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 *investment firm group* is subject to prudential consolidation under ■ MIFIDPRU 2.5; and

(4) the risk evaluation, measurement and control procedures of a *parent undertaking* included within the *consolidated situation* of the *UK parent entity* of the *investment firm group* include the *financial sector entity*.

Qualifying holdings outside the financial sector

3.3.15 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 must not be included:

(a) shares in *non-financial sector entities* where any of the following conditions is met:

(i) the shares are held temporarily during a financial assistance operation referred to in article 79 of the *UK CRR*;

(ii) the holding of the shares is an underwriting position held for five *business days* or fewer; or

(iii) the 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*).

3

Common equity tier 1 instruments of partnerships

3.3.16 R A *partner's* account in relation to a *firm* that is a *partnership* satisfies the conditions in article 28(1)(e) (perpetual) and article 28(1)(f) (reduction or repayment) of the *UK CRR* if:

(1) capital contributed by *partners* is paid into the account; and

(2) under the terms of the partnership agreement an amount representing capital may be withdrawn from the account by a *partner* ("A"), otherwise than with prior *FCA* consent pursuant to ■ MIFIDPRU 3.6.2R or deemed consent under ■ MIFIDPRU 3.6.3R, only if:

(a) A ceases to be a *partner* and an equal amount is transferred to another *partner's* account by A's former *partners* or any *person* replacing A as their *partner*;

(b) any reduction in the capital credited to A's account is immediately offset by additional contributions of at least an equal aggregate amount to other *partner* accounts by one or more of A's *partners* (including any person becoming a *partner* of A at the time that the additional contribution is made);

(c) the *partnership* is wound up or dissolved; or

(d) the *firm* ceases to be *authorised* or no longer has a *Part 4A permission*.

Common equity tier 1 instruments of limited liability partnerships

3.3.17 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* if:

(1) capital contributed by the members is paid into the account; and

(2) under the terms of the *limited liability partnership* agreement, an amount representing capital may be withdrawn from the account by a *partner* ("B"), otherwise than with prior *FCA* consent pursuant to ■ MIFIDPRU 3.6.2R or deemed consent under ■ MIFIDPRU 3.6.3R, only if:

(a) B ceases to be a member and an equal amount is transferred to another member account by B's former fellow members or any *person* replacing B as a member;

(b) any reduction in the capital credited to B's account is immediately offset by additional contributions of at least an equal aggregate amount to other member accounts by one or more of B's fellow members (including any person becoming a fellow member of B at the time that the additional contribution is made);

(c) the *limited liability partnership* is wound up or dissolved; or

(d) the *firm* ceases 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.

3.4.1A G

MIFIDPRU 3 Annex 7R contains supplementary provisions relating to the calculation of a *firm's additional tier 1 capital* and to write-down and conversion requirements for *additional tier 1 instruments*.

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 in the terms of an *additional tier 1 instrument* one or more trigger events for the purposes of article 52(1)(n) of the *UK CRR*.

(2) The trigger events specified under (1) must 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* applies 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 when a trigger event occurs.

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 if the *firm's common equity tier capital* falls below a specified level. This level must be set at no lower than 64% of the *firm's own funds requirement*. The *firm* may set the relevant trigger at a higher level (such as

70% of its *own funds requirement*) if it wishes. The *firm* may also 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 that 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 where ■ MIFIDPRU 3.4.7R applies.

3.4.6 R The following provisions do not apply 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*.

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* if 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*.

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.

3.5.1A G

MIFIDPRU 3 Annex 7R contains additional provisions relating to the calculation of a *firm's tier 2 capital*.

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 that 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 where MIFIDPRU 3.5.4R applies.

3.5.3 R

The following provisions do not apply 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*.

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* if 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.

3.6 General requirements for own funds instruments

3.6.1 R

(1) A *firm* must comply with 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.

3.6.1A G

■ MIFIDPRU 3 Annex 7R contains additional provisions relating to the eligibility of instruments to be classified as *own funds* and to the reduction of *own funds*.

Reduction of own funds instruments

3.6.2 R

To apply for permission for the purposes of articles 77 and 78 of the *UK CRR* to do any of the following, a *firm* must save in the circumstances set out in ■ MIFIDPRU 3.6.3R, complete the form in ■ MIFIDPRU 3 Annex 4R and submit it to the *FCA* using the *online notification and application system*:

(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;

3.6.3 R

Permission under ■ MIFIDPRU 3.6.2R is deemed to have been granted if the following conditions are met:

(1) either of the conditions in ■ MIFIDPRU 3.6.4R apply;

(2) at least 20 *business days* before the *day* on which the reduction, repurchase, call or redemption is proposed to occur, 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 either condition in (1) is satisfied;

3

(3) the notification in (2) is made using the form in ■ MIFIDPRU 3 Annex 5R and submitted using the *online notification and application system*; and

(4) the *FCA* has not notified the *firm* of any objection 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) before 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 on 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:

(a) there is a change in the regulatory classification of the instruments that is 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.

Notification of issuance of additional tier 1 and tier 2 instruments

3.6.5 R (1) A *firm* must notify the *FCA* at least 20 *business days* before the intended issuance date of the *firm's* intention to issue:

(a) additional tier 1 instruments; or

(b) tier 2 instruments.

(2) The notification requirement in (1) does not apply if:

(a) the *firm* has previously notified the *FCA* of an issuance of the same class of *additional tier 1 instruments* or *tier 2 instruments*; and

(b) the terms of the new instruments are identical in all material respects to the terms of the instruments in the issuance previously notified to the *FCA*.

(3) The notification under (1) must:

be submitted to the *FCA* through the *online notification and application system* using the form in ■ MIFIDPRU 3 Annex 6R; and

(b) include the following:

(i) confirmation of whether the instruments are intended to be classified as *additional tier 1 instruments* or *tier 2 instruments*;

(ii) confirmation of whether the instruments are intended to be issued to external investors or only to other members of the *firm's group* or connected parties;

(iii) a copy of the term sheet and details of any features of the capital instrument which are novel, unusual or different from a capital instrument of a similar nature previously issued by the *firm* or widely available in the market;

(iv) confirmation from a member of the *firm's senior management* or *governing body* who has oversight of the intended issuance that the instrument meets the conditions in ■ MIFIDPRU 3.4 or ■ MIFIDPRU 3.5 (as applicable, and including any conditions in the *UK CRR* applied by those sections) to be classified as *additional tier 1 instruments* or *tier 2 instruments*; and

(v) a properly reasoned legal opinion from an appropriately qualified *individual*, confirming that the capital instruments meet the conditions in (iv).

3.6.6 G

(1) *MIFIDPRU investment firms* that were classified as *CRR firms* immediately before 1 January 2022 should refer to ■ MIFIDPRU TP 1 for transitional provisions relating to *own funds* permissions that were issued, and notifications that were made, before that date.

Those *firms* should also refer to ■ MIFIDPRU TP 7, which contains transitional provisions about capital instruments issued before 1 January 2022 and in respect of which the *firm* had not obtained *own funds* permissions or made notifications under the legal requirements in force at that time.

(2) *MIFIDPRU investment firms* that were in existence immediately before 1 January 2022, but were not classified as *CRR firms*, should refer to ■ MIFIDPRU TP 7 for transitional provisions relating to *own funds* instruments issued before that date.

(3) *Parent undertakings* should also refer to the following:

(a) ■ MIFIDPRU TP 1, where they were subject to the *UK CRR* on an individual or a consolidated basis immediately before 1 January 2022 and had obtained permissions or made notifications under the *UK CRR* relating to *own funds* instruments issued before that date; or

(b) ■ MIFIDPRU TP 7 in either of the following cases:

(i) where they were not subject to the *UK CRR* on either an individual or a consolidated basis immediately before 1 January 2022, but wish to rely on transitional provisions relating to capital instruments issued before that date; or

(ii) where they were subject to the *UK CRR* on an individual or a consolidated basis immediately before 1 January 2022, but wish to rely on transitional provisions relating to capital instruments issued before that date in respect of which the *parent undertaking* had not obtained *own funds* permissions or made notifications under the legal requirements in force at that time.

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3.6.7 G *Firms* that are proposing to classify an issuance of capital instruments as *common equity tier 1 capital* should refer to the obligations and guidance in ■ MIFIDPRU 3.3.3R and ■ MIFIDPRU 3.3.4G. In particular, *firms* must obtain the *FCA's* prior permission for the first issuance of a class of instruments that is intended to comprise *common equity tier 1 capital*.

3.6.8 R (1) A *UK parent entity* must apply the modifications in (2) when either of the following apply on a *consolidated basis* in accordance with ■ MIFIDPRU 2.5.7R:

(a) ■ MIFIDPRU 3.3.2R to ■ MIFIDPRU 3.3.4G; and

(b) ■ MIFIDPRU 3.6.5R.

(2) The *Handbook* provisions in (1)(a) and (b) apply as if a reference to:

(a) a "*firm*" is a reference to the *UK parent entity*;

(b) "capital instruments" is a reference to capital instruments issued by the *UK parent entity*;

(c) "*additional tier 1 instruments*" and "*tier 2 instruments*" is a reference to these instruments issued by the *UK parent entity*; and

(d) "*common equity tier 1 capital*" is a reference to that type of capital as calculated on a *consolidated basis*.

3.6.9 G Submitting a notification in accordance with ■ MIFIDPRU 3.6.5R to ■ MIFIDPRU 3.6.8R does not guarantee that the relevant instruments meet the required conditions in ■ MIFIDPRU 3.4 or ■ MIFIDPRU 3.5 to qualify as *own funds*. The *firm* or *parent undertaking* must ensure that an instrument continues to meet the conditions to be counted as *own funds*, including if its terms are varied on a later date.

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* that satisfy 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.

3.7.3 G As explained in ■ MIFIDPRU 2.6.6G, the *group capital test* effectively applies to each intermediate parent undertaking, as well as to the ultimate *parent undertaking* of the *investment firm group*.

3.7.4 R (1) Subject to (2), a *parent undertaking* must comply with:

(a) ■ MIFIDPRU 3.3.2R to ■ MIFIDPRU 3.3.4G when issuing *own funds instruments* which are intended to qualify as *common equity tier 1 capital*;

(b) ■ MIFIDPRU 3.6.5R when issuing *own funds instruments* which are intended to qualify as *additional tier 1 instruments* or *tier 2 instruments.*

(12) Where the *Handbook* provisions in (1)(a) and (b) apply, they apply as if a reference to:

(a) a "*firm*" is a reference to the *parent undertaking*;

(b) "capital instruments" is a reference to capital instruments issued by the *parent undertaking*;

(c) "*additional tier 1 instruments*" and "*tier 2 instruments*" is a reference to these instruments issued by the *parent undertaking*; and

(d) "*common equity tier 1 capital*" is a reference to this type of capital as held by the *parent undertaking*.

3.7.5 R

(1) This *rule* applies where a *responsible UK parent* applies the approach in MIFIDPRU 2.6.7R(2)(a) in relation to an *undertaking* established in a *third country*.

(2) Where this *rule* applies, a *responsible UK parent* must comply with MIFIDPRU 3.7.4R in relation to any issuance of own funds instruments by the *undertaking* established in a *third country*.

Application under MIFIDPRU 3.3.2R - permission to include interim or year-end profits as CET1

[*Editor's note:* The form can be found at this address: https://www.handbook.fca.org.uk/form/mifidpru/MIFIDPRU 3 Annex 1R Application under MIFIDPRU 3.3.2R for permission to include interim or year-end profits as common equity tier 1 (CET1) capital before the firm.pdf

Application under MIFIDPRU 3.3.3R(1) - permission to classify capital instruments as CET1

[*Editor's note:* The form can be found at this address: https://www.handbook.fca.org.uk//form/mifidpru/MIFIDPRU_3Annex2R_27.09.2022.pdf

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Notification under MIFIDPRU 3.3.3R(2) - issuance of additional capital instruments that have already been approved as CET1 instruments

[*Editor's note:* The form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 3 Annex 3R Notification under MIFIDPRU 3.3.3R(2) of issuance of additional capital instruments that have already been approved as CET1 instruments.pdf

Application under MIFIDPRU 3.6.2R - permission to reduce own funds instruments when neither condition in MIFIDPRU 3.6.4R applies

[*Editor's note:* The form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 3 Annex 4R Application under MIFIDPRU 3.6.2R for permission to reduce own funds instruments where neither condition in MIFIDPRU 3.6.4R applies.pdf

Notification under MIFIDPRU 3.6.3R - intended reduction in own funds instruments where a condition in MIFIDPRU 3.6.4R applies

[*Editor's note:* The form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 3 Annex 5R Notification under MIFIDPRU 3.6.3R of the intended reduction in own funds instruments where a condition in MIFIDPRU 3.6.4R applies.pdf

Notification under MIFIDPRU 3.6.5R of issuance of additional tier 1 or tier 2 instruments

[*Editor's note:* The form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 3 Annex 6R Notification under MIFIDPRU 3.6.5R of the intended issuance of AT1 or T2 instruments.pdf

Additional provisions relating to own funds

Additional provisions relating to own funds

Application and purpose			
7.1	R	This annex applies to any of the following entities when that entity is determining its *own funds* under MIFIDPRU 3:	
		(1)	a *MIFIDPRU investment firm*;
		(2)	a *UK parent entity*; and
		(3)	a *GCT parent undertaking*.
7.2	G	This annex contains additional *rules* and *guidance* that supplement the requirements in MIFIDPRU 3 and *UK CRR* (as applied by MIFIDPRU 3) relating to the calculation of *own funds*.	
7.3	R	Any reference in this annex to the *UK CRR* is to the *UK CRR* as applied and modified by MIFIDPRU 3.	
Definition of cooperative societies and similar undertakings			
7.4	R	For the purposes of article 27(1)(a)(ii) of the *UK CRR*, a *firm* is a *cooperative society* where the following conditions are met:	
		(1)	the *firm* is a registered society within the meaning of the Co-operative and Community Benefit Societies Act 2014, or a society registered or treated as registered under the Cooperative and Community Benefit Societies Act (Northern Ireland) 1969;
		(2)	with respect to *common equity tier 1 capital*, the *firm* is able to issue, under the applicable law of the *United Kingdom* (or any part of it) or the *firm's* statutes, at the level of the legal entity, only capital instruments referred to in article 29 of the *UK CRR*;
		(3)	where, under the applicable law of the *United Kingdom* (or any part of it), the holders of the *firm's common equity tier 1 instruments* (whether they are members or non-members of the *firm*) have the ability to resign and return the capital instrument to the *firm*, this must be subject to any applicable restrictions under the following:
			(a) the law of the *United Kingdom* (or any part of it);
			(b) the statutes of the *firm*;
			(c) any provision of the *UK CRR* that is applied by *MIFIDPRU*; and
			(d) any provision of the *Handbook*.
		[**Note**: article 4 of BTS 241/2014]	
7.5	R	For the purposes of article 27(1)(a)(iv) of the *UK CRR*, a *firm* is a *similar institution* where the following conditions are met:	

(1) with respect to *common equity tier 1 capital*, the *firm* is able to issue, under the applicable law of the *United Kingdom* (or any part of it) or the *firm's* statutes, at the level of the legal entity, only capital instruments referred to in article 29 of the *UK CRR*; and

(2) at least one of the following applies:

(a) where the holders of the *firm's common equity tier 1 instruments* (whether they are members or non-members of the *firm*) have the ability to resign under the applicable law of the *United Kingdom* (or any part of it) and have the right to put the capital instrument back to the *firm*, this must be subject to any applicable restrictions under the following:

(i) the law of the *United Kingdom* (or any part of it);

(ii) the statutes of the *firm*;

(iii) any provision of the *UK CRR* that is applied by *MIFIDPRU*; and

(iv) any provision of the *Handbook*;

(b) the sum of capital, reserves and interim or year-end profits is not allowed, under the applicable law of the *United Kingdom* (or any part of it), to be distributed to holders of the *common equity tier 1 instruments* of the *firm*, except where:

(i) the *common equity tier instruments* grant the holders, on a going concern basis, a right to a part of the profits and reserves that is proportionate to their contribution to the capital and reserves of the *firm* or is otherwise determined in ac

				cordance with an alternative arrangement, and in either case, this is permitted under applicable law;
			(ii)	the *common equity tier 1 instruments* grant the holders, in the case of the insolvency or liquidation of the *firm*, the right to reserves that need not be proportionate to the contribution to capital and reserves, provided that the conditions in article 29(4) and article 29(5) of the *UK CRR* are met; or
			(iii)	the total amount or a partial amount of the sum of capital and reserves is owned by members of the *firm* who do not, in the ordinary course of business, benefit from direct distribution of the reserves, in particular through the payment of dividends.
		[**Note**: article 7 of BTS 241/2014.]		
7.6	R	MIFIDPRU 3 Annex 7.4R(3) and MIFIDPRU 3 Annex 7.5(2)(a) do not prevent the *firm* from issuing, whether under the law of the *United Kingdom* (or any part of it) or of a *third country*, *common equity tier 1 instruments* to members or non-members that comply with article 29 of the *UK CRR* and do not grant a right to return the capital instrument to the firm. [**Note**: article 4(4) and article 7(4)(a) of BTS 241/2014.]		
Distributions constituting disproportionate drags on capital or preferential distributions				
7.7	R	(1)	This *rule* applies for the purpose of determining whether a distribution on an instrument intended to qualify as a *common equity tier 1 capital instrument* constitutes a disproportionate drag	

on capital under article 28(1)(h)(iii) and 28(3) of the *UK CRR*.

(2) References in this *rule* to the "dividend multiple" are to the dividend multiple referred to in article 28(3) of the *UK CRR*.

(3) Distributions on an instrument will not constitute a disproportionate drag on capital for the purposes of (1) where:

(a) the dividend multiple is a multiple of the distribution paid on the voting instruments and is not a predetermined fixed amount;

(b) the dividend multiple is set contractually or under the statutes of the *firm*;

(c) the dividend multiple is not revisable;

(d) the same dividend multiple applies to all instruments with a dividend multiple;

(e) the amount of distribution on one instrument with a dividend multiple does not represent more than 125% of the amount of the distribution on one voting *common equity tier 1 instrument*, as determined in accordance with the formula in (6);

(f) the total amount of the distributions paid on all *common equity tier 1 instruments* during a one-year period does not exceed 105% of the amount that would have been paid if instruments with fewer or no voting rights received the same distributions as voting instruments, as determined in accordance with the formula in (7).

(4) Where the conditions in (3)(a) to (3)(e) are not met, all outstanding instruments with a dividend multiple shall be deemed to cause a disproportionate drag on capital for the purposes of (1).

(5) Where the condition in (3)(f) is not met, only the amount of the instruments with a dividend multiple that exceeds the threshold in that provision shall be deemed to cause a disproportionate drag on capital for the purposes of (1).

(6) The formula referred to in (3)(e) is:

$$l \leq 1.25 \times k$$

where:

k = the amount of the distribution on one instrument without a dividend multiple; and

l = the amount of the distribution on one instrument with a dividend multiple.

		(7)	The formula referred to in (3)(f) applies on a one-year basis and is as follows:	
			$kX + lY \leq (1.05) \times k \times (X + Y)$	
			k =the amount of the distribution on one instrument without a dividend multiple;	
			l =the amount of the distribution on one instrument with a dividend multiple;	
			X =the number of voting instruments; and	
			Y =the number of non-voting instruments.	
		[**Note**: article 7a of BTS 241/2014.]		
7.8	R	A distribution on a *common equity tier 1 instrument* referred to in article 28 of the *UK CRR* shall be deemed to be a preferential distribution under article 28(1)(h)(i) of the *UK CRR* relative to other *common equity tier 1 instruments* where there are differentiated levels of distributions, unless the conditions in MIFIDPRU 3 Annex 7.7R are met.		
		[**Note**: article 7b(1) of BTS 241/2014.]		
7.9	R	(1)	This *rule* applies where:	
			(a)	a *common equity tier 1 instrument* has been issued by a *firm* that is a *cooperative society* or a *similar institution*;
			(b)	the instrument in (a) has fewer or no voting rights when compared to a *common equity tier 1 instrument* of the *firm* with full voting rights;
			(c)	the distribution on the instrument in (a) is a multiple of the distribution on the voting instruments; and
			(d)	the distribution in (c) is set contractually or under statute.
		(2)	Where this rule applies, a distribution on the instrument in (1)(a) is deemed not to be preferential relative to the *common equity tier 1 instrument* in (1)(b) for the purposes of article 28(1)(h)(i) of the *UK CRR* where:	
			(a)	the dividend multiple is a multiple of the distribution paid on the voting instruments and not a predetermined fixed amount;
			(b)	the dividend multiple is set contractually or under the statutes of the *firm*;
			(c)	the dividend multiple is not revisable;
			(d)	the same dividend multiple applies to all instruments with a dividend multiple;
			(e)	the amount of the distribution on one instrument with a dividend multiple does not represent more than 125% of the

amount of the distribution on one voting *common equity tier 1 instrument*, as determined in accordance with the formula in (5); and

(f) the total amount of distributions paid on all *common equity tier 1 instruments* during a one-year period does not exceed 105% of the amount that would have been paid if instruments with fewer or no voting rights received the same distributions as the voting instruments, as determined in accordance with the formula in (6).

(3) Where any of the conditions in (2)(a) to (2)(e) are not met, all outstanding instruments with a dividend multiple shall be disqualified from the *common equity tier 1 capital* of the *firm*.

(4) Where the condition in (2)(f) is not met, only the amount of the instruments with a dividend multiple that exceeds the threshold defined in that provision shall be disqualified from the *common equity tier 1 capital* of the *firm*.

(5) Subject to (7), the formula referred to in (2)(e) is:

$l \leq 1.25 \times k$

where:

k = the amount of the distribution on one instrument without a dividend multiple; and

l = the amount of the distribution on one instrument with a dividend multiple.

(6) Subject to (7), the formula referred to in (2)(f) applies on a one-year basis and is as follows:

$kX + lY \leq (1.05) \times k \times (X + Y)$

k =the amount of the distribution on one instrument without a dividend multiple;

l =the amount of the distribution on one instrument with a dividend multiple;

X =the number of voting instruments; and

Y =the number of non-voting instruments.

(7) Where the distributions on *common equity tier 1 instruments* (whether for voting or non-voting instruments) are expressed with reference to the purchase price of the instrument at issuance, the formulae in (5) and (6) shall be adapted as follows for those instruments:

(a) l shall represent the amount of the distribution on one instrument without a dividend multiple divided by the purchase price at issuance of that instrument; and

				(b)	*k* shall represent the amount of the distribution on one instrument with a dividend multiple divided by the purchase price at issuance of that instrument.
			(8)	The one-year period referred to in (6) shall be deemed to end on the date of the last financial statements of the *firm*.	
			[**Note**: article 7b(2) to 7b(5) of BTS 241/2014.]		
7.10		R	(1)	This rule applies where:	
				(a)	a *common equity tier 1 instrument* has been issued by a firm that is a *cooperative society* or a *similar institution*;
				(b)	the instrument in (a) has fewer or no voting rights when compared to a *common equity tier 1 instrument* of the *firm* with full voting rights; and
				(c)	the distribution on the instrument in (a) is not a multiple of the distribution on the voting instruments.
			(2)	Where this *rule* applies, a distribution on the instrument in (1)(a) shall be deemed not to be preferential relative to the *common equity tier 1 instrument* in (1)(b) for the purposes of article 28(1)(h)(i) of the *UK CRR* where:	
				(a)	either of the conditions in (3) is met; and
				(b)	both of the conditions in (5) are met.
			(3)	The relevant conditions in (2)(a) are that either:	
				(a)	both of the following points are satisfied:
					(i) the instrument with fewer or no voting rights can only be subscribed and held by the holders of voting instruments; and
					(ii) the number of the voting rights of any single holder is limited, as specified in (4); or
				(b)	the distributions on the voting instruments issued by the *firm* are subject to a cap set out under the applicable law of the

3

United Kingdom (or any part of it), or of a *third country*.

(4) For the purposes of (3)(a)(ii), the voting rights of any single holder shall be deemed to be limited in the following cases:

(a) where each holder only receives one voting right irrespective of the number of voting instruments for any holder;

(b) where the number of voting rights is capped irrespective of the number of voting instruments held by any holder; or

(c) where the number of voting instruments any holder may hold is limited under the statutes of the *firm* or under the applicable law of the *United Kingdom* (or any part of it), or of a *third country*.

(5) The relevant conditions in (2)(b) are that:

(a) the average of the distributions on voting instruments of the *firm* during the preceding 5 years is low in relation to other comparable instruments; and

(b) the payout ratio as calculated under MIFIDPRU 3 Annex 7.12R is under 30%.

(6) A *firm* must assess compliance with the conditions in (3) and (5) and notify the *FCA* of the results of that assessment in the following situations:

(a) every time the *firm* takes a decision on the amount of distributions on *common equity tier 1 instruments*; and

(b) every time the *firm* issues a new class of *common equity tier 1 instruments* with fewer or no voting rights when compared with *common equity tier 1 instruments* of the *firm* with full voting rights.

(7) A *firm* must make the notification in (6) by completing the form in MIFIDPRU 1 Annex 6R and submitting it to the *FCA* using the *online notification and application system*.

(8) Where neither of the conditions in (3) are met, the distributions on all outstanding non-voting instruments are deemed to be preferential unless they meet the conditions in MIFIDPRU 3 Annex 7.9R(2).

(9) Where the condition in (5)(a) is not met, the distributions on all outstanding non-voting instruments shall be deemed to be preferential unless

			they meet the conditions in MIFIDPRU 3 Annex 7.9R(2).
		(10)	Where the condition in (5)(b) is not met, only the amount of the non-voting instruments for which distributions exceed the threshold specified in that provision shall be deemed to entail preferential distributions.
		[**Note**: article 7b(6) to 7b(14) of BTS 241/2014.]	
7.11	G	A *firm* may apply under section 138A of the *Act* for a waiver of the requirements in MIFIDPRU 3 Annex 7.10R(3)(a)(i) or MIFIDPRU 3 Annex 7.10R(5)(b) where:	
		(1)	the *firm* is in breach of, or due to a rapidly deteriorating financial condition, is likely in the near future to be in breach of, the requirements in *MIFIDPRU* (other than those in MIFIDPRU 3 Annex 7.10R(3)(a)(i) or MIFIDPRU 3 Annex 7.10R(5)(b));
		(2)	the *FCA* has required the *firm* to increase its *common equity tier 1 capital* within a specified period; and
		(3)	the *firm* considers that it will not be able to rectify or avoid the breach of *MIFIDPRU* within that specified period unless the relevant requirement in MIFIDPRU 3 Annex 7.10R(3)(a)(i) or MIFIDPRU 3 Annex 7.10R(5)(b) is waived.
		[**Note**: article 7b(15) of BTS 241/2014.]	
7.12	R	(1)	A *firm* must calculate the payout ratio under MIFIDPRU 3 Annex 7.10R(5)(b) using the following formula:
			R= D/P
			where:
			R =the payout ratio;
			D =the sum of the distributions related to total *common equity tier 1 instruments* over the previous 5 yearly periods; and
			P =the sum of profits related to the previous 5 yearly periods.
		(2)	For the purposes of paragraph (1), profits shall be:
			(a) in the case of a period for which the *firm* submitted *data item* FSA030 (Income Statement), the amount of profit after taxation reported in cell 25A of that *data item*;
			(b) in the case of a period for which the *firm* submitted *data item* FSA002 (Income Statement), the amount of net profit reported in cell 46B of that *data item*; and
			(c) in the case of a period for which the *firm* submitted FINREP return F02.00 (Statement of profit or loss), whether under IFRS or GAAP, the amount of

			profit after tax reported in row 670.
		[**Note**: article 7c of BTS 241/2014.]	
7.13	R	For the purposes of article 28 of the *UK CRR*, a distribution on a *common equity tier 1 instrument* shall be deemed to be preferential relative to other *common equity tier 1 instruments* regarding the order of distribution payments where at least one of the following conditions is met:	
		(1)	distributions are decided at different times;
		(2)	distributions are paid at different times;
		(3)	there is an obligation on the firm to pay the distributions on one type of *common equity tier 1 instruments* before paying the distributions on another type of *common equity tier 1 instruments*; or
		(4)	a distribution is paid on some *common equity tier 1 instruments* but not on others, unless the condition in MIFIDPRU 3 Annex 7.10R3(a) is satisfied.
		[**Note**: article 7d of BTS 241/2014.]	
Deduction of foreseeable dividends from interim or year-end profits to be recognised as CET1 items			
7.14	R	(1)	This *rule* applies for the purpose of determining the amount of any foreseeable dividend that must be deducted by a *MIFIDPRU investment firm* from its interim or year-end profits under article 26(2)(b) of the *UK CRR*.
		(2)	Where the *firm's management body* has formally taken a decision or proposed a decision to the *firm's relevant body* regarding the amount of dividends to be distributed, that amount must be deducted from the corresponding interim or year-end profits.
		(3)	Before the *firm's management body* has formally taken a decision or proposed a decision to the *firm's relevant body* on the distribution of dividends, the amount of foreseeable dividends to be deducted by the *firm* from the interim or year-end profits must equal the amount of interim or year-end profits multiplied by the dividend payout ratio (as calculated in accordance with MIFIDPRU 3 Annex 7.16R).
		(4)	Where the *firm* pays an interim dividend, the residual amount of interim profit which is to be added to the *firm's common equity tier 1* items must be reduced (taking into account the requirement in (3)), by the amount of any foreseeable dividend which can be expected to be paid out from that residual interim profit with the final dividends for the full business year.
		(5)	This *rule* is subject to MIFIDPRU 3 Annex 7.15R.
		[**Note**: article 2 of BTS 241/2014.]	
7.15	R	(1)	Where a foreseeable dividend is to be paid in a form that does not reduce the common equity tier 1 items of the *firm* (such as through a scrip dividend), the amount of that dividend does not need to be deducted from a *firm's* interim or

			year-end profits for the purposes of article 26(2) of the *UK CRR*.
		(2)	Where a *firm* is subject to a regulatory restriction on the amount of any dividend it can pay, the amount of any foreseeable dividend to be deducted must be determined taking into account that restriction.
		[**Note**: article 2(9) and 2(10) of BTS 241/2014.]	
7.16	R	(1)	This *rule* applies for the purposes of determining the dividend payout ratio referred to in MIFIDPRU 3 Annex 7.14R(3).
		(2)	Subject to (3), the dividend payout ratio must be determined on the basis of the dividend policy approved for the relevant period by the *firm's management body* or *relevant body*.
		(3)	Where the *firm's* dividend policy in (2) contains a payout range instead of a fixed value, the upper end of the range must be used when determining the dividend payout ratio.
		(4)	Where the *firm* does not have an approved dividend policy, the dividend payout ratio is the higher of the following: (a) the average dividend payout ratio over the three years prior to the year under consideration; or (b) the dividend payout ratio of the year preceding the year under consideration.
		(5)	The dividend payout ratio in (4)(a) and (4)(b) must be calculated using the following formula: R=D/N where: *R* =the dividend payout ratio for the relevant period; *D* =the sum of distributions made by the *firm* during the relevant period; and **N** =the net income of the *firm* during the relevant period.
		[**Note**: article 2(4) to 2(6) of BTS 241/2014.]	
7.17	G	(1)	The *FCA* may require a *firm* to use the alternative calculation of the dividend payout ratio in MIFIDPRU 3 Annex 7.16R(4) where, even though the *firm* has an approved dividend policy, the *FCA* considers that: (a) the *firm* would not apply the dividend policy in practice; or (b) the policy is not a prudent basis on which to determine the amount to be deducted from interim or year-end profits for the purposes of MIFIDPRU 3 Annex 7.14R.

		(2)	In the circumstances in (1), the *FCA* will normally invite the *firm* to apply for the imposition of a *requirement* on the *firm* under section 55L(5) of the *Act* to apply the alternative calculation. Alternatively, the *FCA* may seek to impose such a *requirement* on its own initiative under section 55L(3) of the *Act*.
		[**Note**: article 2(7) of BTS 241/2014.]	
7.18	G	A *firm* may apply to the *FCA* under section 138A of the *Act* for a modification of MIFIDPRU 3 Annex 7.16R(4) to exclude exceptional dividends where the *firm* has paid those dividends during the period for which the dividend payout ratio is being determined. The *FCA* will consider whether including those dividends in the calculation would be unduly onerous or would otherwise fail to achieve the purpose of that *rule*. This is likely to depend on whether the *firm* can demonstrate that the dividends are genuinely exceptional in nature.	
		[**Note**: article 2(8) of BTS 241/2014.]	
Deduction of foreseeable charges from interim or year-end profits to be recognised as CET1 items			
7.19	R	(1)	This *rule* applies for the purpose of determining the amount and timing of any foreseeable charge that must be deducted by a *MIFIDPRU investment firm* from its interim or year-end profits under article 26(2)(b) of the *UK CRR*.
		(2)	The amount of foreseeable charges to be deducted must include the following:
			(a) any taxes;
			(b) any amounts resulting from obligations or circumstances that may arise during the related reporting period where:
			(i) those amounts are likely to reduce the profits of the *firm*; and
			(ii) the *firm* has not made all necessary value adjustments or provisions, including *AVAs* under article 34 of the *UK CRR*, to cover such amounts.
		(3)	Where the *firm* has not already taken a foreseeable charge into account in the profit and loss account, the charge must be assigned to the interim period during which it was incurred.
		(4)	For the purposes of (3), where a charge was incurred during more than one interim period, the *firm* must allocate the amount so that each interim period bears a reasonable amount of the relevant charge.

		(5)		A charge that occurs from a material or non-recurrent event must be allocated in full without delay to the interim period during which the event arises.
		[**Note**: article 3 of BTS 241/2014.]		
Prohibition on direct or indirect funding of own funds instruments				
7.20	R	(1)		This *rule* applies for the purpose of determining when an instrument has been funded indirectly by a *firm* for the purposes of any of the following provisions of the *UK CRR*:
			(a)	article 28(1)(b);
			(b)	article 52(1)(c); or
			(c)	article 63(c).
		(2)		Funding will be indirect funding for the purposes of (1) when it is not direct funding as defined in (3).
		(3)		Direct funding is either of the following:
			(a)	a situation where a *firm* has granted a loan or other funding in any form to an investor that is used to purchase the *firm's* capital instruments; or
			(b)	funding granted by the *firm* for purposes other than those in (a) to any natural or legal person in the following situations, where the conditions in (4) are not met:
				(i) the person has a qualifying holding (as defined in article 4(1)(36) of the *UK CRR*) in the *firm*; or
				(ii) the person is deemed to be a related party within the meaning of the definitions in paragraph 9 of International Accounting Standard 24 on Related Party Disclosures, as applied by *UK-adopted international accounting standards* on 1 January 2022.
		(4)		The conditions in (3)(b) are:

			(a)	the transaction is realised at similar conditions to other transactions with third parties; and
			(b)	the natural or legal *person* does not have to rely on the distributions or on the sale of the capital instruments held to support the payment of interest or the repayment of the funding granted by the *firm*.
		[**Note**: article 8 of BTS 241/2014.]		
7.21	R	(1)	The following are non-exhaustive examples of indirect funding for the purposes of the provisions of the *UK CRR* listed in MIFIDPRU 3 Annex 7.20R(1) where the condition in (2) is also satisfied:	
			(a)	funding of an investor's purchase, at issuance or thereafter, of a *firm's* capital instruments by entities over which the *firm* has direct or indirect control, or by entities included in any of the following:
				(i) the scope of accounting or prudential consolidation of the *firm*; or
				(ii) the scope of supplementary supervision of the *firm* under *Directive 2002/87/EC UK law*;
			(b)	funding of an investor's purchase, at issuance or thereafter, of a *firm's* capital instruments by external entities that are protected by a guarantee or by the use of a credit derivative or are secured in some other way so that the credit risk is transferred to the *firm* or to any entities on which the *firm* has a direct or indirect control or any entities included in any of the following:
				(i) the scope of accounting or prudential consolidation of the *firm*; or
				(ii) the scope of supplementary supervision of the *firm* under *Directive 2002/87/EC UK law*;

			(c)	funding of a borrower that passes the funding on to the ultimate investor for the purchase, at issuance or thereafter, of a *firm's* capital instruments.
		(2)	The relevant condition is that the investor or, where applicable, the external entity is not included in any of the following:	
			(a)	the scope of accounting or prudential consolidation of the *firm*; or
			(b)	the scope of supplementary supervision of the *firm* under *Directive 2002/87/EC UK law*.
		[**Note**: article 9(1) and 9(2) of BTS 241/2014.]		
7.22	R	When establishing whether the purchase of a capital instrument involves direct or indirect funding for the purposes of MIFIDPRU 3 Annex 7.20R, the amount to be considered must be net of any individually assessed impairment allowance made.		
		[**Note**: article 9(3) of BTS 241/2014.]		
7.23	R	To prevent a loan or other form of funding or guarantee being classified as direct or indirect funding for the purposes of MIFIDPRU 3 Annex 7.20R, the *firm* must:		
		(1)	where the loan, funding or guarantee is granted to any natural or legal person referred to in MIFIDPRU 3 Annex 7.20R(3)(b)(i) or (ii), ensure on an ongoing basis that the loan, funding or guarantee has not been provided for the purpose of subscribing directly or indirectly for the *firm's* capital instruments; and	
		(2)	where the loan, funding or guarantee has been granted to other types of parties, use the *firm's* best efforts to avoid providing the loan, funding or guarantee for the purpose of subscribing directly or indirectly for the *firm's* capital instruments.	
		[**Note**: article 9(4) of BTS 241/2014.]		
7.24	R	(1)	This *rule* applies to a *firm* that is:	
			(a)	a *cooperative society*; or
			(b)	a *similar institution*.
		(2)	Where a *firm* in (1) has an obligation under the law of the *United Kingdom* (or any part of it) or the statutes of the *firm* for a customer to subscribe for capital instruments in the *firm* in order to receive a loan, that loan shall not be considered as direct or indirect funding for the purposes of MIFIDPRU 3 Annex 7.20R where the following conditions are met:	
			(a)	the value of the subscription amount is not material;
			(b)	the purpose of the loan is not the purchase of capital instruments in the *firm*; and

			(c)	subscription for one or more capital instruments of the *firm* is necessary for the customer to become a member of the *firm*.
		[Note: article 9(5) of BTS 241/2014.]		
Requirements relating to the reduction of own funds instruments				
7.25	R	For the purposes of MIFIDPRU 3.6.4R(1), terms will be sustainable for the income capacity of the *firm* where:		
		(1)	the profitability of the *firm* will continue to be sound and will not see any negative change in the foreseeable future after the replacement of the original *own funds instruments* with *own funds instruments* of equal or higher quality; and	
		(2)	the assessment of profitability in the foreseeable future in (1) takes into account the *firm's* profitability in stressed situations.	
		[**Note**: article 27 of BTS 241/2014.]		
7.26	R	Where the prior permission of the *FCA* is required for the redemption, repurchase or reduction of *own funds instruments* under article 77 of the *UK CRR*, a *firm* must not announce the redemption, repurchase or reduction to holders of the relevant *own funds instruments* until it has obtained that permission.		
		[**Note**: article 28(1) of BTS 241/2014.]		
7.27	R	(1)	A *firm* must deduct from the corresponding elements of its *own funds* any amounts of its *own funds instruments* to be reduced, redeemed or repurchased as soon as the following conditions are met:	
			(a)	where required, the *firm* has obtained permission from the *FCA* under article 78 of the *UK CRR*; and
			(b)	the reduction, redemption or repurchase is expected to take place with sufficient certainty.
		(2)	For the purposes of (1)(b), a situation in which sufficient certainty will exist includes, but is not limited to, where the *firm* has publicly announced its intention to redeem, reduce or repurchase an *own funds instrument*.	
		[**Note**: article 28(2) of BTS 241/2014.]		
7.28	R	(1)	This *rule* applies for the purposes of limitations on redemption applied by any of the following under article 29(2)(b) of the *UK CRR* or article 78(3) of the *UK CRR*:	
			(a)	a *cooperative society*; or
			(b)	a *similar institution*.
		(2)	A *firm* may issue *common equity tier 1 instruments* with a possibility to redeem only where permitted by the applicable law of the *United Kingdom* (or any part of it) or of a *third country*.	
		(3)	The ability of a *firm* to limit the redemption of a capital instrument under article 29(2)(b) or article 78(3) of the *UK CRR* includes:	

			(a)	the right to defer the redemption; and
			(b)	the right to limit the amount to be redeemed.
		(4)	There is no specific limit on the period of time for which a *firm* may defer the redemption of a capital instrument or may limit the amount to be redeemed under (3), but the *firm* must comply with the requirement in (5).	
		(5)	The extent of the limitations on redemption included in the provisions governing the instruments must be determined by the *firm* on the basis of its prudential situation at any time, having regard in particular to the following non-exhaustive factors:	
			(a)	the overall financial, liquidity and solvency situation of the *firm*;
			(b)	the amount of the *firm's common equity tier 1 capital*, *tier 1 capital* and total *own funds* compared to the *firm's own funds requirement*.
		(6)	A *firm* must:	
			(a)	document any decision to limit the redemption of a capital instrument under this *rule*; and
			(b)	notify the *FCA* of the decision by completing the form in MIFIDPRU 1 Annex 6R and submitting it via the *online notification and application system*, explaining the reasons for the limitation and how the factors in (5) apply.
		[**Note**: article 10 and article 11(3) and 11(4) of BTS 241/2014.]		
Gains on a sale				
7.29	R	(1)	This *rule* applies for the purpose of defining the concept of a gain on sale under article 32(1)(a) of the *UK CRR*.	
		(2)	A gain on sale is any recognised gain on sale for the *firm* that:	
			(a)	is recorded as an increase in any element of *own funds*; and
			(b)	is associated with future margin income arising from a sale of securitised assets when they are removed from the *firm's* balance sheet in the context of a securitised transaction.
		(3)	The recognised gain on sale must be determined as the difference between the following, as determined by applying the relevant accounting framework:	

			(a)	the net value of the assets received (including any new asset obtained) less any other asset given or any new liability assumed; and
			(b)	the carrying amount of the securitised assets or of the part derecognised.
		(4)	The recognised gain on sale which is associated with the future margin income is the expected future express spread, which is determined as the finance charge collections and other fee income received in respect of the securitised exposures net of costs and expenses.	
		[**Note**: article 12 of BTS 241/2014.]		
Deductions from own funds				
7.30	R	(1)	Subject to (3), for the purpose of calculating its *common equity tier 1* capital during the year, and irrespective of whether the *firm* closes its financial accounts at the end of each interim period, the *firm* must determine its profit and loss accounts and deduct any resulting losses from common equity tier 1 items under MIFIDPRU 3.3.6R(1) as they arise.	
		(2)	For the purpose of determining a *firm's* profit or loss accounts under (1), a *firm* must:	
			(a)	determine its income and expenses under the same process and on the basis of the same accounting standards as those used for the year-end financial report;
			(b)	prudently estimate income and expenses and assign them to the interim period in which they are incurred so that each interim period bears a reasonable amount of the anticipated annual income and expenses; and
			(c)	consider material or non-recurrent events in full and without delay in the interim period during which they arise.
		(3)	Where losses for the current financial year have already reduced the *firm's* common equity tier 1 items as a result of an interim or a year-end financial report, a deduction is not required.	
		(4)	For the purposes of this *rule*, a "financial report" means that the profit and losses have been determined after a closing of the interim or the annual accounts in accordance with the applicable accounting framework.	
		(5)	This *rule* applies in the same manner to gains and losses included in accumulated other comprehensive income.	
		[**Note**: article 13 of BTS 241/2014.]		

7.31	R	(1)	This *rule* applies for the purposes of determining the deduction of deferred tax assets that rely on future profitability under MIFIDPRU 3.3.6R(3).
		(2)	The offsetting between deferred tax assets and associated deferred tax liabilities must be done separately for each taxable entity.
		(3)	Associated deferred tax liabilities must be limited to those that arise from the tax law of the same jurisdiction as the deferred tax assets.
		(4)	For the calculation of deferred tax assets and liabilities at consolidated level, a taxable entity includes any number of entities which are members of the same tax group, fiscal consolidation, fiscal unity or consolidated tax return under any applicable law of the *United Kingdom* or of a *third country*.
		(5)	The amount of associated deferred tax liabilities which are eligible for offsetting deferred tax assets that rely on future profitability is equal to the difference between the following:
			(a) the amount of deferred tax liabilities as recognised under the applicable accounting framework;
			(b) the amount of associated deferred tax liabilities arising from intangible assets and from defined benefit pension fund assets.
		[**Note**: article 14 of BTS 241/2014.]	
7.32	R	(1)	This *rule* defines an *intermediate entity* for the purposes of MIFIDPRU 3 Annex 7.33R to MIFIDPRU 3 Annex 7.40R.
		(2)	An *intermediate entity* is any of the following entities, where that entity holds capital instruments of a *financial sector entity*:
			(a) a collective investment undertaking;
			(b) a pension fund other than a defined benefit pension fund;
			(c) a defined benefit pension fund, where the *firm* is supporting the investment risk and where the defined benefit pension fund is not independent from its sponsoring institution in accordance with (4);
			(d) an entity that is directly or indirectly under the control or under significant influence of one of the following:
			(i) the *firm* or its *subsidiaries*;
			(ii) the *parent undertaking* of the *firm* or the

subsidiaries of that *parent undertaking*;

(iii) the parent *financial holding company* of the *firm* or the *subsidiaries* of that parent *financial holding company*;

(iv) the parent *investment holding company* of the *firm* of the *subsidiaries* of that parent *investment holding company*;

(v) the parent *mixed-activity holding company* of the *firm* or the *subsidiaries* of the parent *mixed activity holding company*; or

(vi) the parent *mixed financial holding company* of the *firm* or the *subsidiaries* of the parent *mixed financial holding company*;

(e) a special purpose entity;

(f) an entity whose activity is to hold *financial instruments* of *financial sector entities*; and

(g) an entity that is used for the purpose of circumventing the rules relating to the deduction of indirect and synthetic holdings.

(3) Except where (2)(g) applies, the following are not *intermediate entities*:

(a) *mixed-activity holding companies*;

(b) *institutions*;

(c) *MIFIDPRU investment firms*;

(d) *insurance undertakings*;

(e) *reinsurance undertakings*;

(f) *financial sector entities* (other than those in (a) to (e)) that are supervised and required to deduct the following from their regulatory capital:

(i) direct and indirect holdings of their own capital instruments; and

(ii) holdings of capital instruments of *financial sector entities*.

(4) For the purposes of (2)(c), a defined benefit pension fund will be deemed to be independent from its sponsoring institution where the following conditions are met:

(a) the defined benefit pension fund is legally separate from the sponsoring institution and its governance is independent;

(b) either:

(i) the statutes, the instruments of incorporation and the internal rules of the specific pension fund, as applicable, have been approved by an independent regulator; or

(ii) the rules governing the incorporation and functioning of the defined benefit pension fund, as applicable, are established in the applicable law of the relevant country;

(c) the trustees or administrators of the defined pension fund have an obligation under applicable national law to:

(i) act impartially in the best interests of the scheme beneficiaries instead of those of the sponsor;

(ii) manage assets of the defined pension fund prudently; and

(iii) conform to the restrictions set out in the statutes, the instruments of incorporation and the internal rules of the specific pension fund, as applicable, or statutory or regulatory framework described in point (b); and

(d) the statutes or the instruments of incorporation or the rules governing the incorporation and functioning of the defined benefit pension fund referred to in point (b) include restrictions on investments that the defined pension scheme can make in own funds instruments issued by the sponsoring institution.

(5) Where a defined benefit pension fund referred to in (2)(c) holds own funds instruments of the sponsoring institution, the sponsoring institution must:

(a) treat that holding as an indirect holding of its own *common equity tier 1 instruments*, own *additional tier 1 instruments* or own *tier 2 instruments*, as applicable; and

(b) determine the amount to be deducted from its common equity tier 1 items, additional tier 1 items or tier 2 items (as applicable) in accordance with MIFIDPRU 3 Annex 7.34R and MIFIDPRU 3 Annex 7.39R.

[**Note**: article 15a of BTS 241/2014.]

7.33	R	(1)	The following financial products are synthetic holdings of capital instruments for the purposes of MIFIDPRU 3.3.6R(5), (7) and (8): (a) derivative instruments that have capital instruments of a *financial sector entity* as their underlying or have the *financial sector entity* as their reference entity; (b) guarantees or credit protection provided to a third party in respect of the third party's investments in a capital instrument of a *financial sector entity*.
		(2)	The financial products in (1) include the following: (a) investments in total return swaps on a capital instrument of a *financial sector entity*; (b) call options purchased by the firm on a capital instrument of a *financial sector entity*; (c) put options sold by the *firm* on a capital instrument of a *financial sector entity* or any other actual or contingent contractual obligation of the *firm* to purchase its *own funds instruments*; and (d) investments in forward purchase agreements on a capital instrument of a *financial sector entity*.
		[**Note**: article 15b of BTS 241/2014.]	
7.34	R	(1)	The amount of indirect holdings that a *firm* must deduct from its common equity tier 1 items under MIFIDPRU 3.3.6R(5), (7) or (8) must be calculated in one of the following ways: (a) according to the default approach set out in MIFIDPRU 3 Annex 7.35R; or (b) subject to (3), with the prior permission of the *FCA*, the structure-based approach in MIFIDPRU 3 Annex 7.36R.
		(2)	To obtain the permission in (1)(b), a *firm* must: (a) complete the application form in MIFIDPRU 1 Annex 5R and submit to the *FCA* using the *online notification and application system*; and (b) demonstrate to the satisfaction of the *FCA* that it would be impractical or excessively complex to apply the default ap-

3

proach in MIFIDPRU 3 Annex 7.35R.

(3) A *firm* must not use the structure-based approach to calculate deductions in relation to investments in the *intermediate entities* in MIFIDPRU 3 Annex 7.32R(2)(d) and (e).

[**Note**: article 15c of BTS 241/2014.]

7.35 R (1) This *rule* contains the default approach for the deduction of indirect holdings under MIFIDPRU 3 Annex 7.34R(1)(a).

(2) A *firm* must calculate the amount of indirect holdings of *common equity tier 1 instruments* to be deducted as follows:

(a) where the exposures of all investors to the *intermediate entity* rank pari passu, the amount shall be equal to the percentage of funding multiplied by the amount of *common equity tier 1 instruments* of the *financial sector entity* held by the *intermediate entity*;

(b) where the exposures of all investors to the *intermediate entity* do not rank pari passu, the amount shall be equal to the percentage of funding multiplied by the lower of the following amounts:

(i) the amount of *common equity tier 1 instruments* of the *financial sector entity* held by the *intermediate entity*;

(ii) the *firm's* exposure to the *intermediate entity* together with all other funding provided to the *intermediate entity* that rank pari passu with the *firm's* exposure.

(3) A *firm* must use the calculation method in (2)(b) for each tranche of funding that ranks pari passu with the funding provided by the *firm*.

(4) The percentage of funding in (2) is calculated as the firm's exposure to the *intermediate entity* divided by the sum of the *firm's* exposure to the *intermediate entity* and all other exposures to the

intermediate entity that rank pari passu with the *firm's* exposure.

(5) A *firm* must carry out the calculation in (2) separately for each holding in a *financial sector entity* held by each *intermediate entity*.

(6) Where a *firm* holds investments in *common equity tier 1 instruments* of a *financial sector entity* indirectly through several *intermediate entities*, the *firm* must determine the percentage of funding in (2) by dividing the amount in (a) below by the amount in (b):

(a) the result of the multiplication of amounts of funding provided by the *firm* to *intermediate entities* by the amounts of funding provided by these *intermediate entities* to subsequent *intermediate entities* and by amounts of funding provided by these subsequent *intermediate entities* to the *financial sector entity*;

(b) the result of the multiplication of amounts of capital instruments or other instruments as relevant, issued by each *intermediate entity*.

(7) The percentage of funding referred to in (6) must be calculated separately for each holding in a *financial sector entity* held by *intermediate entities* and for each tranche of funding that ranks pari passu with the funding provided by the *firm* and the subsequent *intermediate entities*.

[**Note**: article 15d of BTS 241/2014.]

7.36 R (1) This *rule* contains the structure-based approach for the deduction of indirect holdings under MIFIDPRU 3 Annex 7.34R(1)(b).

(2) The amount to be deducted from *common equity tier 1* items referred to in MIFIDPRU 3.3.6R(5) shall be equal to the percentage of funding, as defined in MIFIDPRU 3 Annex 7.35R(4), multiplied by the amount of *common equity tier 1 instruments* of the *firm* held by the *intermediate entity*.

(3) The amount to be deducted from common equity tier 1 items referred to in MIFIDPRU 3.3.6R(7) and (8) shall be equal to the percentage of funding, as defined in MIFIDPRU 3 Annex 7.35R(4), multiplied by the aggregate amount of *common equity tier 1 instruments* of *financial sector entities* held by the *intermediate entity*.

(4) (For the purposes of (2) and (3), a *firm* must calculate separately for each *intermediate entity* the aggregate amount of *common equity tier 1 instruments* of the *firm* that the *intermediate entity* holds and the aggregate amount of *common equity tier 1 instruments* of other *financial sector entities* that the *intermediate entity* holds.

		(5)	The *firm* must treat the amount of holdings in *common equity tier 1 instruments* of *financial sector entities* calculated in accordance with (3) as a significant investment referred to in article 43 of the *UK CRR* and must deduct the amount in accordance with MIFIDPRU 3.3.6R(8).
		(6)	Where investments in *common equity tier 1 instruments* are held indirectly through subsequent or several *intermediate entities*, MIFIDPRU 3 Annex 7.35R(6) and (7) apply.
		(7)	Where a *firm* is not able to identify the aggregate amounts that the *intermediate entity* holds in *common equity tier 1 instruments* of the *firm* or in *common equity tier 1 instruments* of *financial sector entities*, the *firm* must estimate the amounts it cannot identify by using the maximum amounts that the *intermediate entity* is able to hold on the basis of its investment mandates.
		(8)	Subject to (9), where the *firm* is not able to determine, on the basis of the investment mandate, the maximum amount that the *intermediate entity* holds in *common equity tier 1 instruments* of the institution or in *common equity tier 1 instruments* of *financial sector entities*, the *firm* must treat the amount of funding that it holds in the *intermediate entity* as an investment in its own *common equity tier 1 instruments* and must deduct them in accordance with MIFIDPRU 3.3.6R(5).
		(9)	By way of derogation from (8), the *firm* must treat the amount of funding that it holds in the *intermediate entity* as a non-significant investment and must deduct that investment in accordance with MIFIDPRU 3.3.6R(7), where all of the following conditions are met: (a) the amounts of funding are less than 0.25% of the *firm's common equity tier 1 capital*; (b) the amounts of funding are less than £10 million; (c) the *firm* cannot reasonably determine the amounts of its own *common equity tier 1 instruments* that the *intermediate entity* holds.
		(10)	Where funding to the *intermediate entity* is in the form of units or shares of a CIU, the *firm* may rely on the third parties referred to in article 132(5) of the *UK CRR*, and under the conditions set by that article, to calculate and report the aggregate amounts referred to in (7).
		[**Note**: article 15e of BTS 241/2014.]	
7.37	R	(1)	The amount of synthetic holdings to be deducted from common equity tier 1 items under MIFIDPRU 3.3.6R(5), (7) and (8) is determined as follows:

				(a)	for holdings in the *trading book*:	
					(i)	for options, the delta equivalent amount of the relevant instruments calculated in accordance with Title IV of Part III of the *UK CRR*; and
					(ii)	for any other synthetic holdings, the nominal or notional amount, as applicable; and
				(b)	for holdings that are not in the *trading book*:	
					(i)	for call options, the current market value; and
					(ii)	for any other synthetic holdings, the nominal or notional amount, as applicable.
			(2)	A *firm* must deduct the synthetic holdings in (1) from the date of signature of the contract between the *firm* and the counterparty.		
			[**Note**: article 15g of BTS 241/2014.]			
7.38		R	(1)	For the purposes of MIFIDPRU 3.3.6R(8), in order to assess whether a *firm* owns more than 10% of the *common equity tier 1 instruments* issued by a *financial sector entity* in accordance with article 43(a) of the *UK CRR*, a *firm* must add together:		
				(a)	its gross long positions in direct holdings in the *financial sector entity*; and	
				(b)	its indirect holdings in the *financial sector entity*, as calculated in accordance with MIFIDPRU 3 Annex 7.32R(2)(d) to (g).	
			(2)	A *firm* must take into account any indirect or synthetic holdings when assessing whether the conditions in article 43(b) or (c) of the *UK CRR* are met.		
7.39		R	(1)	The methodology in MIFIDPRU 3 Annex 7.32R to MIFIDPRU 3 Annex 7.38R also applies with the modifications in (2) for the purposes of the requirements relating to:		

			(a)	the deductions of holdings in *additional tier 1 instruments* in article 56(a), (c) and (d) of the *UK CRR*; and
			(b)	the deductions of holdings in *tier 2 instruments* in article 66(a), (c) and (d) of the *UK CRR*.
		(2)	When applying MIFIDPRU 3 Annex 7.32R to MIFIDPRU 3 Annex 7.38R:	
			(a)	for the purpose in (1)(a), references to "common equity tier 1" are references to "additional tier 1"; and
			(b)	for the purpose in (1)(b), references to "common equity tier 1" are references to "tier 2".
		[**Note**: article 15h of BTS 241/2014.]		
7.40	R	(1)	Subject to (2) and (3), where an *intermediate entity* holds *common equity tier 1 instruments*, *additional tier 1 instruments* or *tier 2 instruments* of *financial sector entities*:	
			(a)	the *common equity tier 1 instruments* must be deducted first;
			(b)	the *additional tier 1 instruments* must be deducted second; and
			(c)	the *tier 2 instruments* must be deducted last.
		(2)	Where the intermediate entity holds *own funds instruments* of the *firm*, when applying (1), the *firm* must deduct the holdings of the *firm's own funds instruments* first.	
		(3)	Where a *firm* holds capital instruments of *financial sector entities* indirectly, the amount to deducted from the *firm's own funds* is limited to the lower of the following amounts:	
			(a)	the total funding provided by the *firm* to the *intermediate entity*; or
			(b)	the amount of *own funds instruments* held by the *intermediate entity* in the *financial sector entity*.
		[**Note**: article 15i of BTS 241/2014.]		
7.41	R	(1)	This *rule* applies for the purposes of the deduction of foreseeable tax charges under MIFIDPRU 3.3.6R(10) and article 56(f) of the *UK CRR*.	
		(2)	A *firm* may proceed on the basis that foreseeable tax charges have already been taken into account, and therefore no further deduction is required, where:	
			(a)	the *firm* applies an accounting framework and accounting policies that provide for the full recognition of current and de

ferred tax liabilities related to transactions and other events recognised in the balance sheet or the profit and loss account; and

(b) all other necessary deductions have been made under applicable accounting standards or other adjustments.

(3) Where the *firm* is calculating its *common equity tier 1 capital* on the basis of financial statements made in accordance with *UK-adopted international accounting standards*, the conditions in (2) are deemed to be met.

(4) Where the *firm* does not meet, and has not been deemed to meet, the conditions in (2), it must decrease its common equity tier 1 items by the estimated amount of current and deferred tax charges not yet recognised in:

(a) the balance sheet profit and loss account related to transactions; and

(b) other events in the balance sheet profit and loss account.

(5) The estimated amount of current and deferred tax charges in (4) must be determined using an approach equivalent to the one provided by *UK-adopted international accounting standards*.

(6) The estimated amount of deferred tax charges in (4) may not be netted against deferred tax assets that are not recognised in the financial statements.

[**Note**: article 16 of BTS 241/2014.]

Deduction of holdings of capital instruments issued by financial institutions

7.42 R Subject to MIFIDPRU 3 Annex 7.43R, for the purposes of article 36(3) of the *UK CRR*, a *firm* must deduct its holdings of capital instruments of *financial institutions* as follows:

(1) the *firm* must deduct from its common equity tier 1 items any instruments of the *financial institution* that meet the following conditions:

(a) the instruments qualify as capital under the company law applicable to the *financial institution*; and

(b) where the *financial institution* is subject to solvency requirements, the instruments are included in the highest quality tier of regulatory own funds without any limits; or

(c) where the *financial institution* is not subject to solvency requirements, the instruments:

(i) are perpetual;

3

(ii) absorb the first and proportionately greatest share of losses as they occur;

(iii) rank below all other claims in the event of insolvency and liquidation; and

(iv) have no preferential or predetermined distributions;

(2) the *firm* must deduct its holdings of subordinated capital instruments of the *financial institution* on the following basis:

(a) where the subordinated instruments absorb losses on a going-concern basis (including where the issuer has the discretion to cancel coupon payments), the *firm* must:

(i) deduct them from the *firm's* additional tier 1 items; and

(ii) if the value of the subordinated instruments exceeds the value of the firm's additional tier 1 capital, deduct the excess amount from the *firm's* common equity tier 1 items;

(b) the *firm* must deduct all other subordinated instruments not included in (a) on the following basis:

(i) the *firm* must first deduct them from the *firm's* tier 2 items; and

(ii) if the value of the subordinated instruments exceeds the value of the *firm's* tier 2

					capital, the firm must deduct the excess amount from the *firm's* additional tier 1 items; and
				(iii)	if the additional tier 1 items are not sufficient, the firm must deduct the remaining excess amount from the *firm's* common equity tier 1 items;
		(3)	the *firm* must deduct its holdings of any other instruments of the *financial institution* from the firm's common equity tier 1 items where:		
			(a)		the instruments are included in the *financial institution's* own funds under the prudential framework applicable to the *financial institution*; and
			(b)		the instruments do not meet the conditions to be deducted under (a) or (b).
		[**Note**: article 36(3) of the UK CRR and article 17(1) of BTS 241/2014.]			
7.43	R	(1)	In the cases set out in (2):		
			(a)		the deductions in MIFIDPRU 3 Annex 7.42R do not apply; and
			(b)		a *firm* must instead apply the deductions in MIFIDPRU 3 and the *UK CRR* (as applied by MIFIDPRU 3) for holdings of capital instruments based on the approach that would apply to the same component of capital for which those instruments would qualify if they were issued by the *firm* itself.
		(2)	The relevant cases are where the *financial institution* is:		
			(a)		a *UK AIFM*;
			(b)		a *management company*;
			(c)		an *authorised payment institution*;
			(d)		an *authorised electronic money institution*; or
			(e)		an entity that is authorised and supervised by an *overseas regulator*, provided that the *firm* applying the deduction is able to

					apply the approach in (1)(b) in relation to that entity.	
			[**Note**: article 17(2) and 17(3) of BTS 241/2014.]			
7.44	R	(1)	This *rule* applies to a *firm's* holdings of capital instruments in a *third country insurance undertaking* or a *third country reinsurance undertaking* where either of the following conditions are met:			
				(a)	the *third country insurance undertaking* or *third country reinsurance undertaking* is subject to a solvency regime that:	
					(i)	before *IP completion day*, had been assessed as non-equivalent to that laid down in Title I, Chapter VI of the *Solvency II Directive* according to the procedure set out in article 227 of that directive; and
					(ii)	has not subsequently been subject to a determination of equivalence by HM Treasury under article 379A of the Solvency II Delegated Regulation (EU) 2015/35 or by the PRA under regulation 19 of the *Solvency 2 Regulations 2015*; or
				(b)	the *third country insurance undertaking* or *third country reinsurance undertaking* is subject to a solvency regime that has not been assessed for equivalence:	
					(i)	before *IP completion day*, in accordance with the procedure in (a)(i); and

(ii) on or after *IP completion day*, in accordance with either of the procedures in (a)(ii).

(2) Where this *rule* applies, a *firm* must deduct holdings in the capital instruments of the *third country insurance undertaking* or *third country reinsurance undertaking* in (1) as follows:

(a) all instruments qualifying as capital under the company law applicable to the *third country insurance undertaking* or *third country reinsurance undertaking* that issued them, and which are included in the highest quality tier of regulatory own funds without any limits under the *third country* regime, must be deducted from the *firm's* common equity tier 1 items;

(b) for subordinated instruments absorbing losses on a going-concern basis (including where the issuer has discretion to cancel coupon payments):

(i) the amount must first be deducted from the *firm's additional tier 1* items; and

(ii) where the amount of the subordinated instruments exceeds the amount of the *firm's additional tier 1 capital*, the excess amount must be deducted from the *firm's* common equity tier 1 items;

(c) for any subordinated instruments other than those in (b):

(i) the amount must first be deducted from the *firm's* tier 2 items;

(ii) where the amount of those subor-

			dinated instruments exceeds the amount of the *firm's tier 2 capital*, the excess amount must be deducted from the *firm's* additional tier 1 items; and
		(iii)	where the excess amount exceeds the amount of the *firm's additional tier 1 capital*, the remaining excess amount must be deducted from the *firm's* common equity tier 1 items;
	(d)	any holdings of other instruments of the *third country insurance undertaking* or *third country reinsurance undertaking* must be deducted from the *firm's* common equity tier 1 items where:	
		(i)	the *third country insurance undertaking* or *third country reinsurance undertaking* is subject to prudential solvency requirements;
		(ii)	the instruments are included in the *third country insurance undertaking* or *third country reinsurance undertaking's* own funds under the applicable solvency regime; and
		(iii)	the instruments do not meet the conditions to be

deducted under (a) to (c).

[**Note**: article 18(1) of BTS 241/2014.]

7.45 R (1) This *rule* applies to a *firm's* holdings of capital instruments in a *third country insurance undertaking* or a *third country reinsurance undertaking* where the *third country* solvency regime, including requirements on own funds, applicable to the *third country insurance undertaking* or *third country reinsurance undertaking* meets either of the following conditions:

(a) before *IP completion day*, it has been assessed as equivalent to the requirements laid down in Title I, Chapter VI of the *Solvency II Directive*, according to the procedure set out in article 227 of that directive, and that assessment has not been revoked by HM Treasury on or after *IP completion day*; or

(b) on or after *IP completion day*, it has been assessed as equivalent to the requirements laid down in the law of the *United Kingdom* that implemented Title I, Chapter VI of the *Solvency II Directive*, according to the procedure set out in article 379A of the Solvency II Delegated Regulation (EU) 2015/35, or has been assessed as equivalent by the *PRA* according to the procedure in regulation 19 of the *Solvency 2 Regulations 2015*.

(2) Where this *rule* applies, a *firm* must:

(a) treat the relevant holdings of capital instruments as holdings of the capital instruments of insurance undertakings or reinsurance undertakings (as each is defined in section 417(1) of the Act); and

(b) apply the deductions in article 44(b), article 58(b) and article 68(b) of the UK CRR, as applicable, to the holdings in (a).

[**Note**: article 18(2) and (3) of BTS 241/2014.]

7.46 R A *firm* must deduct holdings of capital instruments of undertakings falling within article 4(1)(27)(k) of the *UK CRR* as follows:

(1) a *firm* must deduct instruments meeting the following conditions from the *firm's common equity tier 1 capital*:

(a) the instruments qualify as capital under the company law applicable to the *undertaking* that issued them; and

(b) the instruments are included in the highest quality tier of regulatory own funds of the *undertaking* that issued them without any limits;

(2) a *firm* must deduct any subordinated instruments that absorb losses on a going-concern basis (including where the issuer has discretion to cancel coupon payments) on the following basis:

(a) first, the instruments must be deducted from the *firm's* additional tier 1 items; and

(b) if the amount of the subordinated instruments exceeds the amount of the *firm's additional tier 1 capital*, the excess amount must be deducted from the *firm's* common equity tier 1 items;

(3) a *firm* must deduct any subordinated instruments other than those in (2) on the following basis:

(a) first, the instruments must be deducted from the *firm's* tier 2 items;

(b) if the amount of the subordinated instruments exceeds the amount of the *firm's tier 2 capital*, the excess amount must be deducted from the *firm's* additional tier 1 items; and

(c) if the excess amount exceeds the *firm's additional tier 1 capital*, the remaining excess amount must be deducted from the firm's common equity tier 1 items; and

(4) a *firm* must deduct any other holdings of instruments issued by the *undertaking* from the *firm's common equity tier 1 capital* where the instruments:

(a) are included in the *undertaking's* own funds under the solvency regime applicable to that *undertaking*; and

(b) do not fall within (1) to (3) above.

[**Note**: article 19 of BTS 241/2014.]

Conversion and write-down of additional tier 1 instruments

7.47 R (1) This *rule* applies for the purposes of:

(a) any write-down of the principal amount of an *additional tier 1 instrument* under article 52(1)(n) of the *UK CRR*; and

(b) any subsequent write-up of the principal amount of an *additional tier 1 instrument* for the purposes of article 52(2)(c) of the *UK CRR*.

(2) The write-down of the principal amount of an *additional tier 1 instrument* of a *firm* must apply on a pro rata basis to all holders of *additional tier 1 instruments* that include a similar write-down mechanism and an identical trigger level.

(3) For a write-down to be considered temporary, all of the following conditions must be met:

(a) any distributions payable after a write-down must be based on the reduced amount of the principal;

(b) any write-up must be based on profits after the *firm* has taken a formal decision confirming the final profits;

(c) any write-up of the instrument or payment of coupons on the reduced amount of the principal must be operated at the full discretion of the *firm*, subject to the constraints arising from (d) to (f) below, and there must be no obligation for the *firm* to operate or accelerate a write-up under specific circumstances;

(d) a write-up must be operated on a pro rata basis among similar *additional tier 1 instruments* of the *firm* that have been subject to a write-down;

(e) the maximum amount to be attributed to the sum of the write-up of the *additional tier 1 instruments*, together with the payment of coupons on the reduced amount of the principal of *additional tier 1 instruments*, must be calculated according to the following formula, which must be applied at the time that the write-up operates: M= P × A/T where: *M* =the maximum amount to be attributed to the write-up, together with the payment of coupons on the reduced amount of principal; *P* =the profit of the *firm*; *A* = the sum of the nominal value (before write-down) of all *additional tier instruments* of the *firm* that have been subject to a write-down; and *T* =the tier 1 capital of the firm;

			(f)	the sum of any write-up amounts and payments of coupons on the reduced amount of the principal of the *additional tier 1 instruments* must be treated as a payment that reduces the *common equity tier 1 capital* of the *firm*.
		[**Note**: article 21 of BTS 241/2014.]		
7.48	R	(1)	This *rule* applies for the purposes of specifying the procedures and timing for determining that a trigger event has occurred in relation to an *additional tier 1 instrument* under article 52(1)(n) of the *UK CRR*.	
		(2)	Where a *firm* establishes that its *common equity tier 1 capital* has fallen below the level of the trigger event of an *additional tier 1 instrument*:	
			(a)	the *management body* or any other *relevant body* of the *firm* must, without delay, determine that a trigger event has occurred; and
			(b)	the *firm* is under an irrevocable obligation to write-down or convert the *additional tier 1 instrument*.
		(3)	The amount to be written down or converted must be determined as soon as possible and in any case, within a maximum period of one *month* from the time that the *firm* has determined that a trigger event had occurred under (2).	
		(4)	If the terms of the *additional tier 1 instrument* require an independent review of the amount to be written down or converted, the *management body* or other *relevant body* of a *firm* must ensure that the review:	
			(a)	is commenced immediately;
			(b)	is completed as soon as possible; and
			(c)	does not create impediments to the firm writing-down or converting the *additional tier 1 instrument* or to meeting the requirement in (3).
		[**Note:** article 22(1), (2) and (4) of BTS 241/2014.]		
7.49	G	In appropriate cases, the *FCA* may exercise its powers under:		
		(1)	section 55L of the *Act* to impose a *requirement* on a *firm* to determine the required write-down or conversion amount more quickly than the one-*month* period in MIFIDPRU 3 Annex 7.48R(3); or	
		(2)	section 166 of the *Act* to require the *firm* to commission an independent review of the amount to be written down or converted for the purposes of MIFIDPRU 3 Annex 7.48R.	
		[**Note:** article 22(3) and (4) of BTS 241/2014.]		

7.50	R	For the purposes of article 52(1)(o) of the *UK CRR*, features that could hinder the recapitalisation of a *firm* include provisions that require the *firm* to compensate existing holders of capital instruments where a new capital instrument is issued.			
		[**Note:** article 23 of BTS 241/2014.]			
	Incentives to redeem				
7.51	R	(1)	For the purposes of article 52(1)(g) and article 63(h) of the *UK CRR*, an incentive to redeem means any feature that provides, at the date of issuance of a capital instrument, an expectation that the capital instrument is likely to be redeemed.		
		(2)	An incentive to redeem under (1) includes:		
				(a)	a call option combined with an increase in the credit spread of the instrument if the call is not exercised;
				(b)	a call option combined with a requirement or an investor option to convert the instrument into a *common equity tier 1 instrument* where the call is not exercised;
				(c)	a call option combined with a change in reference rate where the credit spread over the second reference rate is greater than the initial payment rate minus the swap rate;
				(d)	a call option combined with an increase of the redemption amount in the future;
				(e)	a remarketing option combined with an increase in the credit spread of the instrument or a change in reference rate where the credit spread over the second reference rate is greater than the initial payment rate minus the swap rate where the instrument is not remarketed; and
				(f)	a marketing of the instrument in a way which suggests to investors that the instrument will be called.
		[**Note:** article 20 of BTS 241/2014.]			
	Use of special purpose vehicles for indirect issuance of own funds				
7.52	R	(1)	This *rule* applies for the purposes of article 52(1)(p) and article 63(n) of the *UK CRR*.		
		(2)	Where the *firm* issues a capital instrument that is subscribed for by a special purpose entity, the capital instrument must not be recognised by the *firm* as capital of a higher quality than the lowest quality of:		
				(a)	the capital issued to the special purpose entity; and

			(b)	the capital issued to third parties by the special purpose entity.
		(3)	Where another entity ("A") within the same *consolidated situation* as the *firm* issues a capital instrument that is subscribed for by a special purpose entity, the capital instrument must not be recognised by A as capital of a higher quality than the lowest quality of:	
			(a)	the capital issued to the special purpose entity; and
			(b)	the capital issued to third parties by the special purpose entity.
		(4)	The requirement in (2) also applies on an equivalent basis to a *UK parent entity* for the purposes of determining its consolidated *own funds*, with the reference to the "*firm*" being read as a reference to the *UK parent entity*.	
		(5)	The rights of the holders of instruments issued by a special purpose entity in (2), (3) or (4) must be no more favourable than if the instrument was issued directly by the *firm*, A or the *UK parent entity*, as applicable.	
		[**Note:** article 24 of BTS 241/2014.]		
	Distributions on own funds instruments			
7.53	R	(1)	This *rule* contains the definition of a broad market index for the purpose of article 73(5) of the *UK CRR*.	
		(2)	An interest rate index is a broad market index if it fulfils all of the following conditions:	
			(a)	it is used to set interbank lending rates in one or more currencies;
			(b)	it is used as a reference rate for floating rate debt issued by the *firm* in the same currency, where applicable;
			(c)	it is calculated as an average rate by a body independent of the *institutions* or *MIFIDPRU investment firms* that are contributing to the index (a "panel");
			(d)	each of the rates set under the index is based on quotes submitted by a panel of *institutions* or *MIFIDPRU investment firms* active in that interbank market; and
			(e)	the composition of the panel referred to in point (c) ensures a sufficient level of representativeness of *institutions* or *MIFIDPRU investment firms* present in the *United Kingdom*.

(3) For the purposes of (2)(e), a sufficient level of representativeness will be deemed to exist in either of the following cases:

(a) where the panel in (2)(c) includes at least six different contributors before any discount of quotes is applied for the purposes of setting the rate; or

(b) where both of the following conditions are met:

(i) the panel in (2)(c) includes at least four different contributors before any discount of quotes is applied for the purposes of setting the rate; and

(ii) the contributors to the panel in (2)(c) represent at least 60% of the related market.

(4) The related market referred to in (3)(b)(ii) is calculated by dividing the amount in (a) by the amount in (b):

(a) the sum of the assets and liabilities of the effective contributors to the panel in the domestic currency;

(b) the sum of assets and liabilities in the domestic currency of *credit institutions* in the United Kingdom, including branches established in the *United Kingdom*, and money market funds in the *United Kingdom*.

(5) A stock index is deemed to be a broad market index where it is appropriately diversified in accordance with article 344 of the *UK CRR*.

[**Note:** article 24a of BTS 241/2014.]

Indirect holdings arising from index holdings

7.54 R (1) This rule applies for the purpose of determining whether an estimate is sufficiently conservative for the purposes of article 76(2) of the *UK CRR*.

(2) An estimate is sufficiently conservative where either of the following conditions are met:

(a) the investment mandate of the index specifies that a capital instrument of a *financial sector entity* that is part of the index

cannot exceed a maximum percentage of that index and the *firm* uses that percentage as an estimate of the value of the holdings that must be deducted from:

(i) its *common equity tier 1 capital*, *additional tier 1 capital* or *tier 2 capital* (as applicable) in accordance with MIFIDPRU 3 Annex 7.43R(1)(b); or

(ii) its *common equity tier 1 capital* where the *firm* cannot determine the precise nature of the holding; or

(b) if the *firm* is unable to determine the maximum percentage referred to in (a) and the index includes capital instruments of *financial sector entities* (as evidenced by its investment mandate or other relevant information), the *firm* deducts the full amount of the index holdings from:

(i) its *common equity tier 1 capital*, *additional tier 1 capital* or *tier 2 capital* (as applicable) in accordance with MIFIDPRU 3 Annex 7.43R(1)(b); or

(ii) its *common equity tier 1 capital* where the *firm* cannot determine the precise nature of the holding.

(3) For the purposes of (2):

(a) an indirect holding arising from an index holding consists of the proportion of the index invested in the *common equity tier 1 instruments*, *additional*

				tier 1 instruments and *tier 2 instruments* of *financial sector entities* included in the index; and
			(b)	an index includes, but is not limited to, index funds, equity or bond indices or any other scheme where the underlying instrument is a capital instrument issued by a *financial sector entity*.
		[**Note:** article 25 of BTS 241/2014.]		
7.55	G	(1)	Under article 76(3) of the *UK CRR*, a *firm* may apply for permission to use the conservative estimate approach in article 76(2) of the *UK CRR* (as supplemented by MIFIDPRU 3 Annex 7.54R) where the *firm* has demonstrated that it would be operationally burdensome to monitor its underlying exposure to the items referred to in articles 76(2)(a) and (b) of the *UK CRR*.	
		(2)	For these purposes, "operationally burdensome" means situations in which the look-through approach to capital holdings in *financial sector entities* on an ongoing basis would be unjustified. When considering whether a situation is operationally burdensome, the *FCA* will take into account whether the *firm's* index holding:	
			(a)	is immaterial when compared with the *firm's own funds*; and
			(b)	has a short holding period or is highly liquid in nature.
		[**Note:** article 26 of BTS 241/2014.]		
		Temporary waiver of deduction from own funds		
7.56	G	(1)	In accordance with article 79 of the *UK CRR* (as applied by MIFIDPRU 3.6.1R), the *FCA* may waive the requirement for a *firm* to deduct holdings of capital instruments or subordinated loans that the *firm* has granted that qualify as *common equity tier 1 instruments*, *additional tier 1 instruments* or *tier 1 instruments* of a *financial sector entity* where:	
			(a)	the *firm* will hold the capital instruments or subordinated loans only temporarily; and
			(b)	the *FCA* considers that the holdings are for the purposes of a financial assistance operational designed to reorganise and save the *financial sector entity*.
		(2)	A *firm* that wishes to apply for a waiver for the purposes of article 79 of the *UK CRR* should apply for a waiver of MIFIDPRU 3.6.1R (insofar as it applies that article) under section 138A of the Act.	
		(3)	When considering an application for a waiver under (2), the *FCA* considers that the conditions for a waiver will be unlikely to be met where:	

			(a)	the duration of the waiver exceeds the timeframe envisaged under the financial assistance operation plan or exceeds five years;
			(b)	the waiver is not limited to new holdings of instruments in the *financial sector entity*;
			(c)	the financial assistance operation has not been discussed with and, where necessary, approved by the *FCA*; or
			(d)	the financial assistance operation does not clearly state phases, timing and objectives and does not specify the interaction between the *firm's* temporary holdings and the broader financial assistance operation.
		[**Note:** article 79 of the UK CRR and article 33 of BTS 241/2014.]		
	Own funds instruments issued by special purpose entities			
7.57	G	(1)	Under article 83(1) of the *UK CRR* (as applied by MIFIDPRU 2.5.10R(1)), a *UK parent entity* may include *additional tier 1 instruments*, *tier 2 instruments* issued by a special purpose entity, and their related share premium accounts, in qualifying *own funds* under Title II of Part Two only where the conditions in article 83(1) are met.	
		(2)	Under article 83(1)(d) of the *UK CRR*, one of the conditions is that the only asset of the special purpose entity is its investment in the *own funds* of the *parent undertaking* or a *subsidiary* of that *parent undertaking* that is included within the same prudential consolidation group.	
		(3)	Article 83 of the *UK CRR* permits the *FCA* to waive the condition in article 83(1)(d) where the assets of the relevant special purpose entity (other than its investment in the *own funds* of the *parent undertaking* or *subsidiary*) are minimal and insignificant for that entity.	
		(4)	The *FCA* expects that a firm that wishes to obtain the waiver in (3) will make an application under section 138A of the *Act* to waive the application of MIFIDPRU 2.5.10R(1), insofar as it applies the condition in article 83(1)(d) of the *UK CRR*. When considering any such application, the *FCA* will normally consider, among other factors, whether the assets of the special purpose entity (other than the investments in the *own funds* of the *parent undertaking* or *subsidiary* within the same prudential consolidation group):	
			(a)	are limited to cash assets dedicated to the payment of coupons and redemption of the *own funds instruments* that are due; and

			(b)	are no higher than 0.5% of the average total assets of the special purpose entity over the last three years.
		(5)	The *FCA* considers that it may be appropriate to grant a *firm* a waiver when a special purpose entity has a higher percentage of assets than that specified in (4)(b) provided that:	
			(a)	the higher percentage is necessary exclusively to cover the running costs of the special purpose entity; and
			(b)	the corresponding nominal amount of those assets does not exceed £500,000.
		[**Note:** article 83(1) of the UK CRR and article 34 of BTS 241/2014.]		
7.58	R	(1)	For the purpose of the sub-consolidation calculation required under articles 84(2), 85(2) and 87(2) of the UK CRR, the qualifying minority interests of a *subsidiary* referred to in article 81 of the *UK CRR* ("X") that is itself a *parent undertaking* of an entity referred to in article 81(1) of the *UK CRR* must be calculated in accordance with the remainder of this *rule*.	
		(2)	Where X complies with either of the following on the basis of its *consolidated situation*, the treatment in (3) applies:	
			(a)	MIFIDPRU 4 and 5 ; or
			(b)	Part Three of the *UK CRR*.
		(3)	The relevant treatment in (2) is as follows:	
			(a)	the *common equity tier 1 capital* of X on a *consolidated basis* (as referred to in article 84(1)(a) of the *UK CRR*) shall be taken to include the eligible minority interests that arise from X's own *subsidiaries* calculated under article 84 of the *UK CRR* and MIFIDPRU 3 Annex 7R;
			(b)	for the purpose of the sub-consolidation calculation, the amount of *common equity tier 1 capital* required under article 84(1)(a)(i) of the *UK CRR* is the amount required to meet X's *common equity tier 1 capital* requirements at the level of its *consolidated situation* calculated in accordance with article 84(1)(a) of the *UK CRR*:
			(c)	for the purpose of the sub-consolidation calculation, the specific own funds requirements in article 84(1)(a)(i) of the *UK CRR* are:

(i) any amount in excess of X's *own funds requirement* that X is required to hold to meet its *own funds threshold requirement*; or

(ii) any amount specified by the PRA under regulation 34 of the Capital Requirements Regulations 2013 in relation to X;

(d) the amount of consolidated *common equity tier 1 capital* required under article 84(1)(a)(ii) of the *UK CRR* is the contribution of X on the basis of its *consolidated situation* to the common equity tier 1 own funds requirements of the *firm* for which the eligible minority interests are calculated on a consolidated basis ("Y");

(e) for the purpose of calculating the contribution of X under (d):

(i) all intra-group transactions between *undertakings* included in the scope of prudential consolidation of Y must be eliminated; and

(ii) X must not include capital requirements arising from its *subsidiaries* that are not included in the scope of prudential consolidation of Y.

(4) Where a *UK parent entity* has an intermediate *subsidiary* that meets the following conditions, the treatment in (5) applies:

(a) the intermediate *subsidiary* is not referred to in article 81(1) of the *UK CRR*; and

		(b)	the intermediate subsidiary has *subsidiaries* that are referred to in article 81(1) of the *UK CRR*.
	(5)	Where (4) applies, the *UK parent entity*:	
		(a)	may include in its *common equity tier 1 capital* the amount of minority interests arising from those *subsidiaries* calculated in accordance with article 84(1) of the *UK CRR*; but
		(b)	must not include in its *common equity tier 1 capital* any minority interests arising from a *subsidiary* that is not referred to in article 81(1) of the *UK CRR*.
	(6)	This *rule* applies on an equivalent basis to the calculation of:	
		(a)	qualifying *tier 1 instruments* under article 85 of the *UK CRR*, in which case references to "common equity tier 1" in this *rule* are references to "tier 1"; and
		(b)	qualifying own funds under article 87 of the *UK CRR*, in which case references to "common equity tier 1" in this *rule* are references to "own funds".

Prudent valuation and additional valuation adjustments

Application and purpose			
8.1	R	(1)	This annex applies for the purposes of calculating additional valuation adjustments under article 34 of the *UK CRR* (as applied by MIFIDPRU 3.3.1AR).
		(2)	Any reference to the *UK CRR* in this annex is to the *UK CRR* as applied and modified by MIFIDPRU 3.3.1R.
8.2	G	(1)	Under article 34 of the *UK CRR*, a *firm* must apply the requirements of article 105 of the *UK CRR* to the *firm's* assets measured at fair value when calculating the amount of its *own funds*.
		(2)	Under MIFIDPRU 3.3.1AR, a *firm* is only required to apply article 34 of the *UK CRR* to positions held within its *trading book*.
Sources of market data			
8.3	R	(1)	Where a *firm* calculates an *AVA* based on market data, it must consider the same range of market data as the data used in the independent price verification process referred to in article 105(8) of the *UK CRR*, subject to the adjustments in this *rule*.
		(2)	A *firm* must consider the full range of available and reliable market data sources to determine a prudent value, including each of the following to the extent relevant: (a) exchange prices in a liquid market; (b) trades in the *financial instrument* or a very similar instrument, either from the *firm's* own records or, where available, trades from across the market; (c) tradable quotes from brokers and other market participants; (d) consensus service data; (e) indicative broker quotes; and (f) counterparty collateral valuations.
			[**Note**: article 3 of BTS 2016/101.]
Determination of AVAs			
8.4	R	(1)	A *firm* must calculate the value of assets for which the *firm* must determine *AVAs* in accordance with this *rule*.

		(2)	The value in (1) is the sum of the absolute value of fair-valued assets and liabilities, as stated in the *firm's* financial statements in accordance with the applicable accounting framework, modified as follows: (a) exactly matching offsetting fair-valued and liabilities must be excluded; and (b) where a change in the accounting valuation of fair-valued assets and liabilities would: (i) only be partially reflected in *common equity tier 1 capital*, the value of those assets or liabilities must only be included in proportion to the impact of the relevant valuation change on *common equity tier 1 capital*; or (ii) have no impact on *common equity tier 1 capital*, the value of those assets or liabilities must be excluded.
		[**Note**: article 4 of BTS 2016/101.]	
8.5	R	A *firm's* total *AVAs* are 0.1% of the sum of the assets calculated under MIFIDPRU 3 Annex 8.4R(1). [**Note**: articles 5 and 6 of BTS 2016/101.]	
Documentation, systems and controls			
8.6	R	A *firm* must appropriately document its prudent valuation methodology and its policies on the following:	
		(1)	the range of methodologies for quantifying *AVAs* for each valuation position;
		(2)	the hierarchy of methodologies for each asset class, product, or *valuation position*;
		(3)	the hierarchy of market data sources used in the *AVA* methodology;
		(4)	the required characteristics of market data to justify a zero *AVA* for each asset class, product, or *valuation position*; and
		(5)	the fair-valued assets and liabilities for which a change in accounting valuation has a partial or no impact on *common equity tier 1 capital* according to MIFIDPRU 3 Annex 8.4R(2)(b).

		[**Note**: article 18(1) of BTS 2016/101.]		
8.7	R	The *firm* must ensure that the documentation and policies in MIFIDPRU 3 Annex 8.6R are:		
		(1)	reviewed at least annually; and	
		(2)	approved by the firm's senior management following each review. [Note: article 18(3) of BTS 2016/101.]	
8.8	R	A *firm* must:		
		(1)	maintain records to allow the calculation of *AVAs* at *valuation exposure* level to be analysed; and	
		(2)	ensure that the senior management of the *firm* are provided with information from the *AVA* calculation process to permit them to understand the level of valuation uncertainty on the *firm's* portfolio of fair-valued positions.	
		[**Note**: article 18(3) of BTS 2016/101.]		
Systems and controls requirements				
8.9	R	A *firm* must ensure that *AVAs* are authorised and subsequently monitored by an independent control function.		
		[**Note**: article 19(1) of BTS 2016/101.]		
8.10	R	(1)	A *firm* must have:	
			(a)	effective controls related to the governance of all fair-valued positions; and
			(b)	adequate resources to implement the controls in (a) and ensure robust valuation processes even during a stressed period.
		(2)	The controls and processes in (1) must include the following:	
			(a)	a review of the performance of the *firm's* valuation model at least annually;
			(b)	approval by senior management of all significant changes to valuation policies;
			(c)	a clear statement of the *firm's* risk appetite for exposure to positions subject to valuation uncertainty, which must be monitored at an aggregate *firm*-wide level;
			(d)	independence in the valuation process between risk-taking and internal control functions; and
			(e)	a comprehensive internal audit process relating to valuation processes and controls.
		[**Note**:article 19(2) of BTS 2016/101.]		
8.11	R	(1)	A *firm* must:	

(a) have effective and consistently applied controls relating to the valuation process for all fair-valued positions; and

(b) ensure that the controls in (a) are subject to regular internal audit review.

(2) The controls in (1) must include the following:

(a) a precisely defined *firm*-wide product inventory, ensuring that every *valuation position* is uniquely mapped to a product definition;

(b) valuation methodologies for each product in the inventory covering:

(i) the choice and calibration of model;

(ii) fair value adjustments;

(iii) independent price verification;

(iv) *AVAs*;

(v) the methodologies applicable to the product; and

(vi) the measurement of valuation uncertainty.

(c) a validation process ensuring that, for each product, both the risk-taking and relevant control functions approve the product-level methodologies described in point (b) and certify that they reflect the actual practice for every *valuation position* mapped to the product;

(d) defined thresholds based on observed market data for determining when valuation models are no longer sufficiently robust;

(e) a formal independent price verification process based on prices independent from the relevant trading desk;

(f) a new product approval process referencing the product inventory and involving all internal stakeholders relevant to risk measurement, risk control, financial reporting and the assignment and verification of valu

		ations of *financial instruments*; and
	(g)	a new deal review process to ensure that pricing data from new trades are used to assess whether valuations of similar valuation exposures remain appropriately prudent.

[**Note**: article 19(3) of BTS 2016/101.]

Chapter 4

Own funds requirements

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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 to a *UK parent entity* under ■ MIFIDPRU 4.1.1R(2), it applies with the following modifications:

(1) ■ MIFIDPRU 4.2.1R (Initial capital requirement) does not apply; and

(2) any reference to a "*firm*" or "*MIFIDPRU investment firm*" in this chapter is 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*.

4.2.2 G

(1) The initial capital requirement in MIFIDPRU 4.2.1R applies only at the point at which the *FCA* first grants *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

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.

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.

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, unless ■ MIFIDPRU 4.4.6R applies.

(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.

(3) Where a *MIFIDPRU investment firm* is appointed to act as a *depositary* of an *unauthorised AIF* in accordance with ■ FUND 3.11.10R(2), its *permanent minimum capital requirement* is £750,000, unless ■ MIFIDPRU 4.4.6R applies.

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) matched principal trading in the course of operating the *OTF*; or

(b) 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 the activities on the basis of 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* is £750,000.

4.4.3 R

(1) Where a *MIFIDPRU investment firm* satisfies the conditions in (2), its *permanent minimum capital requirement* is £150,000.

4

(2) The relevant conditions are:

(a) the *firm* has *permission* for 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* or *client* assets in the course of *MiFID business*;

(b) the *firm* does not have *permission* for 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; and

(c) the *firm* is not appointed to act as a *depositary* in accordance with ■ FUND 3.11.10R(2) or ■ COLL 6.6A.8R(3)(b)(i).

4.4.4 R (1) Where a *MIFIDPRU investment firm* satisfies 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*; and

(c) the *firm* is not appointed to act as a *depositary* in accordance with ■ FUND 3.11.10R(2) or ■ COLL 6.6A.8R(3)(b)(i).

4.4.5 G The relevant *permanent minimum capital requirement* under this section applies to a *collective portfolio management investment firm* in parallel with its *base own funds requirement* under ■ IPRU-INV 11. This means that a *collective portfolio management investment firm* must comply with both requirements, but they are not cumulative.

4.4.6 R Where a *MIFIDPRU investment firm* is appointed to act as the *depositary* of a *UK UCITS* or an *authorised AIF*, its *permanent minimum capital requirement* is £4 million.

4.5 Fixed overheads requirement

4.5.1 R

(1) The *fixed overheads requirement* of a *MIFIDPRU investment firm* is an amount equal to one quarter of the *firm's relevant expenditure* during the preceding year.

(2) When calculating its *fixed overheads requirement* in (1), a *firm* must use the figures resulting from the accounting framework applied by the *firm* in accordance with ■ MIFIDPRU 4.5.2R.

(3) This rule is subject to ■ MIFIDPRU 4.5.7R and ■ MIFIDPRU 4.5.9R.

4.5.2 R

(1) For the purposes of the calculation in ■ MIFIDPRU 4.5.1R, a *firm* must use the figures in its most recent:

(a) audited *annual financial statements*; or

(b) unaudited *annual financial statements*, where audited financial statements are not available.

(2) If a *firm* has used unaudited *annual financial statements* in accordance with (1)(b) and audited *annual financial statements* subsequently become available, the *firm* must update the calculation in ■ MIFIDPRU 4.5.1R using the audited figures.

(3) Where the financial statements in (1) do not cover a 12-*month* period, the firm must:

(a) divide the amounts included in those statements by the number of *months* the financial statements cover; and

(b) multiply the result of the calculation in (a) by 12 to produce an equivalent annual amount.

4.5.3 R

(1) For the purpose of ■ MIFIDPRU 4.5.1R(1), a *firm* must calculate its *relevant expenditure* by:

(a) calculating the *firm's* total expenditure before distribution of profits; and

(b) deducting any of the items in (2) from the total expenditure in (1)(a) to the extent that those items have been included in the expenditure.

(2) The items that a *firm* may deduct from its total expenditure are:

(a) any of the following, if they are fully discretionary:

(i) staff bonuses and other variable *remuneration*;

(ii) *employees'*, *directors'*, *partners'* and *limited liability partnership* members' shares in profits; and

(iii) other appropriations of profits;

(b) shared commission and fees payable that meet all of the following conditions:

(i) they are directly related to commission and fees receivable;

(ii) the commission and fees receivable are included within total revenue; and

(iii) the payment of the commission and fees payable is contingent on receipt of the commission and fees receivable;

(c) fees paid to *tied agents*;

(d) non-recurring expenses from non-ordinary activities;

(e) unless ■ MIFIDPRU 4.5.4R applies, fees, brokerage and other charges paid to *central counterparties*, exchanges and other *trading venues* and intermediate brokers for the purposes of executing, registering and clearing transactions, provided that the fees, brokerage and charges are directly passed on and charged to customers;

(f) 80% of the value of any fees, brokerage and other charges, excluding any fees or charges to which ■ MIFIDPRU 4.5.4R applies, paid to *central counterparties*, exchanges and other *trading venues* and intermediate brokers for the purposes of executing, registering and clearing transactions in relation to which:

(i) the *firm* is *dealing on own account*; and

(ii) the fees, brokerage or charges have not already been deducted under (e);

(g) interest paid to customers on *client money*, where there is no obligation of any kind to pay the interest;

(h) taxes where they fall due in relation to the annual profits of the *firm*;

(i) losses from trading on own account in *financial instruments*;

(j) payments related to contract-based profit and loss transfer agreements according to which the *firm* is obliged to transfer its annual profit to the *parent undertaking* following the preparation of the *firm's annual financial statements*;

(k) payments into a fund for general banking risk in accordance with article 26(1)(f) of the *UK CRR*, as applied by ■ MIFIDPRU 3.3.1R; and

(l) other expenses, to the extent that their value has already been reflected in a deduction from *own funds* under ■ MIFIDPRU 3.3.6R.

4.5.4 R The deducted amounts in ■ MIFIDPRU 4.5.3R(2)(e) and ■ (f) must not include fees and other charges necessary to maintain membership of, or otherwise meet loss-sharing financial obligations to, central counterparties, exchanges and other trading venues.

Additional deduction for commodity and emission allowance dealers

4.5.5 R In addition to the deductions in MIFIDPRU 4.5.3R(2), a *commodity and emission allowance dealer* may deduct expenditure on raw materials in connection with the underlying commodity of the commodity derivatives the *firm* trades.

Expenses incurred on behalf of the firm by third parties

4.5.6 R (1) A *firm* must add any fixed expenses that have been incurred on its behalf by a third party, including a *tied agent*, to the *firm's* total expenditure for the purposes of MIFIDPRU 4.5.3R in accordance with this *rule*.

(2) A *firm* is not required to add fixed expenses incurred on its behalf by a third party to the *firm's* expenditure if the expenses are already included in the figures resulting from MIFIDPRU 4.5.2R.

(3) Where a breakdown of the third party's expenses is available, the *firm* must add to the *firm's* total expenditure the share of the third party's expenses incurred on behalf of the *firm*.

(4) Where a breakdown of the third party's expenses is not available, the *firm* must:

(a) add to the *firm's* total expenditure the share of the third party's expenses incurred on behalf of the *firm* as projected in the *firm's* business plan; or

(b) if the *firm* does not have a business plan that projects the third party's expenses, reasonably estimate the share of those expenses that are attributable to the *firm's* business and add that estimated share of expenses to the *firm's* total expenditure.

Material change to projected relevant expenditure during the year

4.5.7 R (1) This *rule* applies where there:

(a) is an increase of 30% or more in the *firm's* projected *relevant expenditure* for the current year; or

(b) would be an increase of £2 million or more in the *firm's fixed overheads requirement* based on projected *relevant expenditure* for the current year.

(2) Where this *rule* applies, a *firm* must:

(a) immediately recalculate its *fixed overheads requirement* by applying the methodology in MIFIDPRU 4.5.3R to the projected *relevant expenditure*, taking into account the increase in (1);

(b) immediately substitute the revised *fixed overheads requirement* that results from the calculation in (a) for the *firm's* original *fixed overheads requirement* under MIFIDPRU 4.5.1R(1); and

(c) immediately recalculate its *basic liquid assets requirement* using the revised *fixed overheads requirement* in (b) and substitute the updated amount for its original *basic liquid assets requirement*.

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4.5.8 G

(1) Where there is a material increase in the *firm's* projected *relevant expenditure* that triggers the obligation in ■ MIFIDPRU 4.5.7R, a *firm* should also consider the potential impact on its *ICARA process* and the conclusions documented in its last *ICARA document*. In particular, the *firm* should consider any potential impact on:

(a) the *liquid assets* that the *firm* must hold to comply with ■ MIFIDPRU 6, as the requirements in that chapter are calibrated by reference to the *fixed overheads requirement*;

(b) the level of *own funds* and *liquid assets* that the *firm* must hold to comply with its obligations under ■ MIFIDPRU 7; and

(c) the calibration of the *firm's wind-down triggers*.

(2) The review in (1) is particularly important if the *firm's own funds requirement* was determined by the *fixed overheads requirement* immediately before the change occurred.

4.5.9 R

(1) This *rule* applies where there:

(a) is a decrease of 30% or more in the *firm's* projected *relevant expenditure* for the current year; or

(b) would be a decrease of £2 million or more in the *firm's fixed overheads requirement* based on projected *relevant expenditure* for the current year.

(2) Where this *rule* applies, a *firm* may:

(a) recalculate its *fixed overheads requirement* by applying the methodology in ■ MIFIDPRU 4.5.3R to the projected *relevant expenditure*, taking into account the decrease in (1); and

(b) if it has obtained prior permission from the *FCA*, substitute the revised *fixed overheads requirement* that results from the calculation in (a) for the *firm's* original *fixed overheads requirement* under ■ MIFIDPRU 4.5.1R.

(3) To obtain the permission in (2), a *firm* must:

(a) complete the application form in ■ MIFIDPRU 4 Annex 11R and submit it to the *FCA* in accordance with the instructions on that form;

(b) demonstrate all of the following:

(i) that one of the conditions in (1)(a) or (b) is met and the projected reduction in the *firm's relevant expenditure* is a reasonable projection;

(ii) that the firm has adequately considered the impact of the reduction on the *firm's ICARA process* and the conclusions documented in the firm's last *ICARA document*; and

(iii) that there is a reasonable basis to conclude that, following the reduction in the *firm's fixed overheads requirement*, the *firm* will continue to hold sufficient *own funds* and *liquid assets* to comply with its obligations under ■ MIFIDPRU 7.

4.5.10 G

(1) Under ■ MIFIDPRU 4.5.1R, a *MIFIDPRU investment firm* is required to calculate its *fixed overheads requirement* based on its relevant

expenditure as set out in its *annual financial statements* for the previous year.

(2) Under ■ MIFIDPRU 4.5.7R, if there is a material increase in the *firm's* projected *relevant expenditure* for the current year, the *firm* must recalculate its *fixed overheads requirement* on the basis of the projected increased *relevant expenditure*, taking into account the impact of that change.

(3) However, under ■ MIFIDPRU 4.5.9R, if there is a material change that results in a decrease in the *firm's* projected *relevant expenditure* for the current year, the *firm* must obtain permission from the *FCA* before substituting a reduced *fixed overheads requirement* calculated on the basis of the projected decrease.

(4) In many cases, a material change of the type specified in ■ MIFIDPRU 4.5.7R(1) or ■ MIFIDPRU 4.5.9R(1) would result from planned changes to the *firm's* business. Examples of these changes may include:

(a) starting or ceasing a major business line;

(b) acquiring or disposing of a major business; or

(c) undertaking a significant investment, upgrade or restructuring programme.

A *firm* that is planning to implement a material change to its business should calculate the anticipated impact of that change on its *fixed overheads requirement* (and its broader *own funds requirement*) before executing the relevant change. This should include considering the potential impact on its *ICARA process* and its obligations under ■ MIFIDPRU 7.

Firms that have been providing investment services and/or activities for less than one year

4.5.11 R

(1) This *rule* applies where a *firm* has been in business for less than one year.

(2) For the purposes of the calculation in ■ MIFIDPRU 4.5.1R, a *firm* must use the *relevant expenditure* included in its projections for the first 12 *months'* trading, as submitted in its application for *authorisation*.

4

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*.

4.6.2 G (1) The *rules* and *guidance* in ■ MIFIDPRU 4.7 to ■ MIFIDPRU 4.16 explain how a *MIFIDPRU investment firm* should calculate each component of its overall *K-factor requirement*.

(2) The manner in which *firms* carry on activities that are potentially relevant to one or more *K-factor metrics* may vary considerably. It is not practical for the *FCA* to give an exhaustive set of *rules* and *guidance* covering every conceivable business arrangement that *firms* may operate when carrying on such activities.

(3) If a *firm* is unsure whether a particular arrangement is within scope of one or more components of the *K-factor requirement*, the *FCA* expects the *firm* to apply a purposive approach to the interpretation of the requirement, as required by ■ GEN 2.2.1R. Among other factors, the *FCA* would therefore expect the *firm* to consider:

(a) whether the arrangement is sufficiently analogous to another arrangement that is clearly covered by any *rules* or associated *guidance*;

(b) the risks that the relevant component of the *K-factor requirement* is designed to address and whether the same or similar risks arise in relation to the arrangement in question; and

(c) where the component of the *K-factor requirement* is calculated by reference to a specific *investment service and/or activity*, the approach that the *firm* has adopted to applying other *rules* or *guidance* elsewhere in the *Handbook* to the arrangement, where those *rules* or *guidance* refer to the same *investment service and/or activity*.

(4) The *FCA* expects that if asked, a *firm* will be able to justify the approach that the *firm* has taken to applying the *K-factor requirement* to a particular activity.

(5) *MIFIDPRU investment firms* are reminded that even if an activity does not contribute towards the *K-factor requirement*, they should still consider, in accordance with the requirements in ■ MIFIDPRU 7, whether that activity may give rise to potential material risks of harm or may be relevant to the *firm's* wind-down analysis.

4

4.7 K-AUM requirement

4.7.1 R The *K-AUM requirement* of a *MIFIDPRU investment firm* is equal to 0.02% of the *firm's average AUM*.

4.7.2 R When measuring its *AUM*, a *MIFIDPRU investment firm* must include any amounts that relate to the *MiFID business* of the *firm* that is carried on by any *tied agents* acting on its behalf.

4.7.3 G The definition of *AUM* does not include any amounts arising from the *firm's* provision of the *ancillary service* in paragraph 3 of Part 3A of Schedule 2 to the *Regulated Activities Order* (i.e. providing advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to mergers and the purchase of undertakings).

4.7.4 R A *firm* must calculate its *K-AUM requirement* on the first *business day* of each *month*.

4.7.5 R (1) A *firm* must calculate the amount of its *average AUM* by:

(a) taking the total *AUM* as measured on the last *business day* of each of the previous 15 *months*;

(b) excluding the 3 most recent monthly values; and

(c) calculating the arithmetic mean of the remaining 12 monthly values.

(2) When measuring the value of its *AUM* on the last *business day* of each *month*, a *firm* must convert any amounts in foreign currencies on that date into the *firm's* functional currency.

(3) For the purposes of the currency conversion in (2), a *firm* must:

(a) determine the conversion rate by reference to an appropriate market rate; and

(b) record the rate used.

4.7.6 G (1) The effect of ■ MIFIDPRU 4.7.5R(2) is that when measuring the value of *AUM* at the end of each *month*, a *firm* must apply the relevant conversion rate on that date to the *AUM* attributable to that *month*. The *AUM* for each relevant preceding *month* should continue to be

measured by reference to the conversion rate that was applicable at the end of that particular preceding *month*.

(2) For purposes of ■ MIFIDPRU 4.7.5R(3), where a *firm* is carrying out a conversion that involves sterling, the *FCA* considers that an example of an appropriate market rate is the relevant daily spot exchange rate against sterling published by the Bank of England.

4.7.7 R

(1) When measuring the amount of its *AUM*, a *firm* must:

(a) where available, use the market value of the relevant assets;

(b) where a market value is not available for an asset, use an alternative measure of fair value, which may include an estimated value calculated on a best efforts basis;

(c) exclude any amounts that are included in the *firm's* calculation of its *CMH*.

(2) When measuring the amount of its *AUM*, a *firm* may offset any negative values or liabilities attributable to positions within the relevant portfolios, so that *AUM* is equal to the net total value of the relevant assets.

4.7.8 R

Where the *firm* has delegated the management of assets to another entity, the *firm* must include the value of those assets in its measurement of *AUM*.

4.7.9 R

(1) Subject to (2), where a *financial entity* has formally delegated the management of assets to the *firm*, the *firm* may exclude the value of those assets from its measurement of *AUM*.

(2) The exclusion in (1) does not apply if the *financial entity* has excluded the relevant assets from the *financial entity's* calculation of its own capital requirements because the *financial entity* is also acting as a delegated manager.

(3) For the purposes of (1), formal delegation requires a legally binding agreement between the *financial entity* and the *firm* that sets out the rights and obligations of each party in relation to the delegation of the relevant *portfolio management* activities.

4.7.10 G

(1) ■ MIFIDPRU 4.7.8R and ■ MIFIDPRU 4.7.9R apply where one entity delegates management of assets to another entity. For these purposes, delegation involves a delegating entity ("A") assuming a duty to the relevant *client* to manage the assets, and A then delegating the performance of that duty (in whole or in part) to another entity ("B").

(2) The following are not delegation for the purposes of ■ MIFIDPRU 4.7.8R or ■ MIFIDPRU 4.7.9R:

(a) where A only arranges for B to provide a service directly to a *client*, so that B owes a duty directly to the *client* to manage the assets and A does not; or

(b) where A advises a *client* to use B's management services for the *client's* assets, but A does not assume any responsibility to the *client* for managing the assets.

(3) MIFIDPRU 4.7.8R states that a *MIFIDPRU investment firm* cannot reduce its *AUM* by delegating management of assets to another entity. This is because the *firm* will normally continue to owe a duty directly to the *client*, even if performance of that duty has been delegated (wholly or partly) to another entity.

(4) However, MIFIDPRU 4.7.9R(1) permits a *firm* to which the management of assets has been formally delegated to exclude the value of the assets when measuring its *AUM* if the delegating entity is a *financial entity*. However, if the delegation does not meet the requirements to be a formal delegation, the *firm* may not exclude the relevant assets from its measurement of *AUM*. The definition of a *financial entity* covers:

(a) entities that are subject to an AUM-based capital requirement that is similar to the *K-AUM requirement*;

(b) an *insurance undertaking* that forms part of the same *financial conglomerate* as the *firm* if the *FCA* is the coordinator for that *financial conglomerate*; and

(c) an *undertaking* that is part of the same *investment firm group* as the *firm*, provided that the *investment firm group* is subject to prudential consolidation under MIFIDPRU 2.5 and both entities are included within the resulting *consolidated situation* of the *UK parent entity* of that *investment firm group*.

(5) MIFIDPRU 4.7.9R(1) is a limited exclusion that applies where assets under management have been delegated to the *firm* by a *financial entity*. This reflects the fact that the *financial entity* will either have a minimum AUM-based capital requirement or the *FCA* will have additional supervisory powers to take into account the position of the *financial entity* because it forms part of the same *financial conglomerate* or prudential consolidation group as the *firm*. However, even where a *financial entity* is included within the same *financial conglomerate* or *investment firm group* to which MIFIDPRU 2.5 applies, MIFIDPRU 4.7.9R(1) may be disapplied by MIFIDPRU 4.7.9R(2) for sub-delegation arrangements. This is because extended chains of delegation may involve additional operational risks.

(6) MIFIDPRU 4.7.9R(2) applies if a *firm* is managing a portfolio under sub-delegation arrangements. Its effect is illustrated by the following example: Firm A (a *third country* entity that is a *financial entity*) formally delegates the management of a portfolio of assets to Firm B (a *MIFIDPRU investment firm*). Firm B formally sub-delegates the management of part of the portfolio to Firm C (another *MIFIDPRU investment firm*). Firm B may apply the exclusion in MIFIDPRU 4.7.9R(1), on the basis that Firm A is a *financial entity*. However, if Firm B applies the MIFIDPRU 4.7.9R(1) exclusion, Firm C cannot also exclude the value of the sub-delegated assets from Firm C's measurement of *AUM*. This is because MIFIDPRU 4.7.9R(2) disapplies the MIFIDPRU 4.7.9R(1) exclusion if the delegating entity has already applied a similar exclusion in relation to the same portfolio.

(7) ■ MIFIDPRU 4.7.9R(2) also applies if the delegating entity is a *financial entity* in a *third country* and is applying an equivalent exclusion. For example, Firm D (an entity in a *third country*) delegates the management of a portfolio to Firm E (a *financial entity* in a *third country*). Firm E sub-delegates the management of part of that portfolio to Firm F (a *MIFIDPRU investment firm*). The *third country* rules to which Firm E is subject permit Firm E to exclude the value of the assets delegated by Firm D from Firm E's AUM-based capital requirement. If Firm E is relying on that exclusion, Firm F cannot rely on the exclusion in ■ MIFIDPRU 4.7.9R(1).

4.7.11 G Where a *financial entity* ("A") provides *investment advice of an ongoing nature* to a *MIFIDPRU investment firm* ("B") and B undertakes discretionary *portfolio management*, the arrangement does not fall within ■ MIFIDPRU 4.7.9R. This is because the arrangement is not a formal delegation of the management of assets by A to B, but involves 2 distinct activities: ongoing *investment advice* provided by A and discretionary *portfolio management* undertaken by B. In this situation, if A is a *MIFIDPRU investment firm*, it must include any assets in relation to which it is providing the advice in its measurement of *AUM*. Where B undertakes discretionary *portfolio management* in relation to the same assets, B must also include those assets in its own measurement of *AUM*.

4.7.12 R (1) This *rule* applies where a *firm* has been managing assets for its clients under discretionary *portfolio management* or non-discretionary arrangements constituting *investment advice of an ongoing nature* for less than 15 *months*.

(2) For the purposes of calculating *average AUM* under ■ MIFIDPRU 4.7.5R, a *firm* must use the modified calculation in ■ MIFIDPRU TP 4.11R(1) with the following adjustments:

(a) in ■ MIFIDPRU TP 4.11R(1)(b), *n* is the relevant number of *months* for which the *firm* has been managing assets for its *clients* under discretionary *portfolio management* or non-discretionary arrangements constituting *investment advice of an ongoing nature* (with the *month* during which the *firm* begins that activity counted as *month* zero); and

(b) during *month* zero of the calculation, the *firm* must:

(i) use a best efforts estimate of expected *AUM* for that month based on the *firm's* projections when beginning the new activity; and

(ii) use the estimate in (i) as its *average AUM*;

(c) during *month* 1 of the calculation and each *month* thereafter, the *firm* must apply the approach in (a) using observed historical data from the preceding *months*; and

(d) the modified calculation ceases to apply on the date that falls 15 *months* after the date on which the *firm* began managing assets under (1).

4.7.13 G ■ MIFIDPRU 4.10.26G to ■ MIFIDPRU 4.10.32G and ■ MIFIDPRU 4 Annex 12G contain additional *guidance* on the interaction between the measurement of a *firm's AUM* and the measurement of a *firm's COH*.

Investment advice of an ongoing nature

4.7.14 G

(1) The definition of *investment advice of an ongoing nature* includes:

(a) the recurring provision of *investment advice*; or

(b) *investment advice* given in the context of 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.

(2) In either case, the *firm* must provide *investment advice* as part of the relevant arrangement. This means that the *firm* must provide a personal recommendation to the *client*. Therefore, where a *firm* merely provides generic advice to a *client* that does not result in a personal recommendation, the *firm* does not need to include the value of any assets that are the subject of the generic advice in its measurement of *AUM*. *Firms* should refer to the *guidance* in PERG 13.3 for further information on *investment advice*, personal recommendations and generic advice.

(3) For example, a *firm* may undertake a periodic review of a *client's* portfolio to assess whether the balance between investments in equities and fixed income products is appropriate. If the *firm* advises the *client* only in general terms to invest a higher proportion of the portfolio in equities and a lower proportion in bonds, this would not normally constitute *investment advice*, unless the *firm* also gave advice on investing in specific equities or bonds. Provided that the *firm* does not give advice relating to specific investments (i.e. a personal recommendation), it therefore would not need to include the value of the portfolio when measuring its *AUM*.

4.7.15 G

(1) When giving *investment advice of an ongoing nature*, the assets that the *firm* must include within its measurement of *AUM* will depend on the scope of the *firm's* obligation to provide *investment advice*.

(2) In some circumstances, a *firm* may have assumed a duty to provide *investment advice* in relation to the *client's* entire portfolio. For example, a financial adviser may agree to carry out periodic reviews of a *client's* entire portfolio and to make recommendations to the *client* about the specific *financial instruments* in which the *client* should invest. In that case, the *firm* must include the entire value of the *client's* portfolio (to the extent that the portfolio consists of *financial instruments*) in the *firm's* measurement of *AUM*. This is because the *firm* has assumed a duty to provide *investment advice of an ongoing nature* in relation to the entire portfolio.

(3) In other situations, the scope of the *firm's* duty to provide *investment advice* may be more limited. For example, a *firm* may agree with a *client* that the firm will provide *investment advice* only on a particular subset of assets or only when specifically requested by the *client*. In that case, the *firm's* duty to provide *investment advice of an ongoing nature* is limited to the relevant subset of assets, or the specific *financial instruments* in respect of which the *client* requests advice. Therefore, the *firm* would be required to include only the value of those particular assets or *financial instruments* when measuring its *AUM*.

(4) A *firm* may have assumed different duties in respect of different parts of a *client's* portfolio. For example, a *firm* may have agreed to carry out a general review of whether the *client's* portfolio is appropriately balanced in a manner that would constitute only generic advice, rather than a personal recommendation. However, the *firm* may also be under a duty to provide *investment advice* on the equities held within the portfolio. In that case, the general review would not constitute *investment advice* (as it is only generic advice) and therefore the *firm* does not need to include the entire value of the *client's* portfolio in the *firm's* measurement of *AUM*. However, as the *firm* does have an ongoing duty to provide *investment advice* in relation to the equities held in the portfolio, the *firm* must include the value of those assets within its measurement of *AUM*.

(5) Where a *firm* provides recurring *investment advice* to a *client* without assuming a continuing duty, the *firm* is only required to include the value of the particular *financial instruments* in respect of which it provides *investment advice* in the *firm's* measurement of its *AUM*.

4.7.16 G

(1) *Investment advice of an ongoing nature* includes arrangements involving periodic or continuous *investment advice* and arrangements involving recurring *investment advice*.

(2) Periodic or continuous *investment advice* is most likely to arise where a *firm* agrees with a *client* that the *firm* will keep the *client's* portfolio under review or will provide advice to the *client* at various points during a specified period. For example, a *firm* may agree to manage a *client's* portfolio on a non-discretionary basis so that the *firm* has an ongoing duty to make personal recommendations to the *client*, but the *client* decides whether to proceed with each transaction. Alternatively, the *firm* may agree with the *client* to review the *client's* portfolio on, for example, a quarterly basis and to provide the *client* with personal recommendations following each review.

(3) Recurring *investment advice* does not require the *firm* to have assumed an ongoing or periodic duty to provide *investment advice* to the *client*. Instead, the *firm* provides *investment advice* to the same *client* repeatedly, even though there is no agreement with the *client* to establish a formal ongoing relationship. When considering whether *investment advice* is recurring for these purposes, a *firm* should assess whether, in substance, the type and pattern of advice that it provides is similar to periodic or continuous advice. This means that a *firm* cannot prevent what are, in substance, ongoing advisory arrangements for a *client* from constituting *investment advice of an ongoing nature* by artificially separating them into multiple individual agreements to provide advice to that *client*. If requested by the *FCA*, a *firm* should be able to justify why the *firm* has concluded that a particular set of advisory arrangements with a *client* does not constitute *investment advice of an ongoing nature*.

(4) *Investment advice of an ongoing nature* does not include genuinely isolated or sporadic instances of *investment advice* provided to the same *client* that do not, in substance, amount to ongoing arrangements. However, a *firm* should assess the potential harms arising from any *investment advice* that is not *investment advice of an ongoing nature* as part of its *ICARA process*.

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4.7.17 G

(1) Where a *firm* provides *investment advice* in the context of the continuous or periodic assessment and monitoring or review of a *client* portfolio of *financial instruments*, the value of *AUM* that the *firm* includes in respect of that portfolio should be determined by the scope of the *firm's* duty to the *client*.

(2) If the *firm* is under a duty to review the *client's* entire portfolio and provide *investment advice* as a result, the value of all *financial instruments* in the portfolio should be included in *AUM*. If the *firm's* duty is limited to specific *financial instruments*, only those *financial instruments* need to be included in *AUM*.

4.7.18 R For the purposes of the calculation of *average AUM* in ■ MIFIDPRU 4.7.5R:

(1) if the *firm* is under a duty to undertake a continuous assessment of the portfolio (or a subset of the portfolio), the *firm* must measure the value of *AUM* of the portfolio (or the relevant subset of it) on the last *business day* of each *month* during which that duty applies; and

(2) if the *firm* is under a duty to undertake periodic assessments of the portfolio (or a subset of the portfolio), the firm must use the value of the portfolio (or the relevant subset of it) at the time of the last review as the relevant value of *AUM* for each *month* until the next periodic review occurs (or the firm's duty ends, if earlier).

4.7.19 G The requirement in ■ MIFIDPRU 4.7.18R(2) is illustrated by the following example:

(1) On 1 March, the *firm* reviews the *client's* entire portfolio of *financial instruments* and provides *investment advice* to the *client*. The value of the *client's* portfolio is 100 on that date. The *firm* is required to carry out its next review of the *client's* portfolio on 1 June. The *firm* would include a value of 100 in its *AUM* for each of March, April and May.

(2) On 1 June, the *firm* reviews the *client's* entire portfolio again and provides further *investment advice* to the *client*. The value of the *client's* portfolio on that date is 110. The *firm* would include a value of 110 in its *AUM* for June and each subsequent *month* until the time of the next review, or until the *firm's* duty to carry out a review of the *client's* portfolio ends (if earlier).

4.7.20 G

(1) Where a *firm* provides recurring *investment advice* to a *client*, the value of *AUM* that the *firm* must include in respect of that *client* should be measured by the value of the *financial instruments* that are the subject of the relevant *investment advice*.

(2) Under ■ MIFIDPRU 4.7.5R, to calculate its *average AUM*, a *firm* must take the 15 most recent monthly values of *AUM* and exclude the most recent 3 months before calculating the arithmetic mean of the remaining values. ■ MIFIDPRU 4.7.21R explains how a *firm* should measure the monthly value of *AUM* when it is providing recurring *investment advice* to a *client*.

4.7.21 R

(1) Subject to (2), for the purposes of the calculation of *average AUM* under ■ MIFIDPRU 4.7.5R, the value of *AUM* for recurring *investment advice* given in relation to a *client* in any given *month* is the sum of:

(a) the *AUM* arising from the recurring *investment advice* given by the *firm* to that *client* during that *month*; and

(b) the *AUM* arising from the recurring *investment advice* given by the *firm* to that *client* during the immediately preceding 11 *months*.

(2) When measuring *AUM* under (1), a *firm* may adjust the *AUM* figure to reflect the fact that the *firm* has previously given *investment advice* in relation to the same assets during the preceding 11 *months*.

4.7.22 G

(1) The effect of ■ MIFIDPRU 4.7.21R is illustrated by the following example.

(2) A *firm* provides recurring *investment advice* to a *client*. The dates on which the *firm* provides advice and the value of the *financial instruments* that are the subject of the advice are set out in the table below. In October 2022, the *firm* provides advice in relation to the same assets worth 25 on which the *firm* advised in March 2022, plus additional assets worth 45.

Date of advice	Value of financial instruments
January 2022	50
February 2022	No advice given
March 2022	25
April 2022	100
May 2022	No advice given
June 2022	50
July 2022	No advice given
August 2022	No advice given
September 2022	80
October 2022	70 (consisting of the same assets in March 2022 worth 25 and 45 of new assets)
November 2022	No advice given
December 2022	10
January 2023	No advice given
February 2023	No advice given
March 2023	30

(3) ■ MIFIDPRU 4.7.21R means that *AUM* from recurring *investment advice* is cumulative across a rolling 12-*month* period. The following table shows how the *firm* in (2) would calculate the *AUM* attributable to the provision of recurring *investment advice* to the *client*.

Date of advice	Value of AUM
January 2022	50
February 2022	50

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Date of advice	Value of AUM
March 2022	75
	(i.e. 50 + 25)
April 2022	175
	(i.e. 50 + 25 + 100)
May 2022	175
June 2022	225
	(i.e. 50 + 25 + 100 + 50)
July 2022	225
August 2022	225
September 2022	305
	(i.e. 50 + 25 + 100 + 50 + 80)
October 2022	350
	(i.e. 50 + 25 + 100 + 50 +80 + 70 = 375
	375 – 25 (adjustment for the same assets in March 2022) = 350)
November 2022	350
December 2022	360
	(i.e. 50 + 25 + 100 + 50 + 80 + 70 + 10 = 385
	385 – 25 (adjustment for the same assets in March 2022) = 360)
January 2023	310
	(i.e. 25 + 100 + 50 + 80 + 70 + 10 = 335
	335 – 25 (adjustment for the same assets in March 2022) = 310)
February 2023	310
March 2023	340
	(i.e. 100 + 50 + 80 + 70 + 10 + 30)

(4) At the end of March 2023, the *firm* would therefore calculate *average AUM* and the *K-AUM requirement* resulting from the above example of *investment advice of an ongoing nature* as follows:

Sum of the most recent 15 *months* of *AUM*, excluding the 3 most recent monthly values	50 + 50 + 75 + 175 + 175 + 225 +225 + 225 + 305 + 350 + 350 + 360 = 2,565
Average AUM	2,565 / 12 = 213.75
K-AUM requirement	213.75 * 0.0002 = 0.043

4.8 K-CMH requirement

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4.8.1 R The *K-CMH requirement* of a *MIFIDPRU investment firm* is equal to the sum of:

(1) 0.4% of *average CMH* held by the *firm* in *segregated accounts*; and

(2) 0.5% of *average CMH* held by the *firm* in *non-segregated accounts*.

4.8.2 G (1) Generally, a *MIFIDPRU investment firm* should be holding *client money* in one or more *segregated accounts*. Under MIFIDPRU 4.8.9E, where a *firm* complies with the applicable requirements of CASS 7 in relation to an amount of *client money*, there is a presumption that the *client money* is being held in a *segregated account*.

(2) As a result, the *K-CMH requirement* for *non-segregated accounts* is most likely to be relevant where:

(a) the *K-CMH requirement* applies on a *consolidated basis* and:

(i) the *consolidated situation* includes one or more entities to which *CASS* does not apply, such as *third country* entities, that receive *money* from customers; and

(ii) the arrangements under which the entity in (i) holds *money* received from customers do not meet the conditions in MIFIDPRU 4.8.8R (as they apply on a *consolidated basis* under MIFIDPRU 2.5.30R); or

(b) a *MIFIDPRU investment firm* has not complied with the CASS 7 requirements, in which case the *firm* should treat any non-compliant arrangements as *non-segregated accounts* for the purposes of calculating any *K-CMH requirement* that includes that period of non-compliance.

(3) However, the scenario in (2)(b) does not affect any obligation that the *firm* has under *CASS*, or under any other *rule*, to take specified action or to notify the *FCA* where the *firm* has identified that it has breached the requirements of *CASS*.

4.8.3 R When calculating its *CMH* in accordance with this section, a *MIFIDPRU investment firm* must include any amounts that relate to *MiFID business* of the *firm* that is carried on by any *tied agent* acting on its behalf.

4.8.4 G As a result of the restrictions in SUP 12.6.5R and SUP 12.6.15R, the *FCA* generally expects that MIFIDPRU 4.8.3R would not be directly relevant to

MIFIDPRU investment firms on an individual basis. However, where this section applies on a *consolidated basis* in accordance with ■ MIFIDPRU 2.5 (Prudential consolidation), the *UK parent entity* must include any *CMH* attributable to a *tied agent* of a *third country investment firm* included within the *consolidated situation*.

4.8.5 G

(1) The definition of *CMH* includes only *client money* which is *MiFID client money*. Therefore, *client money* which is received in connection with business other than *MiFID business* does not need to be included within a *MIFIDPRU investment firm's* calculation of *CMH*, except to the extent that ■ MIFIDPRU 4.8.6R applies.

(2) The definition of *MiFID client money* includes the following:

(a) *money* deposited into a *client bank account* in accordance with ■ CASS 7.13.3R;

(b) *money* originally received in connection with *MiFID business* which a *firm* has placed in a *qualifying money market fund* in accordance with ■ CASS 7.13.3R(4). This means that while the *units* or *shares* in the relevant *qualifying money market fund* must still be treated by the *firm* as *client* assets for the purposes of *CASS* and must be dealt with in accordance with ■ CASS 7.13.26R, the value of those *units* or *shares* must be included in *CMH* for the purposes of *MIFIDPRU*;

(c) an amount of the *firm's* own *money* that the *firm* has paid into its *client bank account* for the purposes of ■ CASS 7.13.65R where the *firm* is applying *alternative approach mandatory prudent segregation*; and

(i) *prudent segregation*;

(ii) *alternative approach mandatory prudent segregation*; or

(iii) *clearing arrangement mandatory prudent segregation*; and

(d) *money* received from a *client* in connection with *MiFID business* which a *firm* has allowed a third party (such as an exchange, a *clearing house* or an *intermediate broker*) to hold in accordance with ■ CASS 7.14 (Client money held by a third party).

(3) Where a *firm* controls *money* under a *mandate* in accordance with ■ CASS 8, the *money* is not *MiFID client money* if it is not *client money* received or held by the *firm*. A *firm* is not required to include any *money* it controls but does not hold within its calculation of *CMH*.

(4) Although *money* that is not *MiFID client money* does not contribute to the *K-CMH requirement*, a *MIFIDPRU investment firm* should still consider any potential material harms that may arise in connection with receiving *money* from *clients* as part of their *ICARA process* under ■ MIFIDPRU 7. This includes any material harms that may arise in relation to amounts received that are not treated as *client money*, such as under a *title transfer collateral arrangement*.

4.8.6 R

If a *MIFIDPRU investment firm* is unsure whether *client money* should be classified as *MiFID client money*, it must treat the relevant amount as *MiFID client money* for the purposes of this section until the firm is satisfied that the amount is not *MiFID client money*.

4.8.7 G ■ MIFIDPRU 4.8.6R applies only for the purposes of determining how the *client money* concerned should be treated for the purposes of *MIFIDPRU*. It does not affect how the *client money* should be treated for the purposes of other provisions in the *Handbook* (such as *CASS* or *COBS*) or under any other legislation.

4.8.8 R An arrangement is a *segregated account* if it is an arrangement in respect of which a *firm* ("A") ensures that all of the following conditions are met:

(1) A keeps records and accounts enabling A, at any time and without delay, to distinguish assets held for one *client* from assets held for any other *client* and from A's own assets;

(2) A maintains its records and accounts in a way that ensures their accuracy, and in particular that they correspond to the assets held for *clients* and may be used as an audit trail;

(3) A conducts, on a regular basis, reconciliations between A's internal accounts and records and those of any third parties by whom those assets are held;

(4) A takes the necessary steps to ensure that deposited *client* funds are held in an account or accounts identified separately from any accounts used to hold funds belonging to A;

(5) A operates adequate organisational arrangements to minimise the risk of the loss or diminution of *client* assets or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence; and

(6) the applicable national law provides that, in the event of A's insolvency or entry into resolution or administration, assuming that A has complied with (1) to (5), *client* funds cannot be used to satisfy claims against A, other than claims by the relevant *clients*.

4.8.9 E (1) This *rule* applies for the purposes of ■ MIFIDPRU 4.8.8R.

(2) A *MIFIDPRU investment firm* which holds *client money* must comply with, among other requirements, the applicable requirements on:

(a) organisational requirements in relation to *client money* in ■ CASS 7.12;

(b) segregation of *client money* in ■ CASS 7.13 or *client money* held by a third party in ■ CASS 7.14;

(c) records, accounts and reconciliations in ■ CASS 7.15; and

(d) acknowledgement letters in ■ CASS 7.18.

(3) Compliance with (2) in relation to an arrangement may be relied on as tending to establish compliance with the conditions for that arrangement to be classified as a *segregated account* in ■ MIFIDPRU 4.8.8R.

(4) Contravention of (2) in relation to an arrangement may be relied on as tending to establish contravention of the conditions for that

arrangement to be classified as a *segregated account* in ■ MIFIDPRU 4.8.8R.

4.8.10 G The effect of ■ MIFIDPRU 4.8.9E is that if a *MIFIDPRU investment firm* complies with the provisions of *CASS* specified in ■ MIFIDPRU 4.8.9E(2) for a particular arrangement for *client money*, it can proceed on the basis that the *client money* is being held in a *segregated account* for the purposes of the *K-CMH requirement*. However, if the *firm* does not comply with the relevant *CASS* provisions in relation to a *client money* arrangement, this will generally be evidence that the relevant *client money* should be treated as being held in a *non-segregated account* for the purposes of calculating the *K-CMH requirement*.

4.8.11 G Where consolidation under ■ MIFIDPRU 2.5 (Prudential consolidation) applies to an *investment firm group*, ■ MIFIDPRU 2.5.30R and ■ MIFIDPRU 2.5.31R explain how to calculate the consolidated *K-CMH requirement*.

4.8.12 R A *firm* must calculate its *K-CMH requirement* on the first *business day* of each *month*.

4.8.13 R A *firm* must calculate the amount of its *average CMH* by:

(1) taking the total *CMH* as measured at the end of each *business day* during the previous 9 *months*;

(2) excluding the daily values for the most recent 3 *months*; and

(3) calculating the arithmetic mean of the daily values for the remaining 6 *months*.

4.8.14 R For the purpose of the calculation in ■ MIFIDPRU 4.8.13R, a *firm* must measure *CMH* in accordance with, to the extent applicable:

(1) any records, accounts and reconciliations that the *firm* maintains to comply with the requirements of ■ CASS 7.15 (Records, accounts and reconciliations); and

(2) any values contained in accounting records.

4.8.15 R Where a *firm* has been holding *CMH* for less than 9 *months*, it must calculate its *average CMH* using the modified calculation in ■ MIFIDPRU TP 4.11R(1) with the following adjustments:

(1) in ■ MIFIDPRU TP 4.11R(1)(b), *n* is the relevant number of *months* for which the *firm* has been holding *CMH* (with the *month* during which the firm begins that activity counted as *month* zero);

(2) during *month* zero of the calculation, the *firm* must:

(a) use a best efforts estimate of expected *CMH* for that *month* based on the *firm's* projections when beginning the new activity; and

(b) use the estimate in (a) as its *average CMH*;

(3) during *month* 1 of the calculation and each *month* thereafter, the *firm* must apply the approach in (1) using observed historical data from the preceding *month*;

(4) the modified calculation ceases to apply on the date that falls 9 *months* after the date on which the *firm* began holding *CMH*.

4.8.16 G

(1) Under ■ MIFIDPRU 4.8.13R(1), a *firm* must measure its *CMH* at the end of each *business day*. The relevant amount should reflect any subsequent adjustment that the *firm* must apply as a result of any requirement to carry out internal reconciliations in relation to *client money* (for example, under ■ CASS 7.15). Therefore, where an internal reconciliation subsequently identifies that the amount of *CMH* recorded for a particular *business day* is incorrect, the *firm* should update the relevant amount to reflect the correct figure.

(2) Where the *K-CMH requirement* applies on a *consolidated basis*, the *guidance* in (1) also applies in relation to any reconciliations carried out in accordance with the requirements of the jurisdiction in which any *third country* entity included in the *consolidated situation* is based.

4

4.9 K-ASA requirement

4.9.1 R The *K-ASA requirement* of a *MIFIDPRU investment firm* is equal to 0.04% of the *firm's average ASA*.

4.9.2 R When calculating its *K-ASA requirement* in accordance with this section, a *MIFIDPRU investment firm* must include within its *ASA* any amounts that relate to *MiFID business* of the *firm* that is carried on by any *tied agents* acting on its behalf.

4.9.3 G Due to the limited types of activities in respect of which a *tied agent* may be exempt from the requirement for *authorisation* in the *UK* (as explained in ■ SUP 12.2.7G), the *FCA* generally expects that ■ MIFIDPRU 4.9.2R would not be directly relevant to a *MIFIDPRU investment firm* on an individual basis. However, where ■ MIFIDPRU 4.9 applies on a *consolidated basis* in accordance with ■ MIFIDPRU 2.5 (Prudential consolidation), the *UK parent entity* must include any *ASA* attributable to a *tied agent* of a *third country investment firm* included within the *consolidated situation*.

4.9.4 R A *firm* must exclude from its measurement of *ASA* any units or shares in a *qualifying money market fund* that are treated as *MiFID client money*.

4.9.5 G

(1) The definition of *ASA* includes only *client* assets held by a *MIFIDPRU investment firm* in the course of *MiFID business*. Therefore, *client* assets which are held in connection with business other than *MiFID business* do not need to be included within a *MIFIDPRU investment firm's* calculation of *ASA*, except to the extent that ■ MIFIDPRU 4.9.6R applies.

(2) As explained in ■ MIFIDPRU 4.8.5G, the definitions of *MiFID client money* and *CMH* include amounts that a *MIFIDPRU investment firm* has placed with *qualifying money market funds* in accordance with ■ CASS 7.13.3R(4). As a result, although the resulting units or shares in a *qualifying money market fund* may be treated as *client* assets for the purposes of the *custody rules*, under ■ MIFIDPRU 4.9.4R, their value must be included in *CMH* not in *ASA*.

(3) Although *client* assets that a *firm* holds other than in the course of *MiFID business* do not contribute to the *K-ASA requirement*, a *MIFIDPRU investment firm* should still consider any potential material harms that may arise in connection with receiving assets from *clients* as part of its *ICARA process* under ■ MIFIDPRU 7.

(4) As part of its *ICARA process*, a *firm* should also consider material harms that may arise in relation to amounts received that are not treated as *client* assets for the purposes of the *custody rules* but in relation to which the *firm* may have future obligations to a *client*, such as under a *title transfer collateral arrangement*.

4.9.6 R If a *MIFIDPRU investment firm* is unsure whether *client* assets are held in the course of *MiFID business*, it must treat those assets as held in the course of *MiFID business* for the purposes of this section until it is satisfied that the assets are not held in the course of *MiFID business*.

4.9.7 R A *firm* must calculate its *K-ASA requirement* on the first *business day* of each *month*.

4.9.8 R A *firm* must calculate the amount of its *average ASA* by:

(1) taking the total *ASA* as measured at the end of each *business day* for the previous 9 *months*;

(2) excluding the values for the most recent 3 *months*; and

(3) calculating the arithmetic mean of the daily values for the remaining 6 *months*.

4.9.9 R When measuring *ASA*, a *firm* must:

(1) where available, use the market value of the relevant assets; and

(2) where a market value is not available for an asset, use an alternative measure of fair value, which may include an estimated value calculated on a best efforts basis.

4.9.10 G The values used by a *firm* under ■ MIFIDPRU 4.9.8R should be consistent with the information on *client assets* in any relevant regulatory data reported by the *firm* to the *FCA*, and in any internal or external reconciliations and records maintained in accordance with ■ CASS 6.6 (Records, accounts and reconciliations) unless a *rule* or relevant *guidance* requires the *firm* to take a different approach.

4.9.11 R Where either of the following applies, a *firm* must include the value of the relevant assets in its measurement of *ASA*:

(1) the *firm* has delegated the safeguarding and administration of assets to another entity; or

(2) another entity has delegated the safeguarding and administration of assets to the *firm*.

4.9.12 G The effect of ■ MIFIDPRU 4.9.11R is that a *firm* will not reduce its level of *ASA* by delegating the safeguarding of assets to a third party. However, a *firm* will increase the level of its *ASA* by accepting the delegation of safeguarding

and administration of assets to the *firm* by a third party. This reflects the harm that may result from a breach of the *firm's* direct safeguarding responsibilities or the *firm's* responsibilities in relation to the selection, appointment and periodic review of any third party to which the *firm* has delegated safeguarding.

4.9.13 R Where a *firm* has been safeguarding assets constituting *ASA* for less than 9 *months*, it must calculate its *average ASA* using the modified calculation in ■ MIFIDPRU TP 4.11R(1) with the following adjustments:

(1) in ■ MIFIDPRU TP 4.11R(1)(b), *n* is the relevant number of *months* for which the *firm* has been safeguarding assets (with the *month* during which the *firm* begins that activity counted as *month* zero); and

(2) during *month* zero of the calculation, the *firm* must:

(a) use a best efforts estimate of expected *ASA* for that *month* based on its projections when beginning the new activity;

(b) use the estimate in (a) as its *average ASA*;

(3) during *month* 1 of the calculation and each *month* thereafter, the *firm* must apply the approach in (1) using observed historical data from the preceding *months*; and

(4) the modified calculation ceases to apply on the date that falls 9 *months* after the date on which the *firm* began safeguarding assets constituting *ASA*.

4.10 K-COH requirement

4.10.1 R The *K-COH requirement* of a *MIFIDPRU investment firm* is equal to the sum of:

(1) 0.1% of *average COH* attributable to *cash trades*; and

(2) 0.01% of *average COH* attributable to *derivatives trades*.

4.10.2 R When calculating its *K-COH requirement* in accordance with this section, a *MIFIDPRU investment firm* must include within its *COH* any amounts that relate to *MiFID business* of the *firm* that is carried on by any *tied agent* acting on its behalf.

4.10.3 G The definition of *COH* includes orders that a *firm* handles when carrying on either of the following types of *MiFID business*:

(1) reception and transmission of client orders; and

(2) execution of orders on behalf of a client.

4.10.4 R A *firm* is not required to include the following in its measurement of *COH*:

(1) an order executed by a *firm* in its own name (including where the *firm* executes an order in its own name on behalf of a *client*);

(2) an order that a *firm* handles when acting in the capacity of the operator of a *multilateral trading facility* or *organised trading facility*;

(3) a transaction that falls within the definition of reception and transmission of *client* orders only as a result of the situation described in recital 44 of *MiFID*; and

(4) orders that are not ultimately executed.

4.10.5 G ■ MIFIDPRU 4.10.6G to ■ MIFIDPRU 4.10.17G contain further *guidance* on whether particular arrangements are included within the measurement of *COH*.

Execution of orders in the firm's own name

4.10.6 G Where a *firm* executes an order in its own name (irrespective of whether the order is ultimately for the benefit of a *client*), the order is included within the *firm's* measurement of its *DTF* under ■ MIFIDPRU 4.15 (K-DTF requirement) and not within its measurement of *COH* under this section.

The extended ("bringing together") definition of reception and transmission

4.10.7 G Recital 44 of *MiFID* describes transactions that result from a *firm* bringing together 2 or more investors (such as introducing an issuer to a potential source of funding), but where the *firm* does not otherwise interpose itself within the chain of execution of any resulting order. In practice, this is most likely to be relevant in the context of *corporate finance business* or private equity business. A *firm* may exclude these transactions from its measurement of *COH* provided that its role does not go beyond this "extended" definition of reception and transmission. This is further described in the *guidance* in ■ PERG 13.3 (Investment Services and Activities).

Matched principal trading

4.10.8 G A *firm* that trades in a matched principal capacity will be placing orders in its own name. These orders must therefore be included in the measurement of the *firm's DTF* and are not included in the calculation of *COH*.

Name give-up activities

4.10.9 G

(1) The *FCA* understands that activities that are described as involving "name give-up" may take different forms.

(2) In certain cases, a *firm* may distribute indications of interest that indicate a willingness to enter into a transaction, but do not have fixed terms. The *firm* may then pass the names of the counterparties to each other following a match to allow them to facilitate the trade. These indications of interest and name-passing are not included within the measurement of *COH*. However, this does not mean that every transaction which begins with an indication of interest is outside the scope of *COH*. Where a *firm* is subsequently instructed to transmit an order on firm terms, or to execute an order, that transaction will be within scope of *COH*, even if the order results from a process that began with an initial indication of interest.

(3) In some circumstances, a *firm* may disseminate orders on firm terms that result in a transaction as soon as they are confirmed by the recipient, following which the *firm* will disclose the name of the relevant counterparty. This activity is included within the measurement of *COH* because it involves reception and transmission of an order on firm terms.

Exchange give-up activities

4.10.10 G

(1) A *firm* may facilitate trading by its *clients* on exchanges. Once a transaction has been executed, the relevant trade is then given up to the *client's* clearing firm.

(2) A *firm* should consider the exact capacity in which it is acting, and whether it incurs any liability as principal, when determining whether orders resulting from exchange give-up activities are included within the measurement of *COH*.

(3) If the *firm* enters into the transaction in its own name and therefore incurs principal liability, even for a short period, in relation to the trade before it is given up, the order should be included within the *firm's* measurement of *DTF* and not within its measurement of *COH*.

(4) If the *firm* does not incur liability as principal and merely acts as agent in the name of a third party in relation to the trade, the order should be included within the *firm's* measurement of *COH*.

Exchange block trades

4.10.11 G

(1) A *firm* may be involved in negotiating a bilateral trade in relation to an exchange-traded instrument between counterparties that takes place off-exchange because the size of the trade exceeds certain specified levels. In some cases, the exchange may provide communications functionality to facilitate the block trades, but the trades are not executed on the exchange's public market.

(2) A *firm* must determine the capacity in which the *firm* is acting in relation to the block trade to determine if the value of the trade should be included in the *firm's* measurement of *COH*.

(3) If the *firm* enters into the block trade in its own name and the trade is then given up to a *client*, the *firm* should include the value of that trade in its measurement of *DTF*.

(4) If the *firm* executes the block trade as agent by committing the *client* to the terms of the trade, the *firm* should include the value of that trade in its measurement of *COH*.

(5) If the *firm* receives firm terms of the block trade from the *client* and transmits the terms to the counterparty in order for the counterparty to confirm the terms to create a binding transaction, the *firm* should include the value of that trade in its measurement of *COH*.

Broker functionality

4.10.12 G

A *firm* may be a member of an exchange and may provide functionality whereby trades can be executed and booked directly into the account of the relevant *client*. In this case, the *FCA* considers that the trades should be included in the *firm's* measurement of *COH*, as the *firm* is still being used to execute the relevant trade.

Orders connected with the operation of trading venues

4.10.13 G

(1) A *firm* which is *operating a multilateral trading facility* or *operating an organised trading facility* does not need to include any orders it handles solely in that capacity in its measurement of *COH*. However, it should consider as part of its *ICARA process* whether that activity gives rise to the risk of material potential harm which may require it to hold additional *own funds* or *liquid assets* under ■ MIFIDPRU 7.

(2) However, if the operator of an *organised trading facility* is engaging in *matched principal trading*, as permitted by ■ MAR 5A.3.5R, any matched principal trades are included in its measurement of *DTF* under ■ MIFIDPRU 4.15 (K-DTF requirement).

4.10.14 G A *firm* that executes *client* orders on a *multilateral trading facility* or an *organised trading facility* when the *firm* is not acting in the capacity of the trading venue operator must include the orders in its measurement of *COH* (unless the *firm* executes the orders in its own name, in which case it must include the orders in its measurement of *DTF*).

4.10.15 G In certain circumstances, the same *firm* may both act as the operator of a *multilateral trading facility* or an *organised trading facility* and also submit an order on that *trading venue* on behalf of a *client*. In this case, although the *firm* is not required to measure *COH* in relation to its role as the operator of the *trading venue*, it must still measure *COH* (or *DTF* if it is possible to enter into transactions in its own name on the *trading venue* and it is executing in that capacity) in relation to the order that it executes for the *client*.

Orders that are never executed

4.10.16 G (1) The effect of ■ MIFIDPRU 4.10.4R(4) is that where a *firm* receives a *client* order but that order is not ultimately executed, it does not have to include the value of that order in its measurement of *COH*. However, as part of its *ICARA process*, a *firm* should consider whether the fact that an order has not been executed gives rise to any material risks to the *firm* or to its *clients*. This may depend on the reasons why the *client* order has not been executed.

(2) If, for example, the order was not executed because market conditions did not allow the *firm* (or another entity to whom the order was ultimately transmitted) to achieve an appropriate outcome for the *client*, this may be consistent with the *firm's* contractual and regulatory duties. In that case, this may not give rise to any additional material risks.

(3) However, if the *firm* failed to transmit or execute an order because of an oversight or an internal systems failure, this may indicate that the *firm* has been failing in its duties to its *client* or in its regulatory obligations. Alternatively, the *firm* may have successfully transmitted an order, but failed to select an appropriate entity to receive and execute the order, and therefore may have failed to comply with its obligations to act in the best interests of the *client* when transmitting the order. In this case, the *firm* should consider as part of its *ICARA process* whether the failures may give rise to material risks and how these risks should be addressed.

4.10.17 G (1) Although failure to achieve the execution of an individual order does not necessarily indicate potential material harms, a series or pattern of failures may be evidence of potential material harms.

(2) A *firm's* analysis under its *ICARA process* is separate from the application of any individual regulatory or other legal duties owed to

an individual *client*. Therefore, while a *firm* may conclude that an isolated oversight in relation to a *client* order does not give rise to the risk of material harm under the *ICARA process*, this does not affect any obligations that the *firm* owes to the *client*.

Calculating COH

4.10.18 R A *firm* must calculate its *K-COH requirement* on the first *business day* of each *month*.

4.10.19 R (1) A *firm* must calculate the amount of its *average COH* by:

(a) taking the total *COH* measured throughout each *business day* over the previous 6 *months*;

(b) excluding the daily values for the most recent 3 *months*; and

(c) calculating the arithmetic mean of the daily values of the remaining 3 *months*.

(2) When measuring the value of *COH* for a particular *business day*, a *firm* must convert any amounts in foreign currencies on that date into the *firm's* functional currency.

(3) For the purposes of the currency conversion in (2), a *firm* must:

(a) determine the conversion rate by reference to an appropriate market rate; and

(b) record the rate used.

Measuring the value of orders for COH

4.10.20 R (1) When measuring its *COH*, 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 at the time at which it is executed, unless the firm has applied the approach in ■ MIFIDPRU 4.10.23R.

(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 4.10.25R.

(5) A *firm* may calculate the value of an order by deducting any transaction costs to reflect the consideration received or paid by the *client* for the relevant instruments, provided that the transaction costs are not paid separately to the *firm* by the *client*.

4

4.10.21 G

(1) Under the general approach in ■ MIFIDPRU 4.10.20R(2), a *firm* determines the gross value of an order by multiplying the market price of the instrument by the quantity of the instrument being purchased or sold.

(2) However, ■ MIFIDPRU 4.10.20R(5) permits (but does not require) a *firm* to calculate the value of an order by reference to the consideration paid or received by the *client* for the instruments (i.e. net of transaction costs), provided that the transaction costs are included in the gross value of the order and are not paid by the *client* to the *firm* separately.

(3) For example, Firm A executes an order for a *client* to buy 100 shares. The total cost of the order, including transaction costs, is £100. The *client* receives shares worth £88, after the *firm* uses £12 to cover transaction costs. Under the standard approach in ■ MIFIDPRU 4.10.20R(2), the *firm* may record the value of the order in its *COH* as £100 (i.e. the gross cost of the order). The *firm* may, for example, choose this approach for reasons of simplicity and administrative convenience.

(4) Alternatively, in the example above, the *firm* may apply the approach under ■ MIFIDPRU 4.10.20R(5) to record the value of the order in its *COH* as £88 (i.e. net of transaction costs paid by the *client* in relation to the transaction).

(5) However, a *firm* cannot rely on ■ MIFIDPRU 4.10.20R(5) to reduce the value of an order by transaction costs that are paid separately by the *client* to the *firm*. For example, Firm B executes an order for a *client* to buy 100 shares. The total cost of the order is £100. The *client* additionally pays £12 to Firm B for transaction costs. In this case, the *firm* must record the net value of the order under ■ MIFIDPRU 4.10.20R(5) in its *COH* as £100 (and not £88), as the transaction costs have been paid separately.

(6) The effect of ■ MIFIDPRU 4.10.19R(2) is that when measuring the value of *COH* at the end of each *business day*, a *firm* must apply the relevant conversion rate on that date to any amounts in foreign currencies forming part of the *COH* attributable to that *business day*. The *COH* for each preceding *business day* should continue to be measured by reference to the conversion rate that was applicable on that preceding day.

(7) For the purposes of ■ MIFIDPRU 4.10.19R(3), where a *firm* is carrying out a conversion that involves sterling, the *FCA* considers that an example of an appropriate market rate is the relevant daily spot exchange rate against sterling published by the Bank of England.

4.10.22 G

For *cash trades* relating to exchange-traded options, the amount paid or received under ■ MIFIDPRU 4.10.20R(2) is the premium paid for the option.

4.10.23 R

(1) By way of derogation from ■ MIFIDPRU 4.10.20R(2), a *firm* that receives and transmits an order that is a *cash trade* may apply the approach in this *rule* to determine the value of that order for the purposes of measuring *COH*.

(2) Where a *firm* applies the approach in this *rule*, the value of the order shall be determined by reference to:

(a) for an order which specifies a fixed price or limit price at which the order should be executed, that price; or

(b) for an order which does not specify a price, the market price of the relevant instrument at the end of the day on which the order is transmitted by the *firm*.

(3) A *firm* that applies the approach in this *rule* must apply it either:

(a) in relation to all *cash trades* that the *firm* receives and transmits; or

(b) only in relation to *cash trades* that the *firm* receives and transmits where it does not receive timely information from the executing entity about the terms on which the order was executed.

(4) A *firm* that applies the approach in this *rule* must document which basis in (3) applies.

4.10.24 G

(1) The effect of ■ MIFIDPRU 4.10.23R is to permit a *firm* that receives and transmits orders that are *cash trades* to determine the *COH* attributable to the orders using an alternative approach. A *firm* may either:

(a) apply the standard approach in ■ MIFIDPRU 4.10.20R(2) and use the price at which the relevant order was ultimately executed, once this has been confirmed by the entity that executes the order; or

(b) apply the alternative approach in ■ MIFIDPRU 4.10.23R and use a deemed price that is determined by reference to the limit price of the order or, if there is no limit price, the end-of-day market price at the time at which the order is transmitted.

(2) However, a *firm* must not use the alternative approach in ■ MIFIDPRU 4.10.23R for regulatory arbitrage to reduce its *K-COH requirement*. To prevent this, a *firm* may only apply the alternative approach either:

(a) in relation to all *cash trades* that the *firm* receives and transmits; or

(b) in relation to *cash trades* that the *firm* receives and transmits where the *firm* does not receive timely information from the broker about the terms on which the order was executed. In this case, the *firm* must apply the standard approach in ■ MIFIDPRU 4.10.20R(2) in relation to all other *cash trades*. This is designed to ensure that the *firm* can record daily information for *COH* in circumstances where information about the ultimate execution of the order is otherwise missing or significantly delayed.

4.10.25 R

(1) For the purposes of ■ MIFIDPRU 4.10.20R(4), a *firm* must adjust the notional amount of an interest rate derivative by multiplying the notional amount by the duration.

(2) The duration in (1) shall be determined in accordance with the following formula:

Duration = time to maturity (in years) / 10

Interaction between K-COH requirement and K-AUM requirement

4

4.10.26 G ■ MIFIDPRU 4.10.27G to ■ MIFIDPRU 4.10.32G and ■ MIFIDPRU 4 Annex 12G explain the circumstances in which a *firm* must include orders that arise in connection with *portfolio management* or *investment advice* in, or may exclude orders from, its measurement of *COH*.

4.10.27 G (1) The basic definition of *COH* includes:

(a) orders that the *firm* executes when providing execution services for a *client*; and

(b) orders that the *firm* has received from a *client* and transmitted to another entity for execution.

(2) The *rules* and *guidance* in ■ MIFIDPRU 4.10.28R to ■ 4.10.32G explain how this definition applies in particular scenarios and certain exclusions or modifications that may apply.

4.10.28 R A *firm* may exclude from its calculation of *COH* any order that the *firm* generates in the course of providing either of the following in relation to a portfolio, if the portfolio is included in the *firm's* calculation of its *K-AUM requirement*:

(1) portfolio management; or

(2) investment advice of an ongoing nature.

4.10.29 R (1) This *rule* applies where:

(a) portfolio management has been delegated to a *firm* by a *financial entity*; and

(b) as a result of the delegation in (a), the *firm* has excluded the delegated portfolio from its calculation in *AUM* in accordance with ■ MIFIDPRU 4.7.9R.

(2) The *firm* in (1) must include in its measurement of *COH* any orders that the *firm* executes in the course of providing *portfolio management* in relation to the delegated portfolio.

(3) The *firm* in (1) is not required to include in its measurement of *COH*:

(a) any order that the *firm* passes back to the delegating *financial entity* for execution (whether the order is executed by that *financial entity* or is transmitted by the *financial entity* to another entity for execution); or

(b) any order that the *firm* places with another entity for execution in the course of providing *portfolio management* in relation to the delegated portfolio.

4.10.30 G The exclusions in ■ MIFIDPRU 4.7.9R, ■ MIFIDPRU 4.10.28R and ■ MIFIDPRU 4.10.29R(3) may result in a *firm* that carries on delegated *portfolio management* having no *K-AUM requirement* or *K-COH requirement* in relation to all or part of a delegated portfolio. Where one or more exclusions apply, a *firm* should still assess as part of its *ICARA process* whether the activity of providing delegated *portfolio management* may give rise to potential material harms that may need to be covered by additional financial resources. *Firms* should refer to the *rules* and *guidance* in ■ MIFIDPRU 7 for additional information on the *ICARA process*.

4.10.31 G (1) ■ MIFIDPRU 4.10.29R does not apply where a *financial entity* ("A") carries on *portfolio management* in relation to a portfolio and a *MIFIDPRU investment firm* ("B") provides *investment advice of an ongoing nature* to A in relation to that portfolio. In this situation, A has not delegated *portfolio management* to B. Instead, A provides the service of *portfolio management* to A's *client*, and B provides the separate service of *investment advice* to A. If A is a *MIFIDPRU investment firm*, A will include the value of the relevant portfolio when calculating its *K-AUM requirement*. B will calculate its own *K-AUM requirement* in relation to the same portfolio.

(2) Although ■ MIFIDPRU 4.10.29R does not apply in this scenario, B may benefit from the separate exclusion in ■ MIFIDPRU 4.10.28R(2) and therefore would not be required to include any orders that result from its ongoing *investment advice* within B's calculation of *COH*, because B will calculate a *K-AUM requirement* in relation to the relevant portfolio.

4.10.32 G When measuring *COH* for the purposes of ■ MIFIDPRU 4.10.19R, a *firm* must include:

(1) an order that the *firm* executes, or receives and transmits, as a result of providing *investment advice* (other than *investment advice of an ongoing nature*, if the *firm* calculates a *K-AUM requirement* in relation to the advice) to a *client* and subsequently receiving instructions from the *client* to transmit or execute the relevant order; and

(2) an order that a *firm* receives from another *firm* ("X"), where:

(a) X provides *investment advice* (including *investment advice of an ongoing nature*) to a *client*;

(b) as a result of the advice in (a), the *client* instructs X to place an order with the *firm*; and

(c) the *firm* executes or receives and transmits the order received from X.

Firms with less than 6 months data on COH

4.10.33 R (1) This *rule* applies where a *firm* has been handling *client* orders constituting *COH* for less than 6 *months*.

(2) For the purposes of its calculation of *average COH* under ■ MIFIDPRU 4.10.19R, a *firm* must use the modified calculation in ■ MIFIDPRU TP 4.11R(1) with the following adjustments:

(a) in ■ MIFIDPRU TP 4.11R(1)(b), *n* is the relevant number of *months* for which the *firm* has been handling *client* orders constituting *COH* (with the *month* during which the firm begins that activity being counted as *month* zero); and

(b) during *month* zero of the calculation, the *firm* must:

(i) generate a best efforts estimate of expected *COH* for that *month* based on the *firm's* projections when beginning the new activity; and

(ii) use the estimate in (i) as its *average COH*;

(c) during *month* 1 of the calculation and each *month* thereafter, the *firm* must apply the approach in (a) using observed historical data from the preceding *months*; and

(d) the modified calculation ceases to apply on the date that falls 6 *months* after the date on which the *firm* began handling *client* orders constituting *COH*.

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.

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* in the form in which it stood at 31 December 2021, 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" is a reference to "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).

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*; and

(3) the *K-TCD requirement*.

4.11.5 R The *K-DTF requirement* applies to a *firm* that:

(1) deals on own account; or

(2) executes orders on behalf of clients in the *firm's* own name.

4.11.6 G A *MIFIDPRU investment firm* that *deals on own account* is also subject to the *K-CON requirement* in accordance with ■ MIFIDPRU 5.

4.11.7 G A *MIFIDPRU investment firm* that has *permission* to *operate an organised trading facility* may rely on that *permission* to:

(1) carry out *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 and ■ MIFIDPRU 4.11.5R to the extent relevant to the transactions it undertakes. ■ MIFIDPRU 5 explains how the *K-CON requirement* applies to such *firms*.

4.11.8 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 the positions give rise to foreign exchange risk or commodity risk.

4.11.9 R

(1) This *rule* applies where a *firm* has deliberately taken a position to hedge against the adverse impact of a foreign exchange rate on:

(a) the *firm's own funds requirement*; or

(b) an item which the *firm* has deducted from its *own funds*.

(2) A *firm* may exclude a position in (1) from its net open currency positions for the purpose of article 352 of the *UK CRR* (as applied by ■ MIFIDPRU 4.12.2R) if the *firm* has prior permission from the *FCA*.

(3) To obtain the permission in (2), a *firm* must:

(a) complete the application form in ■ MIFIDPRU 4 Annex 1R and submit it to the *FCA* using the *online notification and application system*;

(b) in the application, demonstrate to the satisfaction of the *FCA* that the position is:

(i) used for one of the hedging purposes in (1)(a) or (1)(b); and

(ii) of a non-trading or structural nature.

(4) This *rule* replaces article 352(2) *UK CRR* where that article would otherwise apply under ■ MIFIDPRU 4.12.2R.

4.11.10 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 specified in ■ MIFIDPRU 4.14.3R(7).

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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 4.11.8R 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 31 December 2021.

(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 reference in Title IV of Part Three of the *UK CRR* to:

(i) article 363 of the *UK CRR* (permission to use internal models) refers to MIFIDPRU 4.12.4R to MIFIDPRU 4.12.7R; and

(ii) permissions granted under article 363 of the *UK CRR* refers to equivalent permissions granted under MIFIDPRU 4.12.4R to MIFIDPRU 4.12.7R.

4.12.2A R (1) When applying the *UK CRR* for the purposes of this section, a *firm* must apply the following, as modified by (2):

(a) the *Appropriately Diversified Indices RTS*;

(b) the *Market Definition RTS*; and

(c) the *Non-Delta Risk of Options RTS*.

(2) The relevant modifications are as follows:

(a) a reference to an "institution" is a reference to the *firm*;

(b) a reference to "Regulation (EU) No 575/2013" is a reference to the *UK CRR* as modified by the *rules* in *MIFIDPRU*;

(c) a reference to an "own funds requirement" is a reference to the contribution of a position to the *firm's K-NPR requirement*; and

(d) a reference to the calculation of requirements "on a consolidated basis" is a reference to the calculation of those requirements on a *consolidated basis* under ■ MIFIDPRU 2.5.

[**Note**: BTS 525/2014, BTS 528/2014 and BTS 945/2014.]

4.12.2B R Where a provision in Title IV of Part Three of the *UK CRR* requires a *firm* to determine a risk weighting by reference to the Standardised Approach to credit risk, for the purposes of this section, a *firm* must:

(1) apply the provisions in the *UK CRR* relating to the Standardised Approach to credit risk in the form in which they stood on 31 December 2021; but

(2) for the purposes of determining any mapping of credit quality steps under the provisions in (1), use the ECAI mappings applied by the *PRA* for the purposes of the rules in the *PRA Rulebook* relating to the Standardised Approach to credit risk for CRR firms, as amended from time to time.

[**Note**: BTS 2016/1799.]

4.12.2C G (1) Certain market risk provisions in the *UK CRR* (in the form in which it stood on 31 December 2021) require a *firm* to consider the underlying credit risk attaching to a position under the *UK CRR* Standardised Approach to credit risk. In certain cases, the credit risk rules require a *firm* to determine the risk attaching to the position by reference to "credit quality steps", which are mapped to credit ratings issued by particular *credit rating agencies*. As the credit risk requirements in the *UK CRR* are no longer directly relevant under *MIFIDPRU*, the *FCA* will no longer be maintaining an *FCA* version of the ECAI credit quality step mappings in BTS 2016/1799 for these purposes.

(2) The effect of ■ MIFIDPRU 4.12.2BR is that where a *firm* needs to determine the underlying credit risk of a position for the purposes of the *K-NPR requirement* by reference to credit quality steps, the *firm* should use the updated ECAI mappings maintained by the *PRA* for the purposes of the Standardised Approach to credit risk as it applies to CRR firms under the *PRA Rulebook*.

4.12.2D R A *firm* may treat the currency pairs listed in ■ MIFIDPRU 4 Annex 13R as closely correlated for the purposes of article 354(1) of the *UK CRR*.

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 is specified in the *UK CRR*, it must consider whether:

(a) the position is sufficiently similar to a position for which a treatment is 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 requirements 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 requirements 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* of positions under this *rule* in its *trading book* policy statement.

Permission to use internal models

4.12.4 R

(1) A *firm* must obtain prior permission from 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 in (1), a *firm* must:

(a) complete the application form in MIFIDPRU 4 Annex 2R and submit it to the *FCA* using the *online notification and application system*; and

(b) in the application, demonstrate to the satisfaction of the *FCA* that:

(i) the *firm* meets the 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; and

(ii) the internal model 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* for each risk category in (1).

4.12.5 G ■ MIFIDPRU 4.12.8R to ■ MIFIDPRU 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* that has a permission under ■ MIFIDPRU 4.12.4R for an internal model must obtain approval from the *FCA* before it:

(a) implements a material change to the use of the model; or

(b) makes 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 article 3 (to the extent that it relates to the Internal Models Approach (IMA)), articles 7a and 7b and Annex III 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 ■ MIFIDPRU 4 Annex 3R and submit it to the *FCA* using the *online notification and application system*; 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 as part of the application in (a).

4.12.7 R (1) A *firm* that has a permission under ■ MIFIDPRU 4.12.4R for an internal model must notify the *FCA* before it:

(a) implements a change to the use of the model that is not a material change; or

(b) extends the use of the model in a manner that is not material.

(2) A *firm* must notify the *FCA* by completing the form in ■ MIFIDPRU 4 Annex 4R and submitting it using the *online notification and application system*.

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* must:

(1) identify any material risks (or group of risks are material in aggregate) that are not captured by those models;

(2) hold *own funds* to cover those risk(s) in addition to the *own funds* required to comply with the *K-NPR requirement*, calculated in accordance with Part Three, Title IV, Chapter 5 of the *UK CRR*; and

(3) hold additional *own funds* for value-at-risk (VaR) and stressed value-at-risk (sVaR) models that apply to the *firm*.

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4.12.9 G

(1) The methodology for identifying the risks in ■ MIFIDPRU 4.12.8R and calculating additional *own funds* for VaR and sVaR 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 sVaR 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, but the *FCA* may request more frequent analysis. 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 permission for the relevant internal model, but are not adequately captured by the relevant internal model.

(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 sVaR metric for each risk factor within scope of the framework. The stressed period for the RNIV framework should be consistent with that used for sVaR. No offsetting or diversification may be recognised across risk factors included in the RNIV framework. The multipliers used for VaR and sVaR should be applied to generate a *K-NPR requirement*.

(b) If it is not appropriate to calculate a VaR and sVaR 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

(1) A *MIFIDPRU investment firm* may use its own estimates for delta for the purposes of the standardised approach for options under article 329, article 352(1) or article 358 of the *UK CRR* if:

(a) the option is:

(i) an over-the-counter option; or

(ii) is traded on an exchange, but delta for the option is not available from that exchange;

(b) the *firm* adequately reflects non-delta risks in the *K-NPR requirement* in accordance with the *Non-Delta Risk of Options RTS*;

(c) 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;

(d) the *firm* notifies the *FCA* that the requirements in (a) to (c) have been met before the *firm* begins to use its own estimates for the relevant delta; and

(e) the notification in (d) is made using the form in ■ MIFIDPRU 4 Annex 5R and submitted using the *online notification and application system*.

(2) The value of delta is 1 where:

(a) a *MIFIDPRU investment firm* is not permitted to use its own estimates for delta in accordance with (1); and

(b) if the option is traded on an exchange, delta is not available from that exchange.

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* does not comply with the risk mitigation plan within the mandated timeframe, the *FCA* may take further supervisory measures. This may include variation of a *firm's Part 4A permission* so that the *firm* is no longer allowed to trade the relevant option types.

Minimum standards for own estimates of delta

4.12.12 G The sophistication of a pricing model 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 recalculated at least daily. A *firm* should also recalculate delta promptly if there are 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.

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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 delta is 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 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) sets out 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. A *firm* that wishes to use sensitivity models to calculate interest rate risk on derivative instruments in accordance with article 331(1) of the *UK CRR* should refer to ■ MIFIDPRU 4.12.66R.

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 to calculate addends. If a *firm* believes that an overshooting should not count for that purpose, it should seek a variation of its VaR model permission from the *FCA* in accordance with ■ MIFIDPRU 4.12.4R to exclude the overshooting.

(2) An 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 a *firm's* 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 if 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 for which 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, as set out in 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	or	A short position if the contract involves an actual (or notional) pur-

Instrument	Notional positions	
	of the underlying equity	chase 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 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 in ■ MIFIDPRU 4.12.30G are set out 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 is a short position 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 the price prevailing at contract expiry, 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, a notional position should be derived for each of the reference dates used in the averaging period to calculate the average price, which:

(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) be 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

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 to use an internal model.

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 generally sets out the broad classes of position within each risk category in its scope. It may also specify how individual products within one of the classes may be brought into or taken out of the scope of the VaR model permission. The broad classes of permission are:

(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.

4

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, the *firm* may use proxies or any other reasonable value-at-risk measurement if the model meets the requirements in article 367(2)(e) of the *UK CRR* (Requirements on risk measurement). The technique must be appropriate and must not materially understate the modelled risks.

4.12.43 G Data may be 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, which takes account of the illiquidity of the risk factor or position.

4.12.44 G A *firm* is expected to update data sets to maintain standards of reliability in accordance with the frequency set out in its VaR model permission, or more frequently if necessary due to volatility in market prices or rates. 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 A *firm* should demonstrate its ability to comply with the requirements for a VaR model permission. In general, a *firm* should have a back-testing programme in place and should provide 3 *months* of back-testing history.

4.12.47 G A *firm* should 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. Therefore, where the *firm* experiences an overshooting and already has 4 or more overshootings during the previous 250 *business days*, changes to the multiplication factor resulting 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 a *firm's* processes and documentation relating to the derivation of profit and loss used for back-testing when assessing a VaR model permission application under ■ MIFIDPRU 4.12.4R. 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 Under ■ MIFIDPRU 4.12.6R, a *firm* must provide the *FCA* with details of any significant planned changes to the VaR model before those changes are implemented. This must include detailed information about the nature of the change, including an estimate of the impact on VaR numbers and the incremental risk charge. Material changes to internal models or material extensions to the use of internal models will require prior approval from the *FCA*.

4

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 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 Under article 365 of the *UK CRR* (VaR and sVaR calculation), a *firm* that uses an internal model for calculating its *K-NPR requirement* must calculate, at least weekly, a sVaR of their current portfolio. The *FCA* would expect a sVaR internal model to contain the features in ■ MIFIDPRU 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 A *firm* should calculate the sVaR measure to be greater than or equal to the average of the second and third 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 A *firm* should ensure that the sVaR period chosen is equivalent to the period that would maximise VaR, given the *firm's* portfolio. 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 reasons 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 uses 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 reasons for the selection of key major risk factors used to find the period of significant financial stress;

(3) a summary of ongoing internal monitoring of stressed period selection for the 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), including a review of the ladders/matrices or spot/vol-matrices, ensuring that they are extended to include wider shocks to risk factors that occur in stress scenarios; and

(7) minutes of risk committee meetings or other evidence of governance and senior management oversight of sVaR methodology.

4.12.62 G Under article 372 of the *UK CRR* (Requirement to have an internal IRC model), a *firm* that uses an internal model for calculating own funds requirements for specific risk of traded debt instruments must 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 into account actual close-out periods during periods of illiquidity.

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 use the entire history of spreads regardless of migration. Point-in-time estimates are not acceptable, unless the *firm* can demonstrate that they are as conservative as long-term averages.

4

Dependence of the recovery rate on the economic cycle

4.12.65 G To achieve a soundness standard comparable to those under the Internal Ratings Based (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 its quarterly reporting to the *FCA*. A *firm* should note that for trading portfolios that contain long and short positions, downturn estimates will not be a conservative choice in all cases.

Permission to use sensitivity models to calculate interest rate risk on derivative instruments

4.12.66 R (1) A *firm* must obtain prior permission from the *FCA* to use a sensitivity model in accordance with article 331(1) of the *UK CRR* to calculate the interest rate risk for positions in:

(a) derivative instruments under articles 328 to 330 of the *UK CRR*; or

(b) any bond which is amortised over its residual life, rather than via one final payment of principal.

(2) To obtain the permission in (1), a *firm* must:

(a) where the permission relates to one or more of the derivative instruments in (1)(a), mark to market the instruments and manage the interest rate risk on the instruments on a discounted cash flow basis;

(b) complete the form in ■ MIFIDPRU 4 Annex 6R and submit it using the *online notification and application system*; and

(c) in its application under (b), demonstrate to the satisfaction of the *FCA* that:

(i) the model generates positions that have the same sensitivity to interest rate changes as the underlying cash flows; and

(ii) the sensitivity in (i) is assessed with reference to independent movements in sample rates across the yield curve, with at least one sensitivity point in each of the maturity bands set out in Table 2 in article 339 of the *UK CRR*.

(3) Where a *firm* has been granted permission to apply a sensitivity model under this *rule*, any relevant positions must be included in the *firm's* calculation of its general risk of debt instruments for its *K-NPR requirement*.

4.13 K-CMG requirement

4.13.1 R

(1) Subject to (2), the *K-CMG requirement* applies to a *MIFIDPRU investment firm* for *portfolios* for which the firm has been granted a *K-CMG permission*.

(2) A *MIFIDPRU investment firm* must include a position specified in MIFIDPRU 4.11.8R 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 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 these 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

In an application for a *K-CMG permission*, a *firm* must identify each *portfolio* for which it wishes to calculate a *K-CMG requirement*.

4.13.4 R

MIFIDPRU 4.11.8R(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 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 calculated using 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*.

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 satisfy 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 commercial negotiations that may result in the *clearing member* or *authorised central counterparty* accepting a lower amount of margin than the model requires.

4.13.8 G The calculation in ■ MIFIDPRU 4.13.5R means that for each trading *day* during the calculation period, the *firm* must calculate the total combined margin 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* for a *portfolio*, a *firm* must:

(1) complete the application form in ■ MIFIDPRU 4 Annex 7R and submit it using the *online notification and application system*;

(2) in the application, demonstrate to the satisfaction of the *FCA* that:

(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) a *MIFIDPRU investment firm* (which may be the *firm* itself, where it is self-clearing);

(ii) a *UK credit institution*;

(iii) a *designated investment firm*;

(iv) a *third country investment firm*; or

(v) a *credit institution* established in a *third country*;

(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) where the *clearing member* in (b) (where applicable, including the *firm* itself) is a *MIFIDPRU investment firm* or a *third country investment firm*, the *authorised central counterparty* in (b); or

(ii) in any other case, the relevant *clearing member* in (b);

(f) the reasons for the *firm's* choice of calculating a *K-CMG requirement* for the *portfolio* have been clearly documented and 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.

4.13.10 R

(1) A *firm* that has been granted a *K-CMG permission* for a *portfolio* must notify the *FCA* immediately if it becomes aware that any of the conditions in ■ MIFIDPRU 4.13.9R are no longer met in relation to the *portfolio*.

(2) The notification in (1) must be made using the form in ■ MIFIDPRU 4 Annex 8R and submitted via the *online notification and application system*.

4.13.11 G

The *FCA* may revoke a *K-CMG permission* for a *portfolio* where one or more of the conditions in ■ MIFIDPRU 4.13.9R is no longer met in relation to that *portfolio*. The *FCA* may 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.

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4.13.12 R A *firm* that is an *indirect client* of a *clearing member* may obtain a *K-CMG permission* if:

(1) the indirect clearing arrangement satisfies all of the conditions in ■ MIFIDPRU 4.13.9R and both the *clearing member* and the *client* of the *clearing member* that is providing clearing services to the *firm* are entities that are listed in ■ MIFIDPRU 4.13.9R(2)(c); and

(2) the *FCA* is satisfied that the relevant arrangement does not result in undue risks.

4.13.13 R (1) A *firm* that is relying on a *K-CMG permission* must ensure that:

(a) the *individuals* in 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 this understanding of the 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)* for 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* is responsible 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) includes:

(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.

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) An 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*.

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). The 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. If 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* is determined by the underlying (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 a downwards adjustment. 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* reasons for choosing a *K-CMG requirement* under ■ MIFIDPRU 4.13.9R(2)(f) have 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.

4.13.18 G

(1) For the purposes of ■ MIFIDPRU 4.13.9R(2)(g), the fact that a *K-CMG permission* for a *portfolio* may result in a *K-CMG requirement* that is lower than the equivalent *K-NPR requirement* for that *portfolio* does not automatically 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*. 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 that type of *portfolio*. A *firm* that is applying for a *K-CMG permission* should provide a clear explanation of how the conditions in ■ MIFIDPRU 4.13.9R(2) are satisfied for the *portfolio*. 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 a *K-CMG permission* for 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) does not 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 *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*, 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;

(b) specify the date on which the *K-CMG permission* should cease to apply to the *firm*; and

(c) be made using the form in MIFIDPRU 4 Annex 9R and submitted using the *online notification and application system*.

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4.13.21 G Where a *firm* has submitted a notification in MIFIDPRU 4.13.20R(2), the *FCA* will not normally grant another *K-CMG permission* for the same *portfolio* until at least 24 *months* after the previous *K-CMG permission* ceased to apply.

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4.14 K-TCD requirement

4.14.1 R

(1) The *K-TCD requirement* of a *MIFIDPRU investment firm* is 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 the 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(2)-(7), are carried out by a *firm* that has the necessary *permissions* to *deal on own account*.

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 specified in ■ MIFIDPRU 4.14.3R(2)-(7). This applies even if the *firm's* involvement in the transaction does not constitute *dealing on own account* and the transaction may not be recorded in its *trading book*.

(2) 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 if it is involved in a transaction that would otherwise fall within ■ MIFIDPRU 4.14.3R(2)-(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 *CCP*, where all of the following conditions are met:

the positions and assets of the *firm* related to the contracts are distinguished and segregated, at the level of both the *clearing member* and the *CCP*, from the position and assets of 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 the 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.

4.14.4 R A derivative contract that is directly or indirectly cleared through an *authorised central counterparty* is deemed to meet the conditions in ■ MIFIDPRU 4.14.3R(1)(a).

4.14.5 R The *K-TCD requirement* does not apply to transactions with the following 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*.

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) 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) To apply for *FCA* consent under (1), a *firm* must complete the form in MIFIDPRU 4 Annex 10R and submit it using the *online notification and application system*.

Calculation of TCD own funds requirement

4.14.7 R The *TCD own funds requirement* for each transaction or *netting set* must be calculated using 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

Exposure value

4.14.8 R The exposure value must be calculated using the following formula:

Exposure value = Max (0; RC + PFE – C)

where:

(1) RC = the replacement cost calculated in accordance with ■ MIFIDPRU 4.14.9R (which may be a positive value, thereby increasing the exposure value, or a negative value, thereby decreasing the exposure value)

(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 ■ MIFIDPRU 4.14.25R (which may be a positive value, thereby decreasing the exposure value, or a negative value, thereby increasing the exposure value)

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.

Potential future exposure

4.14.10 R (1) A *firm* is required to calculate potential future exposure (PFE) only 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.

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.

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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 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 contracts other than written options 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, a *firm* may cap the PFE in relation to that option 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, with long positions to be treated as positive amounts and short positions to be treated as negative amounts.

(2) Subject to (3), a *firm* must assign derivative contracts to separate asset classes as follows:

(a) except as specified in (b) to (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 if:

(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. The 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) For derivative contracts relating to foreign exchange, a *firm* may net contracts relating to a currency pair (for example, USD/EUR) against contracts relating to the inverse pair (i.e. in this example, EUR/USD) by treating one pair as a long position and the inverse pair as a short position.

(5) For interest rate derivative contracts that have multiple legs, the *firm* should add together the notional amounts of the positive (receive) and negative (pay) legs, after adjusting for the duration and the supervisory delta in accordance with the calculation of the effective notional amount in ■ MIFIDPRU 4.14.20R. The net amount should then be included in the calculation of PFE.

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 absolute value of 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 contracts other than written options 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* using the following formula:

$$\text{PFEnet} = \frac{\text{RCnet}}{\text{RCgross}} \cdot \text{PFEgross}$$

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 absolute value of 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 is 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*, and

(5) where the value of RCgross is zero, then the result of RCnet divided by RCgross is deemed to be:

(a) a value of '1' when a *netting set* consists of a single derivative contract; or

(b) a value of zero when a *netting set* consists of more than one derivative contract.

4.14.18A G For the purposes of ■ MIFIDPRU 4.14.18R(5), a *firm* should:

(1) still consider any residual risk of potential harm that may arise in connection with using the derivative netting ratio approach as part of the *ICARA process* under ■ MIFIDPRU 7; and

(2) be consistent in its approach to allocating transactions to *netting sets*.

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 is calculated as follows:

Effective notional amount = N * D * SD

(a) N = the notional amount, determined in accordance with (2);

(b) D = the duration, calculated in accordance with (3); and

(c) SD = the supervisory delta, calculated in accordance with (5).

(2) The notional amount, unless clearly stated and fixed until maturity, is 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

(ii) 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 underlying 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 of 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 ■ MIFIDPRU 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;

(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; and

(iii) the notification in (ii) is made using the form in ■ MIFIDPRU 4 Annex 5R and submitted using the *online notification and application system*;

(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 is 1 or -1; and

(c) in each case, the supervisory delta must reflect the relationship between the contract and the underlying, whereby a contract that increases exposure (by increasing RC) as the underlying increases shall have a positive supervisory delta, and a contract that decreases exposure (by decreasing RC) as the underlying increases shall have a negative supervisory delta.

4.14.21 R

(1) When applying the minimum standards in ■ MIFIDPRU 4.12.12G to ■ MIFIDPRU 4.12.18G for the purposes of ■ MIFIDPRU 4.14.20R(5)(a), the standards apply with the following modifications:

(a) a reference to the "standardised approach" is a reference to the *rules* in this section relating to the calculation of the *K-TCD requirement*; and

(b) a reference to the *K-NPR requirement* is a reference to the *K-TCD requirement*.

(2) In addition to the minimum standards in ■ MIFIDPRU 4.12.12G to ■ MIFIDPRU 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 for small changes in the market value of the underlying.

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%

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.

4

(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.

4.14.25 R

(1) A *firm* must apply the volatility adjustments in (2) to all transactions referred to in ■ MIFIDPRU 4.14.3R.

(2) Collateral for bilateral and cleared transactions shall be subject to volatility adjustments in accordance with the following table:

(A) Asset class		(B) Volatility adjustment: repurchase transactions and securities lending and borrowing transactions	(C) Volatility adjustment: other transactions
Debt securities issued by central governments or central banks	≤ 1 year	0.707%	1%
	> 1 year ≤ 5 year	2.121%	3%
	> 5 years	4.243%	6%

(A) Asset class		(B) Volatility adjustment: repurchase transactions and securities lending and borrowing transactions	(C) Volatility adjustment: other transactions
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%

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 ■ MIFIDPRU 4.14.25R applies. 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 has been applied is therefore 94.

Netting

4.14.28 R For the purposes of calculating its *K-TCD requirement*, 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:

4

(a) the transactions are covered by a 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) in the event of default of a counterparty, the netting contract does not contain any clause that 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.

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; and

(e) credits and loans referred to in ■ MIFIDPRU 4.14.3R(7).

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4.15 K-DTF requirement

4.15.1 R Subject to ■ MIFIDPRU 4.15.11R, the *K-DTF requirement* of a *MIFIDPRU investment firm* is equal to the sum of:

(1) 0.1% of *average DTF* attributable to *cash trades*; and

(2) 0.01% of *average DTF* attributable to *derivatives trades*.

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).

(3) Where a *firm* engages in either activity in (2), it must include those transactions in the measurement of its *DTF*.

(4) 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* includes 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*.

4.15.4 R (1) A *firm* must calculate the amount of its *average DTF* as:

(a) taking the total *DTF* as measured throughout each *business day* in each of the previous 9 *months*;

(b) excluding the daily values for the most recent 3 *months*; and

(c) calculating the arithmetic mean of the daily values for the remaining 6 *months*.

(2) When measuring the value of *DTF* for a particular *business day*, a *firm* must convert any amounts in foreign currencies on that date into the *firm's* functional currency.

(3) For the purposes of the currency conversion in (2), a *firm* must:

(a) determine the conversion rate by reference to an appropriate market rate; and

(b) record the rate that was chosen.

4.15.5 G

(1) The effect of ■ MIFIDPRU 4.15.4R(2) is that when measuring the value of *DTF* at the end of each *business day*, a *firm* must apply the relevant conversion rate on that date to any amounts in foreign currencies forming part of the *DTF* attributable to that *business day*. The *DTF* for each preceding *business day* should continue to be measured by reference to the conversion rate that was applicable on that preceding day.

(2) For the purposes of ■ MIFIDPRU 4.15.4R(3), where a *firm* is carrying out a conversion that involves sterling, the *FCA* considers that an example of an appropriate market rate would be the relevant daily spot exchange rate against sterling published by the Bank of England.

4.15.6 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 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 4.15.8R.

4.15.7 G

For *cash trades* relating to exchange-traded options, the amount paid or received on the trade under ■ MIFIDPRU 4.15.6R(2) is the premium paid for the option.

4.15.8 R

(1) For the purposes of ■ MIFIDPRU 4.15.6R(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

4.15.9 G When measuring *DTF* for the purposes of MIFIDPRU 4.15.4R, a *firm* must include transactions executed by a *firm* in its own name either for itself or on behalf of a *client*.

4.15.10 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 *average DTF* under MIFIDPRU 4.15.4R, a *firm* must use the modified calculation in MIFIDPRU TP 4.11R(1) with the following adjustments:

(a) in MIFIDPRU TP 4.11R(1)(b), *n* is the relevant number of *months* for which the *firm* has had a *daily trading flow* (with the *month* during which the *firm* begins that activity being counted as *month* zero); and

(b) during *month* zero of the calculation, the *firm* must:

(i) use a best efforts estimate of expected *DTF* for that *month* based on its projections when beginning the new activity; and

(ii) use the estimate in (i) as its *average DTF*;

(c) during *month* 1 of the calculation and each *month* thereafter, the *firm* must apply the approach in (a) using observed historical data from the preceding *months*;

(d) the modified calculation ceases to apply on the date that falls 9 *months* after the date on which the *firm* first had a *daily trading flow*.

Adjusted coefficient in stressed market conditions

4.15.11 R (1) This *rule* applies where a *firm's* measurement of its *DTF* under MIFIDPRU 4.15.4R includes a proportion of *daily trading flow* that occurred on a trading segment of a *trading venue* to which stressed market conditions (as defined in article 6 of the *Market Making RTS*) applied.

(2) Where this *rule* applies, a *firm* may apply the following adjusted coefficients:

(a) for *cash trades*, a coefficient determined in accordance with (3) instead of the relevant coefficient in MIFIDPRU 4.15.1R(1); or

(b) for *derivatives trades*, a coefficient determined in accordance with (4) instead of the relevant coefficient in MIFIDPRU 4.15.1R(2).

(3) For *cash trades*, the adjusted coefficient must be determined by using the following formula:

CadjCash = C * (DTFexcl/DTFincl)

where:

(a) CadjCash = the adjusted coefficient in (2)(a);

(b) C = the original coefficient in MIFIDPRU 4.15.1R(1);

(c) DTFexcl = the *average DTF* of *cash trades* calculated in accordance with MIFIDPRU 4.15.4R, excluding the value of any *cash trade*

that occurred on a trading segment of a *trading venue* between the time at which the *trading venue* determined that:

(i) stressed market conditions began to apply; and

(ii) stressed market conditions ceased to apply;

(d) DTFincl = the *average DTF* of all *cash trades* calculated in accordance with MIFIDPRU 4.15.4R.

(4) For *derivative trades*, the adjusted coefficient must be determined by using the following formula:

CadjDer = C * (DTFexcl/DTFincl)

where:

(a) CadjDer = the adjusted coefficient in (2)(b);

(b) C = the original coefficient in MIFIDPRU 4.15.1R(2);

(c) DTFexcl = the *average DTF* of *derivative trades* calculated in accordance with MIFIDPRU 4.15.4R, excluding the value of any *derivative trade* that occurred on a trading segment of a *trading venue* between the time at which the *trading venue* determined that:

(i) stressed market conditions began to apply; and

(ii) stressed market conditions ceased to apply;

(d) DTFincl = the *average DTF* of all *derivative trades* calculated in accordance with MIFIDPRU 4.15.4R.

4.15.12 G

(1) MIFIDPRU 4.15.11R permits a *firm* to apply a reduced coefficient for the purposes of determining its *K-DTF requirement* where part of the *firm's average DTF* for the relevant period is attributable to transactions that took place on a segment of a *trading venue* to which stressed market conditions applied. The relevant coefficient must be calculated separately for *cash trades* and *derivative trades*.

(2) MIFIDPRU 4.15.11R permits a *firm* to substitute a reduced coefficient that applies to the *firm's average DTF* for the relevant calculation period. The size of the reduction is proportional to the value of trades that were placed on a segment of a *trading venue* during stressed market conditions within the calculation period, relative to the overall value of trades entered into by the *firm* during that period.

4.15.13 G

(1) The following is an example of how the adjusted coefficient in MIFIDPRU 4.15.11R applies.

(2) A *firm* executes total *cash trades* in its own name worth £9,600m during the 6-*month* calculation period for determining *average DTF* under MIFIDPRU 4.15.4R(1)(c). That 6-*month* period includes 128 *business days*.

(3) The total £9,600m of *cash trades* includes £375m of *cash trades* that were executed on *trading venues* during stressed market conditions (as defined in article 6 of the *Market Making RTS*).

(4) In this example:

DTFincl = £9,600m / 128 days = £75m

DTFexcl =(£9,600m - £375m) / 128 days = £9,225m / 128 days = £72.07m

C = 0.1%

CadjCash =0.1% x (72.07 / 75) = 0.1% x 0.961 = 0.0961%

(5) To calculate its *K-DTF requirement* for this calculation period, the *firm* multiplies the full amount of its *average DTF* for the period by the adjusted coefficient (CadjCash). Therefore:

K-DTF requirement for *cash trades* = £75m x 0.0961% = £72,075

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*.

Application under MIFIDPRU 4.11.9R – permission to exclude hedges from article 352 of the UK CRR

[Editor's note: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 4 Annex 1R Application under MIFIDPRU 4.11.9R for permission to exclude positions taken to hedge against the adverse effect of the exchange rate on the o.pdf

Application under MIFIDPRU 4.12.4R for permission to use an advanced internal market risk model

[Editor's note: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 4 Annex 2R Application under MIFIDPRU 4.12.4R for permission to use an advanced internal market risk model.pdf

Application under MIFIDPRU 4.12.6R – material change or extension to internal market risk models

[Editor's note: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 4 Annex 3R Application under MIFIDPRU 4.12.6R for permission to make a material change or a material extension to the use of an advanced internal market .pdf

Notification under MIFIDPRU 4.12.7R – non-material change or extension to use of an internal model

[Editor's note: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 4 Annex 4R Notification under MIFIDPRU 4.12.7R of the intended non-material change or extension to the use of an internal model.pdf

Notification under MIFIDPRU 4.12.10R and 4.14.20R – use of own delta estimates for standardised approach for options (K-NPR)

[Editor's note: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 4 Annex 5R Notification under MIFIDPRU 4.12.10R and 4.14.20R of the intended use of own delta estimates.pdf

Application under MIFIDPRU 4.12.66R to use sensitivity models to calculate interest rate risk on derivative instruments

[Editor's note: the form can be found at this address: MIFIDPRU4_Annex 6R_20220101.pdf]

Application under MIFIDPRU 4.13.9R – permission for K-CMG

[Editor's note: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 4 Annex 7R Application under MIFIDPRU 4.13.9R for permission to apply K-CMG to a portfolio, instead of K-NPR.pdf

Notification under MIFIDPRU 4.13.10R – K-CMG conditions no longer satisfied

[Editor's note: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 4 Annex 8R Notification under MIFIDPRU 4.13.10R that a firm no longer satisfies all the conditions of a K-CMG.pdf

Notification under MIFIDPRU 4.13.20R – cancellation of K-CMG permission

[Editor's note: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 4 Annex 9R Notification under MIFIDPRU 4.13.20R to cancel a K-CMG permission.pdf

Application under MIFIDPRU 4.14.6R – permission to exclude transactions with some counterparties from K-TCD

[Editor's note: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 4 Annex 10R Application under MIFIDPRU 4.14.6R for permission to exclude transactions with some counterparties.pdf

Application under MIFIDPRU 4.5.9R – permission to rebase fixed overhead requirement

[Editor's note: the form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 4 Annex 11R Application under MIFIDPRU 4.5.9R for permission to rebase fixed overhead requirement to a lower amount.pdf

Guidance on the interaction between K-AUM and K-COH

(1) This annex contains *guidance* on the interaction between the *K-AUM requirement* and the *K-COH requirement* in certain scenarios.

(2) The scenarios contained in this annex are not intended to be exhaustive. *MIFIDPRU investment firms* should analyse any arrangement that is not covered by the *guidance* in this annex by reference to the *rules* and *guidance* in ■ MIFIDPRU 4.7 (in relation to the *K-AUM requirement*) and ■ MIFIDPRU 4.10 (in relation to the *K-COH requirement*). *Firms* should also refer to the *guidance* in ■ MIFIDPRU 4.6.2G.

(1) The following table indicates whether a *MIFIDPRU investment firm* is required to calculate a *K-AUM requirement* or a *K-COH requirement* in a particular scenario.

(2) In the table, a reference to:

(a) "DPM" is to the activity of discretionary *portfolio management*;

(b) "IF1" is to the first *MIFIDPRU investment firm*;

(c) "IF2" is to the second *MIFIDPRU investment firm*;

(d) "IF3" is to the third *MIFIDPRU investment firm*;

(e) a dash (-) indicates that there is no second *MIFIDPRU investment firm* involved in the relevant scenario;

(f) "Yes" means that the relevant requirement applies to that activity; and

(g) "No" means that the relevant requirement does not apply to that activity.

	IF1	IF1 K-AUM	IF1 K-COH	IF2	IF2 K-AUM	IF2 K-COH
1	DPM, executes the resulting orders	Yes	No	-	-	-
2	DPM, delegates DPM to IF2	Yes	No	Undertakes delegated DPM and executes the resulting orders	No	Yes
3	DPM, delegates DPM to IF2. Receives orders back from IF2 to execute	Yes	No	Undertakes delegated DPM and passes orders back to IF1 to execute	No	No
4	DPM, delegates DPM to IF2	Yes	No	Undertakes delegated DPM and passes orders back to IF3 to executeNoNo	No	No

	IF1	IF1 K-AUM	IF1 K-COH	IF2	IF2 K-AUM	IF2 K-COH
5	DPM, delegates DPM to IF2. Receives orders back from IF2 and passes them to IF3 to execute	Yes	No	Undertakes delegated DPM and passes orders back to IF1	No	No
6	DPM, passes orders to IF2 for execution	Yes	No	Executes orders on behalf of IF1	No	Yes
7	DPM, receives ongoing advice from IF2	Yes	No	Gives ongoing advice on assets managed by IF1	Yes	No
8	Provides ongoing investment advice in relation to assets and executes resulting orders	Yes	No	-	-	-
9	Provides ongoing investment advice in relation to assets, with orders executed by IF2	Yes	No	Executes orders received from IF1 for execution	No	Yes
10	Provides "one-off" investment advice to a client. Any orders are passed to IF2 for execution	No	Yes	Executes orders received from IF1 for execution	No	Yes
11	Provides "one-off" investment advice to a client. Executes any resulting orders	No	Yes	-	-	-
12	Execution only of client orders	No	Yes	-	-	-
13	Client orders received are passed to IF2	No	Yes	Executes orders received from	No	Yes

	IF1	IF1 K-AUM	IF1 K-COH	IF2	IF2 K-AUM	IF2 K-COH
	for execution			IF1 for execution		

K-NPR requirement - provisions on closely correlated currencies

Application and purpose

13.1 R

This annex specifies currency pairs that may be treated as closely correlated for the purposes of article 354(1) of the *UK CRR* (as applied by MIFIDPRU 4.12.2R) when a *MIFIDPRU investment firm* or *UK parent entity* is calculating its *K-NPR requirement*.

13.2 R

The following table lists closely correlated currencies for the purposes of MIFIDPRU 4 Annex 13.1R:

Part 1 **List of closely correlated currencies against the euro (EUR)**

Albanian lek (ALL), Bosnia and Herzegovina mark (BAM), Bulgarian lev (BGN), Czech koruna (CZK), British pound (GBP), Croatian kuna (HRK), Moroccan dirham (MAD), Romanian leu (RON).

Part 2 **List of closely correlated currencies against the Arab Emirates dirham (AED)**

Angolan kwanza (AOA), Canadian dollar (CAD), Chinese yuan (CNY), British pound (GBP), Hong Kong dollar (HKD), Lebanese pound (LBP), Macau pataca (MOP), Peruvian nuevo sol (PEN), Philippine peso (PHP), Singapore dollar (SGD), Thai baht (THB), Taiwanese dollar (TWD), US dollar (USD).

Part 3 **List of closely correlated currencies against the Albanian lek (ALL)**

Bosnia and Herzegovina mark (BAM), Bulgarian lev (BGN), Czech koruna (CZK), Danish krone (DKK), Croatian kuna (HRK), Moroccan dirham (MAD), Romanian leu (RON), euro (EUR).

Part 4 **List of closely correlated currencies against the Angolan kwanza (AOA)**

Arab Emirates dirham (AED), Chinese yuan (CNY), Hong Kong dollar (HKD), Lebanese pound (LBP), Macau pataca (MOP), Peruvian nuevo sol (PEN), Philippine peso (PHP), Singapore dollar (SGD), Thai baht (THB), Taiwanese dollar (TWD), US dollar (USD).

Part 5 **List of closely correlated currencies against the Bosnia and Herzegovina mark (BAM)**

Albanian lek (ALL), Bulgarian lev (BGN), Czech koruna (CZK), Danish krone (DKK), British pound (GBP), Croatian kuna (HRK), Moroccan dirham (MAD), Romanian leu (RON), euro (EUR).

Part 6 **List of closely correlated currencies against the Bulgarian lev (BGN)**

Albanian lek (ALL), Bosnia and Herzegovina mark (BAM), Czech koruna (CZK), Danish krone (DKK), British pound (GBP), Croatian kuna (HRK), Moroccan dirham (MAD), Romanian leu (RON), euro (EUR).

Part 7 **List of closely correlated currencies against the Canadian dollar (CAD)**

Arab Emirates dirham (AED), Hong Kong dollar (HKD), Macau pataca (MOP), Singapore dollar (SGD), Taiwanese dollar (TWD), US dollar (USD).

Part 8 **List of closely correlated currencies against the Chinese yuan (CNY)**

Arab Emirates dirham (AED), Angolan kwanza (AOA), British pound (GBP), Hong Kong dollar (HKD), Lebanese pound (LBP), Macau pataca (MOP), Peruvian nuevo sol (PEN), Philippine peso (PHP), Singapore dollar (SGD), Thai baht (THB), Taiwanese dollar (TWD), US dollar (USD).

Part 9 **List of closely correlated currencies against the Czech koruna (CZK)**

Albanian lek (ALL), Bosnia and Herzegovina mark (BAM), Bulgarian lev (BGN), Danish krone (DKK), Croatian kuna (HRK), Moroccan dirham (MAD), Romanian leu (RON), euro (EUR).

Part 10 **List of closely correlated currencies against the Danish krone (DKK)**

Albanian lek (ALL), Bosnia and Herzegovina mark (BAM), Bulgarian lev (BGN), Czech koruna (CZK), British pound (GBP), Croatian kuna (HRK), Moroccan dirham (MAD), Romanian leu (RON), Singapore dollar (SGD).

Part 11 **List of closely correlated currencies against the British pound (GBP)**

Arab Emirates dirham (AED), Bosnia and Herzegovina mark (BAM), Bulgarian lev (BGN), Chinese yuan (CNY), Danish krone (DKK), Hong Kong dollar (HKD), Croatian kuna (HRK), Lebanese pound (LBP), Moroccan dirham (MAD), Macau pataca (MOP), Singapore dollar (SGD), Taiwanese dollar (TWD), US dollar (USD), euro (EUR).

Part 12 **List of closely correlated currencies against the Hong Kong dollar (HKD)**

Arab Emirates dirham (AED), Angolan kwanza (AOA), Canadian dollar (CAD), Chinese yuan (CNY), British pound (GBP), Lebanese pound (LBP), Macau pataca (MOP), Peruvian nuevo sol (PEN), Philippine peso (PHP), Singapore dollar (SGD), Thai baht (THB), Taiwanese dollar (TWD), US dollar (USD).

Part 13 **List of closely correlated currencies against the Croatian kuna (HRK)**

Albanian lek (ALL), Bosnia and Herzegovina mark (BAM), Bulgarian lev (BGN), Czech koruna (CZK), Danish krone (DKK), British pound (GBP), Moroccan dirham (MAD), Romanian leu (RON), Singapore dollar (SGD), euro (EUR).

Part 14 **List of closely correlated currencies against the South Korean won (KRW)**

Peruvian nuevo sol (PEN), Philippine peso (PHP), Singapore dollar (SGD), Taiwanese dollar (TWD).

Part 15 **List of closely correlated currencies against the Lebanese pound (LBP)**

Arab Emirates dirham (AED), Angolan kwanza (AOA), Chinese yuan (CNY), British pound (GBP), Hong Kong dollar (HKD), Macau pataca (MOP), Peruvian nuevo sol (PEN), Philippine peso (PHP), Singapore dollar (SGD), Thai baht (THB), Taiwanese dollar (TWD), US dollar (USD).

Part 16 **List of closely correlated currencies against the Moroccan dirham (MAD)**

Albanian lek (ALL), Bosnia and Herzegovina mark (BAM), Bulgarian lev (BGN), Czech koruna (CZK), Danish krone (DKK), British pound (GBP), Croatian kuna (HRK), Romanian leu (RON), Singapore dollar (SGD), Thai baht (THB), Taiwanese dollar (TWD), euro (EUR).

Part 17 **List of closely correlated currencies against the Macau pataca (MOP)**

Arab Emirates dirham (AED), Angolan kwanza (AOA), Canadian dollar (CAD), Chinese yuan (CNY), British pound (GBP), Hong Kong dollar (HKD), Lebanese pound (LBP), Peruvian nuevo sol (PEN), Philippine peso (PHP), Singapore dollar (SGD), Thai baht (THB), Taiwanese dollar (TWD), US dollar (USD).

Part 18 **List of closely correlated currencies against the Peruvian nuevo sol (PEN)**

Arab Emirates dirham (AED), Angolan kwanza (AOA), Chinese yuan (CNY), Hong Kong dollar (HKD), South Korean won (KRW), Lebanese pound (LBP), Macau pataca (MOP), Philippine peso (PHP), Singapore dollar (SGD), Thai baht (THB), Taiwanese dollar (TWD), US dollar (USD).

Part 19 **List of closely correlated currencies against the Philippine peso (PHP)**

Arab Emirates dirham (AED), Angolan kwanza (AOA), Chinese yuan (CNY), Hong Kong dollar (HKD), South Korean won (KRW), Lebanese pound (LBP), Macau pataca (MOP), Malaysian Ringgit (MYR), Peruvian nuevo sol (PEN), Singapore dollar (SGD), Thai baht (THB), Taiwanese dollar (TWD), US dollar (USD).

Part 20 **List of closely correlated currencies against the Romanian leu (RON)**

Albanian lek (ALL), Bosnia and Herzegovina mark (BAM), Bulgarian lev (BGN), Czech koruna (CZK), Danish krone (DKK), Croatian kuna (HRK), Moroccan dirham (MAD), euro (EUR).

Part 21 **List of closely correlated currencies against the Singapore dollar (SGD)**

Arab Emirates dirham (AED), Angolan kwanza (AOA), Canadian dollar (CAD), Chinese yuan (CNY), Danish krone (DKK), British pound (GBP), Hong Kong dollar (HKD), Croatian kuna (HRK), South Korean won (KRW), Lebanese pound (LBP), Moroccan dirham (MAD), Macau pataca (MOP), Malaysian ringgit (MYR), Peruvian nuevo sol (PEN), Philippine peso (PHP), Thai baht (THB), Taiwanese dollar (TWD), US dollar (USD).

Part 22 **List of closely correlated currencies against the Thai baht (THB)**

Arab Emirates dirham (AED), Angolan kwanza (AOA), Chinese yuan (CNY), Hong Kong dollar (HKD), Lebanese pound (LBP), Moroccan dirham (MAD), Macau pataca (MOP), Peruvian nuevo sol (PEN), Philippine peso (PHP), Singapore dollar (SGD), Taiwanese dollar (TWD), US dollar (USD).

Part 23 **List of closely correlated currencies against the Taiwanese dollar (TWD)**

Arab Emirates dirham (AED), Angolan kwanza (AOA), Canadian dollar (CAD), Chinese yuan (CNY), British pound (GBP), Hong Kong dollar (HKD), South Korean won (KRW), Lebanese pound (LBP), Moroccan dirham (MAD), Macau pataca (MOP), Malaysian Ringgit (MYR), Peruvian

nuevo sol (PEN), Philippine peso (PHP), Singapore dollar (SGD), Thai baht (THB), US dollar (USD).

Part 24 **List of closely correlated currencies against the US dollar (USD)**

Arab Emirates dirham (AED), Angolan kwanza (AOA), Canadian dollar (CAD), Chinese yuan (CNY), British pound (GBP), Hong Kong dollar (HKD), Lebanese pound (LBP), Macau pataca (MOP), Peruvian nuevo sol (PEN), Philippine peso (PHP), Singapore dollar (SGD), Thai baht (THB), Taiwanese dollar (TWD).

Chapter 5

Concentration risk

5

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 reference to a "*firm*" or "*MIFIDPRU investment firm*" in this chapter is a reference 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 that may give rise to *concentration risk*.

5.1.6 G ■ MIFIDPRU 5.2 is therefore relevant to both 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 that are recorded in the *trading book*.

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).

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 ■ MIFIDPRU 5.10). ■ MIFIDPRU 5.3 sets out an overview of these requirements.

(3) *Rules* and *guidance* on when a *commodity and emission allowance dealer* is 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, whether in the *United Kingdom* or a *third country*, may be treated in the same way as central governments under ■ MIFIDPRU 5.1.13R 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*. A *firm* may have regard to this list when applying the test in ■ MIFIDPRU 5.1.14R to regional governments and local authorities in the *United Kingdom*.

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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.

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

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5.2.1 R A *firm* must monitor and control its *concentration risk* using sound administrative and accounting procedures and robust internal control mechanisms.

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 includes 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:

(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 ■ MIFIDPRU 5.10 contain the *concentration risk* requirements that 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)

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5.4.1 R For the purposes of ■ MIFIDPRU 5.5 to ■ MIFIDPRU 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.

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.

5.4.3 R The *EV* 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.

5.4.4 R When calculating *EVs*, a *firm* must take all reasonable steps to identify underlying assets in relevant transactions and the counterparty of the underlying exposures.

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 *EVs* 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.

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) (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*.

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*.

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* using the following formula:

$$EVE = EV - L$$

where:

L = the *concentration risk soft limit* specified in ■ MIFIDPRU 5.5.1R.

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.*

5.6.3 R A *firm* must make the notification referred to in MIFIDPRU 5.6.2R by completing Part A of the form in MIFIDPRU 5 Annex 1R and submitting it using the *online notification and application system*.

5.7 Calculating K-CON

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5.7.1 R The *K-CON requirement* of a *MIFIDPRU investment firm* is equal to the sum of the *CON own funds requirement* for each *client* or *group of connected clients* for which the *EV* exceeds the *concentration risk soft limit*.

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 own funds requirement for the excess (*OFRE*) in accordance with MIFIDPRU 5.7.3R; and

(2) applying the relevant multiplication factor or factors in accordance with MIFIDPRU 5.7.4R.

5.7.3 R (1) The *OFRE* must be calculated using the following formula:

$$OFRE = \frac{OFR}{EV} \times EVE$$

(2) 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).

(2) 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 using the approach specified for K-NPR in MIFIDPRU 4.12.2R shall only include specific-risk requirements.

(2) A *firm* that calculates a *K-CMG requirement* for a *portfolio* must calculate the *OFR* using the approach specified for K-NPR in MIFIDPRU 4.12.2R, subject to (b).

(2) 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*.

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 1;

(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 1; and

(e) the *CON own funds requirement* is the sum of the amounts calculated in accordance with (d).

(3) Table 1

Column 1:	**Column 2: Factors**
EVE as a percentage of own funds	
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%

5.7.5 G

(1) K-CON is an additional *K-factor* own funds requirement for *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 determine 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 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 shows 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 that 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 shows 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 that 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 2, multiplying each part of the *OFRE* by the applicable factor, and then adding the resulting amounts together:

Application of Table 2

K-CON factor tranche as per Table 1	***EVE* split by tranche**	***OFRE* allocated across K-CON tranche by *EVE* split**	***CON own funds requirement* (*OFRE* × factor in Table 1)**
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

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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.

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 ■ MIFIDPRU 1.1.10R.

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*.

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.

5.9.4 R

A *firm* must make the notification referred to in ■ MIFIDPRU 5.9.3R using Part B of the form in ■ MIFIDPRU 5 Annex 1R, and must submit it using the *online notification and application system.*

5.10 Exclusions

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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) regional governments and *local authorities* of the *UK* or a *third country* which pose no difference in risk compared to a central government covered by (a); 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*.

5.11 Exemption for commodity and emission allowance dealers

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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.

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) If there is 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 using the *online notification and application system*.

Notification under MIFIDPRU 5.6.3R and 5.9.3R that limits for concentration risk have been exceeded

[Editor's note: The forms can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 5 Annex 1R(A) Notification under MIFIDPRU 5.6.3R that the concentration risk soft limit has been exceeded.pdf]

https://www.handbook.fca.org.uk/form/MIFIDPRU 5 Annex 1R(B) Notification under MIFIDPRU 5.9.3R of the concentration risk hard limit breach.pdf

Notifications under MIFIDPRU 5.11.2R in respect of the exemption from K-CON requirement for commodity and emission allowance dealers

[Editor's note: The forms can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 5 Annex 2R Notifications under MIFIDPRU 5.11.2R in respect of the exemption from K-CON requirement.pdf]

Chapter 6

Basic liquid assets requirement

6.1 Application and purpose

6.1.1 R This chapter applies to:

(1) a *MIFIDPRU investment firm*; and

(2) a *UK parent entity* that is required by ■ MIFIDPRU 2.5.11R to comply with ■ MIFIDPRU 6 on the basis of its *consolidated situation*.

6.1.2 R Where this chapter applies on the basis of the *consolidated situation* of the *UK parent entity*, any reference to a "*firm*" or "*MIFIDPRU investment firm*" in this chapter is a reference to the hypothetical single *MIFIDPRU investment firm* created under the *consolidated situation*.

6.1.3 G ■ MIFIDPRU 2.5.47R and ■ MIFIDPRU 2.5.48G contain additional *rules* and *guidance* on how a *UK parent entity* should apply the requirements in this chapter on a *consolidated basis*. A *UK parent entity* may apply for an exemption from the application of this chapter on a consolidated basis under ■ MIFIDPRU 2.5.19R.

Purpose and interpretation

6.1.4 G This chapter contains:

(1) a *basic liquid assets requirement* for *MIFIDPRU investment firms* (■ MIFIDPRU 6.2); and

(2) *rules* and *guidance* on which assets count as *core liquid assets* for the purposes of the *basic liquid assets requirement* (■ MIFIDPRU 6.3).

6.1.5 G (1) Where this chapter applies to a *MIFIDPRU investment firm* on a solo basis, the *firm* must comply with this chapter relying only on the *core liquid assets* it holds itself.

(2) However, the *FCA* recognises that there are circumstances in which it may be appropriate for a *firm* to rely on liquidity support provided by other entities within its group. Therefore, a *firm* that is subject to prudential consolidation may apply for an exemption from the application of this chapter on an individual basis under ■ MIFIDPRU 2.3.2R(1).

6.1.6 G ■ MIFIDPRU 7 contains requirements relating to a *MIFIDPRU investment firm's* systems and controls for the identification, monitoring and management of material potential harms that arise out of liquidity risk.

6.1.7 G The *basic liquid assets requirement* in this chapter is based on a proportion of a *firm's fixed overheads requirement* and any guarantees provided to *clients*. A *firm* may need to hold more *liquid assets* to comply with its *liquid assets threshold requirement* under ■ MIFIDPRU 7.

6.2 Basic liquid assets requirement

6.2.1 R A *firm* must hold an amount of *core liquid assets* equal to the sum of:

(1) one third of the amount of its *fixed overhead requirement*; and

(2) 1.6% of the total amount of any guarantees provided to *clients*.

6.2.2 R Where a *firm* calculates a total amount for guarantees under ■ MIFIDPRU 6.2.1R(2), it must calculate:

(1) the total value of guarantees that the *firm* has outstanding at the end of each *business day*; or

(2) an average value for the guarantees that the *firm* has had outstanding over an appropriate time period, which must be updated at regular, appropriate intervals.

6.2.3 G (1) ■ MIFIDPRU 6.2.2R(2) is intended to allow a *firm* to smooth out its liquidity requirement for guarantees, where the value of its outstanding guarantees fluctuates on a daily basis.

(2) An appropriate time period for calculating and updating this amount is likely to be a period that produces an average value that is representative of the overall liquidity risk arising out of the provision of guarantees to *clients*.

6.2.4 G The approach in ■ MIFIDPRU 6.2.2R(2) is illustrated by the following example:

(1) a *firm* that executes orders on behalf of a *client* may guarantee the settlement of any resulting transactions between the *client* and a third party;

(2) in this case, it may be appropriate for the *firm* to use the principles for calculating *average COH* to calculate an average value for the guarantees that the *firm* has had outstanding over an appropriate time period;

(3) *average COH* is calculated as the arithmetic mean of historic daily *COH* values. The *firm* could use the arithmetic mean of historic daily values for outstanding guarantees to calculate its amount for guarantees;

(4) *average COH* is calculated by reference to the historic three-*month* period beginning six *months* ago (i.e. excluding the three most recent *months*). The *firm* could calculate its amount for guarantees by reference to the same time period, if this produces an average value for guarantees that is representative of the overall liquidity risk in these guarantees; and

(5) a *firm* could update this calculation monthly, in line with the requirement to update *average COH* in ■ MIFIDPRU 4, if this produces a value that is representative of the overall liquidity risk.

6.3 Core liquid assets

6.3.1 R Subject to ■ MIFIDPRU 6.3.3R to ■ MIFIDPRU 6.3.5R, a *core liquid asset* means any of the following, when denominated in pound sterling:

coins and banknotes;

short-term deposits at a *UK-authorised credit institution*;

assets representing claims on or guaranteed by the UK government or the Bank of England;

units or shares in a *short-term MMF*;

units or shares in a *third country* fund that is comparable to a *short-term MMF*; and

trade receivables, if the conditions in ■ MIFIDPRU 6.3.3R are met.

6.3.2 G When assessing whether a *third country* fund is comparable to a *short-term MMF*, a *firm* should consider factors such as:

(1) whether the restrictions on instruments eligible for inclusion in the fund are comparable to the restrictions on instruments in article 10(1) of the *Money Market Funds Regulation*; and

(2) whether the fund is subject to requirements concerning portfolio diversification and risk management which are comparable to the requirements applicable to *short-term MMFs* in the *Money Market Funds Regulation*.

6.3.3 R A *firm* may treat *trade receivables* as *core liquid assets* if:

(1) the *firm* is:

(a) an *SNI MIFIDPRU investment firm*; or

(b) a *MIFIDPRU investment firm* that does not have permission to carry on:

(i) *dealing on own account*; or

(ii) underwriting of *financial instruments* and/or placing of *financial instruments* on a firm commitment basis;

(2) they are receivable within 30 *days*;

(3) they account for no more than one third of the requirement based upon the *fixed overheads requirement* in ■ MIFIDPRU 6.2.1R(1);

(4) they are not used to meet the requirement for guarantees in ■ MIFIDPRU 6.2.1R(2); and

(5) they are subject to a minimum haircut of 50%.

6.3.4 R

(1) If a *firm's relevant expenditure* or guarantees are incurred in a currency other than pound sterling, the *firm* may also treat the following assets as *liquid assets*, when denominated in that currency:

(a) coins and banknotes;

(b) short-term deposits at a *credit institution*;

(c) assets representing claims on or guaranteed by a central bank or government in a *third country*;

(d) units or shares in a *short-term MMF*;

(e) units or shares in a *third country* fund that is comparable to a *short-term MMF*; and

(f) *trade receivables*, if the conditions in ■ MIFIDPRU 6.3.3R are met.

(2) The proportion of *core liquid assets* denominated in any currency other than pound sterling that a *firm* can rely upon to meet its *basic liquid asset requirement*, must be no greater than:

(a) for the requirement in ■ MIFIDPRU 6.2.1R(1), the proportion of *relevant expenditure* incurred in that currency; and

(b) for the requirement in ■ MIFIDPRU 6.2.1R(2), the proportion of *guarantees* provided in that currency.

(3) This *rule* is subject to ■ MIFIDPRU 6.3.5R.

6.3.4A G

The effect of ■ MIFIDPRU 6.3.4R(2) is illustrated by the following example:

(1) A *firm* has total fixed overheads with a value of £1,200,000, as follows:

(a) 20%, equivalent to £240,000, are incurred in USD; and

(b) 5%, equivalent to £60,000, are incurred in Swiss francs (CHF).

(2) In addition, the *firm* has provided total guarantees to *clients* with a value of £10,000,000, of which 50%, equivalent to £5,000,000, are incurred in USD.

(3) The *firm's fixed overheads requirement* (one quarter of its total fixed overheads calculated in accordance with ■ MIFIDPRU 4.5) is £300,000.

(14) Under ■ MIFIDPRU 6.2.1R, the *firm's basic liquid assets requirement* amounts to £260,000, as follows:

(a) £100,000 are in respect of the requirement in ■ MIFIDPRU 6.2.1R(1) (one third of the amount of its *fixed overheads requirement*); and

(b) £160,000 are in respect of the requirement in MIFIDPRU 6.2.1R(2) (1.6% of the total amount of any guarantees provided to *clients*).

(5) To meet its requirement in MIFIDPRU 6.2.1R, a *firm* may choose to use *liquid assets* listed in MIFIDPRU 6.3.4R denominated in a currency other than pound sterling, up to a maximum equivalent to £105,000, as follows:

(a) Up to the equivalent of £100,000 may be held in USD denominated *liquid assets* (i.e. 20% of 100,000 = 20,000, to meet the requirement in MIFIDPRU 6.2.1R(1); and 50% of 160,000 = 80,000 to meet the requirement in MIFIDPRU 6.2.1R(2)); and

(b) Up to the equivalent of £5,000 may be held in CHF denominated *liquid assets* (i.e. 5% of 100,000 = 5,000, to meet the requirement in MIFIDPRU 6.2.1R(1)).

6

6.3.5 R A *firm* must not treat any of the following as a *core liquid asset*:

(1) any asset that belongs to a *client*; and

(2) any other asset that is encumbered.

6.3.6 G (1) For the purposes of MIFIDPRU 6.3.5R(1), an asset may belong to a *client* even if the asset is held in the *firm's* own name. Examples of assets belonging to a *client* include money or other assets held under the *FCA's client asset rules*.

(2) For the purposes of MIFIDPRU 6.3.5R(2), an asset may be encumbered if it is pledged as security or collateral, or subject to some other legal restriction (for example, due to regulatory or contractual requirements) which affects the *firm's* ability to liquidate, sell, transfer, or assign the asset.

Chapter 7

Governance and risk management

7.1 Application

7.1.1 G (1) ■ MIFIDPRU 7 applies to the following:

(a) a *MIFIDPRU investment firm*;

(b) a *UK parent entity* of an *investment firm group* to which consolidation applies under ■ MIFIDPRU 2.5; and

(c) a *parent undertaking* that operates a *group ICARA process* in accordance with ■ MIFIDPRU 7.9.5R.

(2) ■ MIFIDPRU 7.1.3R explains how each section of ■ MIFIDPRU 7 applies to the undertakings in (1).

7.1.2 G The following table summarises the content of ■ MIFIDPRU 7:

Section	Summary of content
MIFIDPRU 7.2	General requirements relating to a *firm's* governance arrangements
MIFIDPRU 7.2A	Requirements relating to the risk management function
MIFIDPRU 7.3	Requirements relating to risk, remuneration and nomination committees
MIFIDPRU 7.4	The *overall financial adequacy rule* and a *firm's* baseline obligations in relation to the *ICARA process*
MIFIDPRU 7.5	The requirements of the *ICARA process* relating to capital and liquidity planning, stress testing and wind-down planning
MIFIDPRU 7.6	*Rules* and *guidance* explaining how a *firm* should assess and monitor the adequacy of its *own funds*
MIFIDPRU 7.7	*Rules* and *guidance* explaining how a *firm* should assess and monitor the adequacy of its *liquid assets*
MIFIDPRU 7.8	Requirements relating to the periodic review of the *ICARA process* and record keeping requirements
MIFIDPRU 7.9	Requirements for *firms* to monitor *group* risk and *rules* explaining when an *investment firm group* may operate a *group-level ICARA process*
MIFIDPRU 7.10	Guidance explaining the *FCA's* general approach to the *SREP*

Section	Summary of content
MIFIDPRU 7 Annex 1G	General *guidance* on assessing potential harms that is potentially relevant to all *MIFIDPRU investment firms*
MIFIDPRU 7 Annex 2G	Additional *guidance* on assessing potential harms that is relevant for *MIFIDPRU investment firms dealing on own account* and *firms* with significant investments on their balance sheet
MIFIDPRU 7 Annex 3R to MIFIDPRU 7 Annex 6R	Notification forms
MIFIDPRU 7 Annex 7G	Table mapping the rules in MIFIDPRU 7 about the *ICARA process* to their associated *guidance* provisions

7.1.3 R ■ MIFIDPRU 7 applies as follows:

Section of MIFIDPRU 7	Application to *SNI MIFIDPRU investment firms*	Application to *non-SNI MIFIDPRU investment firms*	Application at the level of an *investment firm group*
MIFIDPRU 7.2 (Internal governance)	**Applies**	**Applies**	**Applies to the *UK parent entity* of an *investment firm group* to which consolidation applies under MIFIDPRU 2.5**
MIFIDPRU 7.2A (Risk management function)	**Does not apply**	**Applies to a *non-SNI MIFIDPRU investment firm* that has a risk management function in accordance with article 23 of the *MIFID Org Regulation***	**Does not apply**
MIFIDPRU 7.3 (Risk, remuneration and nomination committees)	**Does not apply**	**Applies if the *firm* does not qualify for the exclusion in MIFIDPRU 7.1.4R**	**Does not apply**
MIFIDPRU 7.4 (*Overall financial adequacy rule* and baseline ICARA obligations)	**Applies**	**Applies**	**Applies if the *investment firm group* is operating a *group ICARA process***
MIFIDPRU 7.5 (Capital and liquidity planning, stress testing and wind-down planning)	**Applies**	**Applies**	**Applies if the *investment firm group* is operating a *group ICARA process***

Section of MIFIDPRU 7	Application to *SNI MIFIDPRU investment firms*	Application to *non-SNI MIFIDPRU investment firms*	Application at the level of an *investment firm group*
MIFIDPRU 7.6 (Assessing adequacy of *own funds*)	**Applies**	**Applies**	**Applies if the *investment firm group* is operating a *group ICARA process***
MIFIDPRU 7.7 (Assessing adequacy of *liquid assets*)	**Applies**	**Applies**	**Applies if the *investment firm group* is operating a *group ICARA process***
MIFIDPRU 7.8 (Periodic review of the *ICARA process* and record keeping)	**Applies**	**Applies**	**Applies if the *investment firm group* is operating a *group ICARA process***
MIFIDPRU 7.9 (Group risks and the *group ICARA process*)	**Applies**	**Applies**	**Applies if the *investment firm group* is operating a *group ICARA process***
MIFIDPRU 7.10 (The *FCA's* general approach to the *SREP*)	**Applies as *guidance***	**Applies as *guidance***	**Applies as *guidance***

7

7.1.4 R

(1) ■ MIFIDPRU 7.3 (Risk, remuneration and nomination committees) does not apply to a *non-SNI MIFIDPRU investment firm*:

(a) where the value of the *firm's* on-balance sheet assets and *off-balance sheet items* over the preceding 4-year period is a rolling average of £100 million or less; or

(b) where:

(i) the value of the *firm's* on-balance sheet assets and *off-balance sheet items* over the preceding 4-year period is a rolling average of £300 million or less; and

(ii) the conditions in (2) are (where they are relevant to a *firm*) satisfied.

(2) The conditions referred to in (1)(b)(ii) are that the:

(a) exposure value of the *firm's* on- and off-balance sheet *trading book* business is equal to or less than £150 million; and

(b) exposure value of the *firm's* on- and off-balance sheet derivatives business is equal to or less than £100 million.

(3) For the purposes of paragraph (1), paragraph (4) applies where a *non-SNI MIFIDPRU investment firm* does not have monthly data covering the 4-year period referred to in that paragraph.

(4) Where this paragraph applies, a *non-SNI MIFIDPRU investment firm* must calculate the rolling averages referred to in paragraph (2) using the data points that it does have.

7.1.5 G

(1) For the purposes of MIFIDPRU 7.1.4R(3), the *FCA* expects a *non-SNI MIFIDPRU investment firm* to have insufficient data for a period only where it did not carry on any *MiFID business* during that period, or where (for periods prior to the application of *MIFIDPRU*) the firm did not record the relevant data on a monthly basis.

(2) Where a *firm* does not have all the monthly data points, the *firm* should use the data points it has in the way that paints the most representative picture of the period in question. For example, if a firm has monthly data for 2 years of the 4- year period, but prior to that only recorded the relevant data on a quarterly basis, the firm could sensibly calculate its rolling average by using the quarterly figure for each of the three monthly data points in each quarter.

7.1.6 R

(1) The amounts referred to in MIFIDPRU 7.1.4R must be calculated on an individual basis, and:

(a) in the case of on-balance sheet assets, in accordance with the applicable accounting framework;

(b) in the case of *off-balance sheet items*, using the full nominal value.

(2) The value of the on-balance sheet assets and *off-balance sheet items* in MIFIDPRU 7.1.4R(1)(a) and (b) must be the arithmetic mean of the assets and items over the preceding 4 years, based on monthly data points.

(3) A *firm* may choose the *day* of the *month* that it uses for the data points in (2), but once that day has been chosen the *firm* may only change it for genuine business reasons.

7.1.7 R

(1) When calculating the amounts referred to in MIFIDPRU 7.1.4R(1)(a) and (b), a *firm* must use the total amount of its on-balance sheet assets and off-balance sheet items.

(2) A *firm* must calculate the exposure values referred to in MIFIDPRU 7.1.4R(2)(a) and (b) by adding together the following items:

(a) the positive excess of the *firm's* long positions over its short positions in all *trading book financial instruments*, using the approach specified for K-NPR in MIFIDPRU 4.12.2R to calculate the net position for each instrument; and

(b) the exposure value of contracts and transactions referred to in MIFIDPRU 4.14.3R, calculated using the approach specified for K-TCD in MIFIDPRU 4.14.8R.

(3) Any amounts in foreign currencies must be converted into sterling using the relevant conversion rate.

(4) A *firm* must determine the conversion rate in (3) by reference to an appropriate market rate and must record which rate was chosen.

7.1.8 G An example of an appropriate market rate for the purposes of ■ MIFIDPRU 7.1.7R(4) is the relevant daily spot exchange rate against sterling published by the Bank of England.

7.1.9 R (1) This *rule* applies to a *non-SNI MIFIDPRU investment firm* that did not meet the conditions in ■ MIFIDPRU 7.1.4R(1)(a) or ■ (b) but subsequently does.

(2) ■ MIFIDPRU 7.3 (Risk, remuneration and nomination committees) ceases to apply to the *firm* in (1) if:

(a) the *firm* has met the conditions in ■ MIFIDPRU 7.1.4R(1)(a) or ■ (b) for a continuous period of at least 6 *months* (or such longer period as may have elapsed before the *firm* submits the notification in (b)); and

(b) the *firm* has notified the *FCA* that it has met the conditions in (a).

(3) The notification in (2)(b) must be submitted through the *online notification and application system* using the form in ■ MIFIDPRU 7 Annex 3R.

7.1.10 G The effect of ■ MIFIDPRU 7.1.9R(2)(a) is that a *firm* may move between meeting the conditions in ■ MIFIDPRU 7.1.4R(3)(a) and ■ (b) during the 6-*month* period.

7.1.11 R Where a *non-SNI MIFIDPRU investment firm* has met the conditions in ■ MIFIDPRU 7.1.4R(1)(a) or ■ (b) but then ceases to do so, it must comply with ■ MIFIDPRU 7.3 within 6 *months* from the date on which the *firm* ceased to meet the conditions.

7.1.12 R (1) Where a *non-SNI MIFIDPRU investment firm* ceases to meet the conditions in ■ MIFIDPRU 7.1.4R(1)(a) or ■ (b), it must promptly notify the *FCA*.

(2) The notification in (1) must be submitted through the online notification and application system using the form in ■ MIFIDPRU 7 Annex 3R.

7.1.13 G Where a *firm* ceases to meet the conditions in ■ MIFIDPRU 7.1.4R(1)(a) or ■ (b), but subsequently meets the conditions again within a period of 6 *months*, the *firm* will still be subject to ■ MIFIDPRU 7.3 6 *months* after the date on which it first ceased to meet the conditions. The *firm* will only cease to be subject to ■ MIFIDPRU 7.3 where it meets the conditions in ■ MIFIDPRU 7.1.9R.

7.2 Internal governance

7.2.1 R

(1) A *MIFIDPRU investment firm* must have robust governance arrangements, including:

(a) a clear organisational structure with well defined, transparent and consistent lines of responsibility;

(b) effective processes to identify, manage, monitor and report the risks the *firm* is or might be exposed to, or the *firm* poses or might pose to others; and

(c) adequate internal control mechanisms, including sound administration and accounting procedures.

(2) The arrangements in (1) must:

(a) be appropriate and proportionate to the nature, scale and complexity of the risks inherent in the business model and the activities of the *firm*; and

(b) be compatible with the requirements in the *FCA Handbook* relating to risk management and internal governance, for example those in MIFIDPRU 7 and *SYSC*, that apply to the *firm*.

7.2.2 G

When establishing and maintaining the arrangements in MIFIDPRU 7.2.1R(1), a *firm* should consider at least the following:

(1) the requirements that apply to the *firm* under MIFIDPRU 7 and SYSC 19G (MIFIDPRU Remuneration Code);

(2) the legal structure of the *firm*, including its ownership and funding structure;

(3) whether the *firm* is part of a *group*;

(4) the type of activities for which the *firm* is authorised, including the complexity and volume of those activities;

(5) the business model and strategy of the *firm*, including its risk strategy, risk appetite and risk profile;

(6) the types of client the *firm* has;

(7) the outsourced functions and distribution channels of the *firm*; and

(8) the *firm's* existing IT systems, including continuity systems.

Governance for risk management

7.2.3 R

(1) The *management body* of a *MIFIDPRU investment firm* has overall responsibility for risk management. It must devote sufficient time to the consideration of risk.

(2) The *management body* of a *MIFIDPRU investment firm* must be actively involved in, and ensure that adequate resources are allocated to, the management of all material risks, including the valuation of assets, the use of external ratings and internal models relating to those risks.

(3) A *MIFIDPRU investment firm* must establish reporting lines to the *management body* that cover all material risks and risk management policies and changes thereof.

7.2.4 R

(1) A *MIFIDPRU investment firm* must ensure that the *management body* in its supervisory function and any risk committee that has been established have adequate access to information on the risk profile of the *firm* and, if necessary and appropriate, to the risk management function and to external expert advice.

(2) The *management body* in its supervisory function and any risk committee that has been established must determine the nature, the amount, the format, and the frequency of the information on risk which they are to receive.

7.2A Risk management function

7.2A.1 R ■ MIFIDPRU 7.2A.2R and ■ MIFIDPRU 7.2A.3R apply to a *non-SNI MIFIDPRU investment firm* that has a risk management function in accordance with article 23 of the *MIFID Org Regulation*.

7.2A.2 R

(1) A *firm* must ensure that its risk management function is independent from its operational functions and has sufficient authority, stature, resources and access to the *management body*.

(2) The risk management function in (1) must ensure that all material risks are identified, measured and properly reported. It must be actively involved in elaborating the firm's risk strategy and in all material risk management decisions, and it must be able to deliver a complete view of the whole range of risks of the *firm*.

(3) A *firm* in (1) must ensure that its risk management function is able to report directly to the *management body* in its supervisory function, independent from *senior management*, and that it can raise concerns and warn the *management body*, where appropriate, where specific risk developments affect or may affect the firm, without prejudice to the responsibilities of the *management body* in its supervisory and/or managerial functions.

7.2A.3 R The head of the risk management function must be an independent *senior manager* with distinct responsibility for the risk management function. Where the nature, scale and complexity of the activities of the *MIFIDPRU investment firm* do not justify a specially appointed person, another senior person within the *firm* may fulfil that function, provided there is no conflict of interest. The head of the risk management function must not be removed without prior approval of the *management body* and must be able to have direct access to the *management body* where necessary.

7.3 Risk, remuneration and nomination committees

Risk committee

7.3.1 R

(1) Subject to (2), a *non-SNI MIFIDPRU investment firm* to which this *rule* applies must establish a risk committee.

(2) Subject to (3), a *firm* must ensure that:

(a) at least 50% of the members of the risk committee are members of the *management body* who do not perform any executive function in the *firm*; and

(b) the chair of the risk committee is a member of the *management body* who does not perform any executive function in the *firm*.

(3) The requirements in (2) do not apply to a *firm* that, solely because of its legal structure, cannot have members of the *management body* who do not perform any executive function in the *firm*.

(4) Members of the risk committee must have the appropriate knowledge, skills and expertise to fully understand, manage and monitor the risk strategy and the risk appetite of the *firm*.

(5) The risk committee must advise the *management body* on the *firm's* overall current and future risk appetite and strategy and assist the *management body* in overseeing the implementation of that strategy by *senior management*.

(5A) In order to assist in the establishment of sound remuneration policies and practices, the risk committee must, without prejudice to the tasks of the remuneration committee, examine whether incentives provided by the remuneration system take into consideration risk, capital, liquidity and the likelihood and timing of earnings.

(6) Notwithstanding the role of the risk committee, the *management body* of a *firm* has overall responsibility for the *firm's* risk strategies and policies.

7.3.2 G

(1) MIFIDPRU 7.3.1R(2) only applies to *firms* that are required to establish a risk committee under MIFIDPRU 7.3.1R(1).

(2) The chair may be included for the purposes of calculating the 50% referred to in MIFIDPRU 7.3.1R(2)(a).

(3) Where a *firm* has established a risk committee, its responsibilities should typically include:

(a) providing advice to the *firm's management body* on risk strategy, including the oversight of current risk exposures of the *firm*, with particular, but not exclusive, emphasis on prudential risks;

developing proposals for consideration by the *management body* in respect of overall risk appetite and tolerance, as well as the metrics to be used to monitor the *firm's* risk management performance;

(c) overseeing and challenging the design and execution of stress and scenario testing;

(d) overseeing and challenging the day-to-day risk management and the executive's oversight arrangements;

(e) overseeing and challenging due diligence on risk issues relating to material transactions and strategic proposals that are subject to approval by the *management body*;

(f) providing advice to the *firm's remuneration* committee, as appropriate, in relation to the development, implementation and review of remuneration policies and practices that are consistent with, and promote, effective risk management;

(g) providing advice, oversight and challenge necessary to embed and maintain a supportive risk culture throughout the *firm*.

Remuneration committee

7.3.3 R

(1) Subject to (2), a *non-SNI MIFIDPRU investment firm* to which this *rule* applies must establish a remuneration committee.

(2) The obligation in (1) will be deemed to be satisfied where:

(a) the *non-SNI MIFIDPRU investment firm* is part of an *investment firm group* that is subject to prudential consolidation in accordance with MIFIDPRU 2.5; and

(b) the *UK parent entity* has established a *remuneration* committee that:

(i) meets the requirements of MIFIDPRU 7.3.3R(3) (read in conjunction with MIFIDPRU 7.3.3R(4));

(ii) has the power to comply with those obligations on behalf of the *non-SNI MIFIDPRU investment firm*; and

(iii) has members with the appropriate knowledge, skills and expertise in relation to the *non-SNI MIFIDPRU investment firm*.

(3) Subject to (4), a *firm* must ensure that:

(a) at least 50% of the members of the *remuneration* committee are members of the *management body* who do not perform any executive function in the *firm*; and

(b) the chair of the *remuneration* committee is a member of the *management body* who does not perform any executive function in the *firm*.

(4) The requirements in (3) do not apply to a *firm* that, solely because of its legal structure, cannot have members of the *management body* who do not perform any executive function in the *firm*.

(5) A *firm* must ensure that the *remuneration* committee is constituted in a way that enables it to exercise competent and independent judgment on *remuneration* policies and practices and the incentives created for managing risk, capital and liquidity.

(6) The *remuneration* committee must be responsible for preparing decisions regarding *remuneration*, including decisions which have implications for the risk and risk management of the *firm* and which are to be taken by the *management body*.

(7) When preparing the decisions, the *remuneration* committee must take into account the public interest and the long-term interests of shareholders, investors and other stakeholders in the *firm*.

7.3.4 G

(1) ■ MIFIDPRU 7.3.3R(3) only applies to *firms* that are required to establish a *remuneration* committee under ■ MIFIDPRU 7.3.3R(1).

(2) The chair may be included for the purposes of calculating the 50% referred to in ■ MIFIDPRU 7.3.3R(3)(a).

Nomination committee

7.3.5 R

(1) A *non-SNI MIFIDPRU investment firm* to which this *rule* applies must establish a nomination committee.

(2) Subject to (3), a *firm* must ensure that:

(a) at least 50% of the members of the nomination committee are members of the *management body* who do not perform any executive function in the *firm*; and

(b) the chair of the nomination committee is a member of the *management body* who does not perform any executive function in the *firm*.

(3) The requirements in (2) do not apply to a *firm* that, solely because of its legal structure, cannot have members of the *management body* who do not perform any executive function in the *firm*.

(4) A *firm* must ensure that the nomination committee:

is able to use any forms of resources the nomination committee deems appropriate, including external advice; and

receives appropriate funding.

7.3.6 G

(1) ■ MIFIDPRU 7.3.5R(2) only applies to *firms* that are required to establish a nomination committee under ■ MIFIDPRU 7.3.5R(1).

(2) The chair may be included for the purposes of calculating the 50% referred to in ■ MIFIDPRU 7.3.5R(2)(a).

Establishing committees at group level

7.3.7 G

(1) A *firm* may apply to the *FCA* for a modification under section 138A of the *Act* to permit the *firm* to establish a risk committee, *remuneration* committee, or nomination committee at *group* level instead of complying with the requirement on an individual basis.

(2) The *FCA* may grant a modification under section 138A of the *Act* if:

(a) compliance by the *firm* with the requirement to establish a committee on an individual basis would be unduly burdensome or would not achieve the purpose for which the *rules* were made; and

(b) granting the modification would not adversely affect the advancement of any of the *FCA's* objectives.

(3) To be satisfied that granting the modification would not affect the advancement of any of the *FCA's* objectives under (2)(b), the *FCA* would normally expect the *firm* to demonstrate that the committee established at *group* level:

(a) meets the composition requirements in ■ MIFIDPRU 7.3.1R(2), ■ MIFIDPRU 7.3.3R(3) or ■ MIFIDPRU 7.3.5R(2), as applicable; and

(b) has members with the appropriate knowledge, skills and expertise in relation to the *firm* subject to the requirement to establish a committee.

7.4 Internal capital adequacy and risk assessment (ICARA) process: overview and baseline obligations

7.4.1 R This section applies to a *MIFIDPRU investment firm*.

7

Purpose

7.4.2 G ■ MIFIDPRU 7.4 to ■ MIFIDPRU 7.9 contain *rules* and *guidance* which supplement the overarching requirements for *MIFIDPRU investment firms* under:

(1) the appropriate resources *threshold condition* in Schedule 6 to the *Act* (as explained in ■ COND 2.4) under which a *firm* must have appropriate resources in relation to the *regulated activities* that it carries on; and

(2) *Principle* 4 (Financial prudence) under which a *firm* must maintain adequate financial resources.

7.4.3 G (1) The overall purpose of the rules in ■ MIFIDPRU 7.4 to ■ MIFIDPRU 7.9, together with the other requirements in *MIFIDPRU*, is to ensure that a *MIFIDPRU investment firm*:

(a) has appropriate systems and controls in place to identify, monitor and, where proportionate, reduce all potential material harms that may result from the ongoing operation of its business or winding down its business; and

(b) holds financial resources that are adequate for the business it undertakes.

(2) The requirement for adequate financial resources is designed to achieve 2 key outcomes for *MIFIDPRU investment firms*:

(a) to enable a *firm* to remain financially viable throughout the economic cycle, with the ability to address any potential material harms that may result from its ongoing activities (including both *regulated activities* and *unregulated activities*); and

(b) to enable the *firm* to conduct an orderly wind-down while minimising harm to *consumers* or to other market participants, and without threatening the integrity of the wider *UK* financial system.

(3) The *rules* and *guidance* in ■ MIFIDPRU 7.4 to ■ MIFIDPRU 7.9 build on the *FCA's* general approach to assessing the adequacy of financial

resources explained in Finalised Guidance FG20/1. *Firms* should also refer to that *guidance* when considering their obligations under those sections of *MIFIDPRU*.

7.4.4 G The *FCA* recognises that:

(1) there is a vast range of potential harms and it will not be possible for the *FCA* or *firms* to eliminate all potential risks and sources of harm;

(2) the *FCA* and *firms* should focus on material harms, adopting a proportionate and risk-based approach to each *firm's* business and operating model; and

(3) some *firms* may still fail, but the *FCA* and *firms* should aim to ensure that any wind-down of those *firms* occurs in an orderly manner, minimising the impact on *consumers* and the wider market.

Proportionality and application to different business models

7.4.5 G Although all *MIFIDPRU investment firms* are subject to the appropriate resources *threshold condition* and *Principle* 4, the practical steps that a *firm* must take to meet these requirements will vary according to the *firm's* business model and operating model. Therefore, a *firm* with a more complex business or operating model should generally take a more detailed approach to the monitoring and management of a wider range of potential harms than a smaller *firm* carrying on simpler activities.

7.4.6 G ■ MIFIDPRU 7.4 to ■ MIFIDPRU 7.8 contain a set of core requirements that every *MIFIDPRU investment firm* should incorporate into its *ICARA process*. This does not mean that the manner in which each *firm* implements these core requirements will be identical. When considering the appropriate way to satisfy these core requirements, a *firm* should focus on the potential material harms that may arise:

(1) from the ongoing operation of its business; and

(2) during a wind-down of its business.

Overall financial adequacy rule

7.4.7 R (1) A *firm* must, at all times, hold *own funds* and *liquid assets* which are adequate, both as to their amount and their quality, to ensure that:

(a) the *firm* is able to remain financially viable throughout the economic cycle, with the ability to address any material potential harm that may result from its ongoing activities; and

(b) the *firm's* business can be wound down in an orderly manner, minimising harm to *consumers* or to other market participants.

(2) The requirement in (1) is known as the *overall financial adequacy rule*.

7.4.8 G (1) The *overall financial adequacy rule* establishes the standard that the *FCA* applies to determine whether a *MIFIDPRU investment firm* has

adequate financial resources. The amount and quality of *own funds* and *liquid assets* that each *firm* must hold will vary according to its business model and operating model, the environment in which it operates and the nature of its internal systems and controls.

(2) The remainder of this section explains the basic requirements of the *ICARA process*. The *ICARA process* is the collective term for the internal systems and controls that a *firm* must operate to identify and manage potential material harms that may arise from the operation of its business, and to ensure that its operations can be wound down in an orderly manner.

(3) A *firm* should use the *ICARA process* to identify whether it complies with the *overall financial adequacy rule*. The focus of the *ICARA process* is on identifying and managing risks that may result in material harms. Depending on the nature of the potential harms identified, the only realistic option to manage them and to comply with the *overall financial adequacy rule* may be to hold additional *own funds* or additional *liquid assets* above the *firm's own funds requirement* or *basic liquid assets requirement*. However, in other cases, there may be more appropriate or effective ways to manage the potential harms. ■ MIFIDPRU 7.4.16G contains further *guidance* on reducing the risk of material potential harms.

(4) ■ MIFIDPRU 7.6 contains *rules* and *guidance* about how a *firm* should use the *ICARA process* to assess the *own funds* that the *firm* requires to comply with the *overall financial adequacy rule*.

(5) ■ MIFIDPRU 7.7 contains *rules* and *guidance* about how a *firm* should use the *ICARA process* to assess the *liquid assets* that the *firm* requires to comply with the *overall financial adequacy rule*.

(6) ■ MIFIDPRU 7.10 contains *guidance* on how the *FCA* will normally conduct a *SREP* on a *firm's ICARA process* or may conduct a thematic review of a sector in which multiple *firms* are active. Where the *FCA* considers that the *firm's ICARA process* has not adequately identified and managed the risks of material harm, the *FCA* may require the *firm* to take corrective action. In appropriate cases, this may include requiring the *firm* to hold additional *own funds* or *liquid assets* to ensure that the *firm* is complying with the *overall financial adequacy rule*. The *FCA* may also take supervisory action in connection with the prudential requirements of a *MIFIDPRU investment firm* outside the context of a *SREP*. Where the *FCA* has conducted a sectoral review, it may impose additional requirements on some or all *firms* that are active in the relevant sector.

ICARA process: baseline obligations

7.4.9 R (1) A *firm* must have in place appropriate systems and controls to identify, monitor and, if proportionate, reduce all material potential harms:

(a) that the ongoing operation of the *firm's* business may cause to:

(i) the *firm's clients* and counterparties;

(ii) the markets in which the *firm* operates; and

(iii) the *firm* itself; and

(b) that may result from winding down the *firm's* business, to ensure that the *firm* can be wound down in an orderly manner.

(2) If any material potential harms remain after a *firm* has implemented the systems and controls in (1), the *firm* must assess whether to:

(a) hold additional *own funds* to address the harms in accordance with ■ MIFIDPRU 7.6.2R; and

(b) hold additional *liquid assets* to address the harms in accordance with ■ MIFIDPRU 7.7.2R.

(3) The requirements in this *rule* apply to a *firm's* entire business, including:

(a) all *regulated activities*, irrespective of whether they are *MiFID business*; and

(b) any *unregulated activities*.

(4) The systems, controls and procedures operated by a *firm* to comply with the requirements in this *rule* are known as the *ICARA process*.

7.4.10 R A *firm's ICARA process* must be proportionate to the nature, scale and complexity of the business carried on by the *firm*.

7.4.11 R A *firm* must ensure that its *ICARA process* complies with the requirements in ■ MIFIDPRU 7.4 to ■ MIFIDPRU 7.8 in a consistent and coherent manner.

7.4.12 G (1) ■ MIFIDPRU 7.4.11R requires a *firm* to ensure that the inputs to, analyses applied by, and conclusions arising from, its *ICARA process* are properly linked and reflect a consistent and coherent analysis of the *firm's* business and operating model.

(2) The following are examples of the consistency and coherence required by the *ICARA process*:

(a) the potential material harms that the *firm* identifies under ■ MIFIDPRU 7.4.13R are consistent with the *firm's* articulation of its business model and strategy under ■ MIFIDPRU 7.5.2R(1) and with the *firm's* stated risk appetite under ■ MIFIDPRU 7.5.2R(2);

(b) the *firm's* analysis under ■ MIFIDPRU 7.5.2R(4) of the *own funds* and *liquid assets* that are necessary to comply with the *overall financial adequacy rule* is consistent with:

(i) the potential impact of the potential material harms that the *firm* identifies under ■ MIFIDPRU 7.4.13R;

(ii) the *firm's* projections of its future requirements under ■ MIFIDPRU 7.5.2R(4); and

(iii) the impact of the stressed scenarios that the *firm* has identified under ■ MIFIDPRU 7.5.2R(5);

(c) the potential recovery actions specified by the *firm* under ■ MIFIDPRU 7.5.5R(2) are consistent with the *firm's* projections of its future requirements under ■ MIFIDPRU 7.5.2R(4) and the potential stressed scenarios that the *firm* has identified under ■ MIFIDPRU 7.5.2R(5);

(d) the *firm's* wind-down planning under ■ MIFIDPRU 7.5.7R is consistent with the levels of *own funds* and *liquid assets* that the *firm* has assessed would be necessary to wind-down the *firm* for the purposes of the *overall financial adequacy rule* and with the *firm's* assessment of the potential harms that might result from winding down its business under ■ MIFIDPRU 7.4.13R; and

(e) the *firm's* wind-down planning is consistent with the potential recovery actions specified by the *firm* under ■ MIFIDPRU 7.5.5R(2) and the circumstances in which the *firm* has concluded that no further recovery actions would be feasible or desirable.

ICARA process: identifying harms

7.4.13 R As part of its *ICARA process*, a *firm* must assess its business model and identify all material harms that could result from:

the ongoing operation of the *firm's* business; and

the winding-down of the *firm's* business.

7.4.14 G When assessing potential material harms for the purpose of ■ MIFIDPRU 7.4.13R, the FCA considers that the following non-exhaustive list of considerations will be relevant:

the level of detail required in the assessment is likely to vary depending on the complexity of the business and operating model. More complex business and operating models are likely to involve a wider range of potential material harms and so will generally require a more detailed assessment;

the obligation under ■ MIFIDPRU 7.4.13R is to identify all material harms that could result from the *firm's* business, even if those harms can be appropriately mitigated. It is important that a *firm* starts by identifying all potential material harms that could arise from its business and operating model. The issue of how the identified harms can be mitigated should be considered separately, including assessing under ■ MIFIDPRU 7.6 and ■ 7.7 whether the firm should hold additional *own funds* and *liquid assets*;

the potential for harm may evolve throughout the course of an economic cycle. Therefore, the assessment should consider how the risk of harm may develop in the future, rather than simply performing a static assessment based on current economic circumstances;

risks to the *firm* itself may result in an increased risk of harm to the *firm's clients* or counterparties and therefore should form part of the assessment. For example, if the *firm* is affected by a significant disruption or suffers a significant loss, this may prevent the firm from providing important services to *clients* or from being able to meet its liabilities to counterparties. Significant and unexpected financial losses sustained by a *firm* may also decrease the financial resources available to the *firm* to address other potential harms and may increase the risk of disorderly wind-down and sudden disruption of services to the *firm's clients*; and

firms should refer to the guidance in Finalised Guidance FG20/1 on "Identifying and assessing the risk of harm" when assessing the impact of potential harms.

7.4.15 G

(1) ■ MIFIDPRU 7 Annex 1 contains additional *guidance* on identifying potential material harms that are relevant to the business models of most *firms*.

(2) ■ MIFIDPRU 7 Annex 2 contains additional *guidance* on identifying potential material harms that are likely to be relevant to *firms* that *deal on own account* or hold significant investments on their balance sheets. This *guidance* is intended to apply in addition to the general *guidance* in ■ MIFIDPRU 7 Annex 1.

(3) The *FCA* may issue further *guidance* or publish additional information to reflect its observations of how *firms* are implementing the *ICARA process* or to take into account developments in relation to particular products or sectors. *Firms* should consider any additional *guidance* or information that the *FCA* has published when applying the requirements in this section.

ICARA process: risk mitigation

7.4.16 G

(1) The *ICARA process* is an internal risk management process that a *MIFIDPRU investment firm* must operate on an ongoing basis. As part of that process, a *firm* should consider whether the risk of material potential harms can be reduced through proportionate measures (other than holding additional financial resources) and, if so, whether it is appropriate to implement the measures. The nature of any potential measures will vary depending on the *firm's* business and operating model. Examples may include implementing additional internal systems and controls, strengthening governance and oversight processes or changing the manner in which the firm conducts certain business. A *firm* will need to form a judgement about what is appropriate and proportionate for its particular circumstances. That judgement will be informed by the *firm's* risk appetite.

(2) A *firm* must assess whether it should hold additional *own funds* or additional *liquid assets* to mitigate any material potential harms that it has identified. This may be the case where the *firm* cannot identify other appropriate, proportionate measures to mitigate harms, or where it has applied these measures, but a residual risk of material harm remains. Any assessment must be realistic and based on severe but plausible assumptions.

7.5 ICARA process: capital and liquidity planning, stress testing, wind-down planning and recovery planning

7.5.1 R This section applies to a *MIFIDPRU investment firm*.

7

Business model assessment and capital and liquidity planning

7.5.2 R As part of its *ICARA process*, a *firm* must:

(1) have a clearly articulated business model and strategy;

(2) have a clearly articulated risk appetite that is consistent with the business model and strategy identified under (1);

(3) identify any material risks of misalignment between the *firm's* business model and operating model and the interests of its *clients* and the wider financial markets, and evaluate whether those risks have been adequately mitigated;

(4) consider on a forward-looking basis the *own funds* and *liquid assets* that will be required to meet the *overall financial adequacy rule*, taking into account any planned future growth; and

(5) consider relevant severe but plausible stresses that could affect the *firm's* business and consider whether the *firm* would still have sufficient *own funds* and *liquid assets* to meet the *overall financial adequacy rule*.

Stress testing and reverse stress testing requirement

7.5.3 G ■ MIFIDPRU 7.5.2R(5) requires a *firm* to use stress testing to identify whether it holds sufficient *own funds* and *liquid assets*. *Firms* should refer to Finalised Guidance FG20/1 for specific guidance on the *FCA's* expectations in relation to stress testing.

7.5.4 G (1) As part of their business model assessment and capital and liquidity planning under ■ MIFIDPRU 7.5.2R, *firms* with more complex businesses or operating models should also undertake:

(a) more in-depth stress testing of their business model and strategy; and

(b) reverse stress testing.

(2) *Firms* should refer to ■ MIFIDPRU 7 Annex 1.15G to ■ MIFIDPRU 7 Annex 1.20G for additional information about the *FCA's* expectations in relation to more in-depth stress testing and reverse stress testing.

(3) The *FCA* may request individual *firms* to carry out more in-depth stress testing or reverse stress testing. In appropriate cases, the *FCA* will consider whether it is necessary or desirable to impose a *requirement* on a *firm* to carry out such stress testing. This may involve inviting a *firm* to apply for the voluntary imposition of a requirement under section 55L(5) of the *Act* or the *FCA* imposing a requirement on the *FCA's* own initiative under section 55L(3) of the *Act*.

Recovery actions

7.5.5 R As part of its *ICARA process*, a *firm* must identify:

(1) levels of *own funds* and *liquid assets* that the *firm* considers, if reached, may indicate that there is a credible risk that the *firm* will breach its *threshold requirements*; and

(2) potential recovery actions that the *firm* would expect to take:

(a) to avoid a breach of the *firm's threshold requirements* where the *firm's own funds* or *liquid assets* fall below the levels identified in (1); and

(b) to restore compliance with its *threshold requirements* if the *firm* were to breach its *threshold requirements* during a period of financial difficulty.

7.5.6 G (1) When a *firm* is considering potential recovery actions that the *firm* may take for the purposes of ■ MIFIDPRU 7.5.5R, it should consider at least the following:

the governance arrangements of the *firm*, and in particular which *individuals* will be responsible for taking the relevant decisions within the required timeframe;

the key business lines operated by the *firm* and the critical functions that the *firm* will need to maintain, and the steps necessary to ensure that these can continue to operate;

the level of *own funds* and *liquid assets* that the *firm* is likely to need to restore compliance with the *threshold requirements*;

the options available to the *firm* to raise additional *own funds* or *liquid assets*;

the options available to the *firm* to conserve existing *own funds* or *liquid assets*;

any significant risks that may arise in connection with proposed recovery actions; and

any material impediments that may exist to implementing proposed recovery actions and whether these can be resolved or mitigated.

(2) A *firm* should adopt a proportionate approach to identifying potential recovery actions, taking into account the nature, scale and complexity of the *firm's* business and operating model. The actions that the *firm* proposes must be credible and justifiable, taking into account the circumstances in which the actions may be likely to be required.

Wind-down planning and wind-down triggers

7.5.7 R As part of its *ICARA process*, a *firm* must:

(1) identify the steps and resources that would be required to ensure the orderly wind-down and termination of the *firm's* business in a realistic timescale; and

(2) evaluate the potential harms arising from winding down the *firm's* business and identify how to mitigate them.

7

7.5.8 G When carrying out a wind-down planning assessment under ■ MIFIDPRU 7.5.7R and determining the timeline and any required actions, a *firm* should refer to the guidance in the *FCA's* Wind-Down Planning Guide and in Finalised Guidance FG20/1.

7.5.9 R (1) A *firm* must use its wind-down analysis under ■ MIFIDPRU 7.5.7R to assess the amount of *own funds* and *liquid assets* that would be required to ensure an orderly wind-down of its business for the purposes of the *overall financial adequacy rule*.

(2) The *firm's* assessment in (1) must not result in amounts that are lower than:

(a) in the case of *own funds*, the *firm's fixed overheads requirement*; and

(b) in the case of *liquid assets*, the *firm's basic liquid assets requirement*.

7.5.10 G (1) The *overall financial adequacy rule* requires a *MIFIDPRU investment firm* to hold sufficient *own funds* and *liquid assets* to ensure that it can wind-down its business in an orderly manner (as well as operate its business on an ongoing basis). ■ MIFIDPRU 7.5.9R requires a *firm* to use its wind-down analysis to assess the appropriate level of *own funds* and liquid assets for these purposes.

(2) A *firm's* assessment of the amounts that it needs to hold under the *overall financial adequacy rule* to ensure that it can be wound down in an orderly manner must never be lower than its *wind-down triggers*. The *firm* may conclude that it requires amounts that are higher than these minimum amounts to ensure an orderly wind-down.

(3) In appropriate cases, the *FCA* may consider that either or both of a *firm's wind-down triggers* should be set at a higher level. In this case, the *FCA* may invite a *firm* to apply for a *requirement* under section 55L(5) of the *Act*, or may impose a *requirement* on the *FCA's* own

initiative under section 55L(3) of the *Act*, for the *firm* to use an alternative *wind-down trigger*.

(4) If the *firm's own funds* fall below the *own funds wind-down trigger* or if the *firm's liquid assets* fall below the *liquid assets wind-down trigger*, the *FCA* would normally expect that the *firm* would commence winding down, unless the *firm's governing body* has determined that there is an imminent and credible likelihood of recovery. The supervisory actions that the *FCA* may take in these circumstances are explained in further detail in ■ MIFIDPRU 7.6 in relation to the *own funds wind-down trigger* and ■ MIFIDPRU 7.7 in relation to the *liquid assets wind-down trigger*.

(5) Where a *firm's own funds* or *liquid assets* fall below the level that is required to ensure an orderly wind-down of the *firm*, the *firm* will breach the *overall financial adequacy rule*. However, as explained further in ■ MIFIDPRU 7.6 in relation to *own funds* and ■ MIFIDPRU 7.7 in relation to *liquid assets*, this does not mean that a *firm* must commence winding down immediately. It is only when the *firm* breaches one or both of the *wind-down triggers* that there is a general presumption that the *firm* should wind-down. Where the *firm* has breached the *overall financial adequacy rule* but continues to hold *own funds* and *liquid assets* that exceed the *wind-down triggers*, the *FCA* would typically take the intervention measures set out in ■ MIFIDPRU 7.6.15G and ■ MIFIDPRU 7.7.17G. However, there may be cases where the *firm's* financial position and the projections of its likely future financial resources mean that commencing a wind-down is appropriate, even though the *firm* has not yet breached the *wind-down triggers*. The *FCA* will consider the appropriate supervisory actions according to the facts in each case.

7.6 ICARA process: assessing and monitoring the adequacy of own funds

7.6.1 R This section applies to a *MIFIDPRU investment firm*.

7.6.2 R As part of its *ICARA process*, a *firm* must produce a reasonable estimate of the *own funds* it needs to hold to address:

(1) any potential material harms that the *firm* has identified under ■ MIFIDPRU 7.4.13R and in relation to which it has not taken any measures to reduce the impact of the harms under ■ MIFIDPRU 7.4.9R; and

(2) any residual potential material harms that remain after the *firm* has taken measures to reduce the impact of the harms under ■ MIFIDPRU 7.4.9R.

7.6.3 R (1) A *firm* must assess on the basis of its analysis under ■ MIFIDPRU 7.6.2R whether it should hold additional *own funds* in excess of its *own funds requirement* to comply with the *overall financial adequacy rule*.

(2) When carrying out the assessment in (1), a *firm* must not:

(a) determine that it needs a lower level of *own funds* for an activity or harm than is required by a *rule* in ■ MIFIDPRU 4 (Own funds requirements) or ■ MIFIDPRU 5 (Concentration risk); or

(b) use components of the *own funds requirement* to cover potential material harms that cannot reasonably be attributed to that component.

7.6.4 G (1) The *overall financial adequacy rule* requires a *firm* to hold adequate *own funds* to ensure that:

(a) the *firm* is able to remain financially viable throughout the economic cycle, with the ability to address any potential material harms that may result from its ongoing activities; and

(b) the *firm's* business can be wound down in an orderly manner.

(2) To comply with the *overall financial adequacy rule*, a *firm* must therefore hold the higher of:

(a) the amount of *own funds* that the *firm* requires at any given point in time to *fund* its ongoing business operations, taking into

account potential periods of financial stress during the economic cycle; and

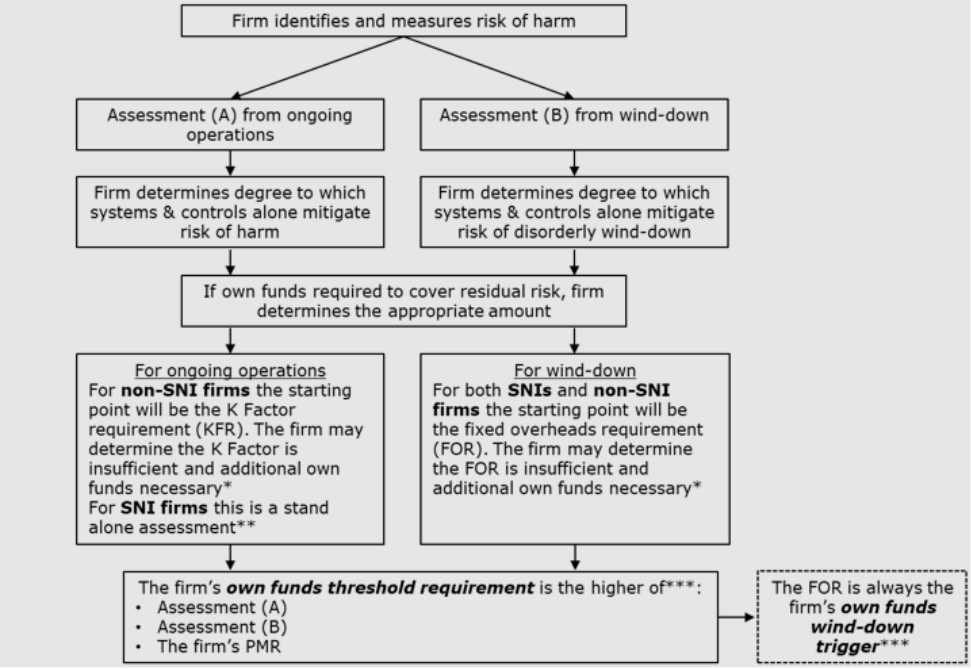
(b) the amount of *own funds* that a *firm* would need to hold to ensure that the *firm* can be wound down in an orderly manner.

(3) The *own funds threshold requirement* is the amount of *own funds* that a *firm* needs to hold at any given time to comply with the *overall financial adequacy rule*.

(4) The *firm's* analysis of potential material harms under ■ MIFIDPRU 7.6.2R is particularly relevant when it is considering the level of *own funds* that are necessary for the ongoing operation of its business. It is also be relevant when considering how the *firm* should address potential material harms as part of an orderly wind-down.

(5) The following diagram summarises the process that a *firm* should undertake to determine its *own funds threshold requirement*:

Calculating the own funds threshold requirement



(6) ■ MIFIDPRU TP 2.25AR and ■ MIFIDPRU TP 2.25BG contain *rules* and *guidance* on the interaction between a firm's *own funds threshold requirement* and the alternative requirement for its *fixed overheads requirement*, *K-factor requirement* or *permanent minimum capital requirement*.

*The *own funds threshold requirement* cannot be lower than the *K-factor requirement* or the *fixed overheads requirement*.

**The *K-factor requirement* does not apply to *SNI MIFIDPRU investment firms* and the *permanent minimum capital requirement* (PMR) is not linked to harm.

***Unless otherwise specified by the *FCA*.

7.6.5 R

(1) Unless (2) applies, a *firm* must meet its *own funds threshold requirement* with *own funds* that satisfy the following conditions:

(a) subject to (b), at least 75% of the *own funds threshold requirement* must be met with any combination of *common equity tier 1 capital* and *additional tier 1 capital*; and

(b) at least 56% of the *own funds threshold requirement* must be met with *common equity tier 1 capital*.

(2) The *FCA* may specify an alternative combination of *own funds* for the purpose of (1) in a requirement applied to a *firm*.

7.6.6 G

(1) ■ MIFIDPRU 7.6.7G and ■ 7.6.8G explain the approach a *non-SNI MIFIDPRU investment firm* should apply to carry out the assessment in ■ MIFIDPRU 7.6.3R.

(2) ■ MIFIDPRU 7.6.9G explains the approach that an *SNI MIFIDPRU investment firm* should apply to carry out the assessment in ■ MIFIDPRU 7.6.3R.

(3) ■ MIFIDPRU G explains the approach that all *MIFIDPRU investment firms* should apply when assessing their *own funds threshold requirement*.

7.6.7 G

(1) ■ MIFIDPRU 4 and ■ 5 explain how a *firm* must determine its *own funds requirement*. Where, as part of its *ICARA process*, a *firm* has identified potential material harms that cannot be fully mitigated, the *firm* should first consider the extent to which the impact of the residual harm on *own funds* is covered (wholly or partly) by the framework in ■ MIFIDPRU 4 and ■ 5.

(2) Example 1: If the potential material harm arises from the ordinary course of the *firm's portfolio management* business, a *non-SNI MIFIDPRU investment firm* should consider the potential impact of the harm by comparison with the *firm's K-AUM requirement*. If the harm is a harm that might typically arise from *portfolio management*, the *firm* may treat the harm as covered by the *K-AUM requirement*. However, if the harm is unusual in nature or might be particularly severe (for example, fraud or other irregularities), it would be unreasonable for the *firm* to treat the harm as fully covered by the *K-AUM requirement*. This is because the *K-AUM requirement* is designed to address typical harms from ordinary *portfolio management*, and not every conceivable material harm that might result from this activity.

(3) Example 2: If the potential material harm arises from the ordinary course of the *firm* investing its own proprietary capital in positions allocated to the *trading book*, a *non-SNI MIFIDPRU firm* should consider the nature of that harm. For example, if the harm relates to the ordinary operational aspects of *dealing on own account*, the *firm* may treat the harm as covered by the *K-DTF requirement*, unless the harm is unusual or particularly severe. If the harm arises from adverse market movements in relation to the *firm's trading book* positions, the *firm* may treat the harm as covered by the *K-NPR requirement* (or *K-CMG requirement* if the position arises in a *portfolio* for which the *firm* has received a *K-CMG permission*), unless the relevant positions

have particular features that mean the harm may be unusual or particularly severe.

(4) Example 3: Some components of the *K-factor requirement*, such as the *K-CON requirement*, reflect specific types of harm. In this case, the *firm* should consider the purpose of the relevant requirement. As the *K-CON requirement* is designed to address the potential harm arising from a *firm* having concentrated exposures to a counterparty or group of connected counterparties, a *non-SNI MIFIDPRU investment firm* should only compare a harm to the *K-CON requirement* where that harm arises from, or is connected to, these concentrated exposures.

(5) Example 4: When assessing harms that may occur during a wind-down of the *firm's* business, a *non-SNI MIFIDPRU investment firm* should consider the potential impact of the harm by comparison with its *fixed overheads requirement*. In this case, the *firm* should identify the likely costs of winding down the *firm* and the potential financial impact of any material harms that might occur while doing so and compare the aggregate amount with the *fixed overheads requirement*. This will allow a *firm* to determine whether they are holding sufficient *own funds* to ensure an orderly wind-down, as required by the *overall financial adequacy rule*.

7.6.8 G

(1) Some harms may not fit within the *own funds requirement* framework in ■ MIFIDPRU 4 or ■ 5 because they cannot reasonably be attributed to the activities or risks that the *rules* in those chapters are designed to address. Where the harms are potentially material in nature, a *non-SNI MIFIDPRU investment firm* will need to assess their potential financial impact separately and cannot treat those harms as covered (either wholly or partly) by a requirement under ■ MIFIDPRU 4 or ■ 5. This includes potential material harms resulting from any *regulated activities* that are not *MiFID business* and from any *unregulated activities*.

(2) Example 1: A *non-SNI MIFIDPRU investment firm* undertakes significant amounts of *corporate finance business*. The *K-factor requirement* does not include any components which are designed to address the potential harms arising from this type of business, as none of the *K-factor metrics* relate to *corporate finance business*. If the *firm* identifies potential material harms that may arise from its corporate finance activities, it cannot therefore compare that harm to any part of the *K-factor requirement*. In this case, the *firm* will need to assess the potential financial impact of that harm and will need to hold additional *own funds* to cover that impact.

(3) Example 2: A *non-SNI MIFIDPRU investment firm* holds *client money* in connection with *designated investment business* that is not *MiFID business*. The *K-CMH requirement* applies only to *MiFID client money*. If the *firm* identifies potential material harms that result from holding *client money* for non-*MiFID business*, it will therefore need to assess the potential financial impact of that harm and hold additional *own funds* to cover that impact. Similarly, if there are material issues arising from currency mismatches in relation to *MiFID client money*, this may be a risk that is not adequately covered by the *K-CMH requirement*.

(4) A *firm* is not required to map the financial impact of every potential material harm to components of its *K-factor requirement*. In some circumstances, it may be impractical or disproportionate to allocate the potential financial impact of harms in this way. Alternatively, it may not be clear that a harm can be allocated to one or more components of the *K-factor requirement*. A *firm* may therefore hold an amount that is additional to its *K-factor requirement* to address a particular harm without determining whether that harm might already be partly covered by the *K-factor requirement*.

(5) Example 3: A *non-SNI MIFIDPRU investment firm* determines that there is a risk of material harm from a cyber incident affecting its IT systems. The *firm's* IT systems are used across all its business lines and the *firm* considers that it is impractical to allocate the financial impact of the cyber incident between particular components of the *K-factor requirement*. In this situation, the *firm* may hold an additional amount of *own funds* (i.e. over and above its *K-factor requirement*) to cover the potential financial impact of the cyber incident without mapping the impact of the harm to specific components of the *K-factor requirement*. However, the *firm* should clearly record the basis on which it has determined the amount of additional *own funds* that are required.

(6) Example 4: A *non-SNI MIFIDPRU investment firm* is appointed as a *depositary*. The *K-CMH requirement* and the *K-ASA requirement* apply only in relation to *MiFID business*, and therefore do not apply to its activities as a *depositary*. If the *firm* identifies a potential material harm that results from its activities as a *depositary*, it will need to assess the potential financial impact of that harm and hold additional *own funds* to cover that impact. A *firm* may have regard to the general methodology for calculating the *K-CMH requirement* and the *K-ASA requirement* when carrying out the assessment in MIFIDPRU 7.6.3R for its activities as a *depositary*.

7.6.9 G

(1) An *SNI MIFIDPRU investment firm* is not subject to the *K-factor requirement*. In practice, this means that its *own funds requirement* is typically determined by the *fixed overheads requirement*, although for smaller *firms*, the *permanent minimum capital requirement* may be determinative.

(2) An *SNI MIFIDPRU investment firm* should therefore identify all relevant potential material harms from its ongoing business operations that cannot be mitigated by other means and estimate their impact on the *firm's own funds*. It should then compare the aggregate financial impact on *own funds* with the *firm's fixed overheads requirement* (or, if higher, the *permanent minimum capital requirement*).

(3) Separately, an *SNI MIFIDPRU investment firm* should also identify the likely costs of winding down the *firm* and the potential financial impact of any material harms that might occur while doing so and should compare the aggregate amount with the *fixed overheads requirement*. This will allow the *firm* to determine if it is holding sufficient *own funds* to ensure an orderly wind-down, as required by the *overall financial adequacy rule*.

(4) Where an *SNI MIFIDPRU investment firm* is close to exceeding one or more of the thresholds in ■ MIFIDPRU 1.2.1R that would result in the *firm* being reclassified as a *non-SNI MIFIDPRU investment firm*, the *firm* should begin to compare its assessment of the *own funds* that it needs to comply with the *overall financial adequacy rule* with the *K-factor requirement* that would apply to the *firm* if it were a *non-SNI MIFIDPRU investment firm*. The *guidance* in ■ MIFIDPRU 7.6.7G and ■ 7.6.8G is relevant in these circumstances. Comparison with the future *K-factor requirement* will ensure that the *firm* is better prepared to comply with the additional obligations in ■ MIFIDPRU 4 and ■ 5, and that its *ICARA process* is calibrated appropriately, at the point at which the *firm* becomes a *non-SNI MIFIDPRU investment firm*.

7.6.10 G

(1) ■ MIFIDPRU 7.6.7G to ■ MIFIDPRU 7.6.9G explain the approach that a *firm* should take to determine if a potential harm is covered by the *firm's own funds requirement*. Where a *firm* has identified potential harms that are not covered by its *own funds requirement*, or are covered only partly by its *own funds requirement*, the *firm* should aggregate the estimated financial impact of those harms to determine the overall additional amount of *own funds* (i.e. above its *own funds requirement*) that the *firm* needs to comply with the *overall financial adequacy rule*.

(2) Where the *FCA* disagrees with a *firm's* assessment of the amount of *own funds* that is required by the *overall financial adequacy rule*, the *FCA* may provide individual *guidance* to that *firm* about the amount of *own funds* that the *FCA* considers is necessary to comply with that *rule*. Alternatively, the *FCA* may apply a *requirement* to the *firm* that specifies an amount of *own funds* that the *firm* must hold for that purpose.

(3) The effect of ■ MIFIDPRU 7.6.3R(2) is that a *firm* must not:

(a) determine that it needs a lower level of *own funds* for an activity or harm than is required by a component of the *own funds requirement* that addresses that risk or harm; or

(b) use components of the *own funds requirement* to cover harms that cannot be attributed to that component.

This is illustrated by the example in (4).

(4) Example: A *non-SNI MIFIDPRU investment firm* carries on *portfolio management* and determines that its *K-AUM requirement* is £50,000. However, the *firm* estimates that the actual financial impact of potential harm that may result from its *portfolio management* activities is only £30,000. The *firm* also carries on corporate finance advisory business (which does not give rise to a *K-factor requirement*) and estimates that the financial impact of the potential harm arising from this business is £40,000. The *firm* should not conclude that its *own funds threshold requirement* is £70,000. This is because the *firm* is not permitted to:

(a) conclude that the amount of *own funds* that it holds in relation to its *portfolio management* activities is less than the *K-AUM requirement*. This means that the *firm* is not permitted to substitute its own estimate of £30,000 for the minimum *K-AUM requirement* of £50,000; or

(b) use part of the *K-AUM requirement* to cover potential material harms that do not arise in connection with *portfolio management*. This means that the *firm* cannot reallocate part of the *own funds* that should be held to cover the *K-AUM requirement* to cover risks arising from its corporate finance business.

(5) Instead, assuming that there are no other relevant potential materials harms to be taken into account, the *firm* should conclude that its *own funds threshold requirement* is £90,000, which is the sum of the *K-AUM requirement* and the *firm's* estimate of the potential financial impact of harms arising from its corporate finance business.

7.6.10A G

(1) Where a *MIFIDPRU investment firm* is also subject to another prudential regime for its non-*MiFID business*, its *own funds threshold requirement* can be no lower than the total financial resources requirement under that prudential regime. This is illustrated by the examples in (2) and (3).

7

(2) Firm A is a *collective portfolio management investment firm* that is required under ■ IPRU-INV 11.6 to comply with the applicable requirements of *MIFIDPRU* in parallel with its requirements under ■ IPRU-INV 11. Firm A has an *own funds requirement* of £2,000,000 under *MIFIDPRU* 4 and, through its *ICARA process*, assesses that it needs £500,000 of additional *own funds* to cover potential material harms. However, Firm A also has a total requirement for *own funds* of £3,000,000 under ■ IPRU-INV 11.2. In this case, Firm A's *own funds threshold requirement* would be £3,000,000, because its *own funds threshold requirement* can be no lower than the total resources requirement under any other prudential regime that applies to it (■ IPRU-INV 11).

(3) Firm B is a *collective portfolio management investment firm* that is required under ■ IPRU-INV 11.6 to comply with the applicable requirements of *MIFIDPRU* in parallel with its requirements under ■ IPRU-INV 11. Firm B has an *own funds requirement* of £2,000,000 under ■ MIFIDPRU 4 and, through its *ICARA process*, assesses that it needs £1,500,000 of additional *own funds* to cover potential material harms. Firm B also has a total requirement for *own funds* of £3,000,000 under ■ IPRU-INV 11.2. In this case, Firm B's *own funds threshold requirement* would be £3,500,000. This is because Firm B's assessment of its *own funds threshold requirement* is higher than the total resources requirement under the other prudential regime that applies to it (■ IPRU-INV 11).

Requirement to notify the FCA of certain levels of own funds

7.6.11 R

(1) A *firm* must notify the *FCA* immediately in each case where its *own funds* fall below the level of the *firm's*:

(a) early warning indicator;

(b) own funds threshold requirement; or

(c) own funds wind-down trigger, or the *firm* considers that there is a reasonable likelihood that its *own funds* will fall below that level in the foreseeable future.

(2) A notification under (1) must include the following information:

(a) a clear statement of the current level of the *firm's own funds* in comparison to:

(i) its *own funds threshold requirement*; and

(ii) in the case of a notification under (1)(c), the *firm's own funds wind-down trigger*;

(b) an explanation of why the *firm's own funds* have reached the current level;

(c) in the case of a notification made under (1)(a), where the *firm* has identified that its *own funds* may fall below a level specified by the *firm* for the purposes of ■ MIFIDPRU 7.5.5R(1), the recovery actions that the *firm* intends to take, as identified under ■ MIFIDPRU 7.5.5R(2)(a) and ■ 7.5.6G;

(d) in the case of a notification made under (1)(a), confirmation of whether the *firm* expects that its *own funds* could fall below its *own funds threshold requirement* in the foreseeable future and an explanation of why the *firm* expects this to happen;

(e) in the case of a notification made under (1)(b), the recovery actions specified for the purposes of ■ MIFIDPRU 7.5.5R(2)(b) and ■ 7.5.6G that the *firm* has already taken or will take to restore compliance with its *own funds threshold requirement*; and

(f) in the case of a notification made under (1)(c), the *firm's* intentions in relation to activating its wind-down plan.

(3) A *firm* must submit the notification in (1) through the *online notification and application system* using the form in ■ MIFIDPRU 7 Annex 4R.

7.6.12 G In appropriate cases, the *FCA* may consider that the *early warning indicator* should be set at a different level from 110% of a *firm's own funds threshold requirement*. In this case, the *FCA* may invite a *firm* to apply for a *requirement* in accordance with section 55L(5) of the *Act*, or may impose a *requirement* on the *FCA's* own initiative in accordance with section 55L(3) of the *Act*, to provide for notification to the *FCA* if the *firm's own funds* reach the alternative level.

7.6.13 G (1) The notification requirement in ■ MIFIDPRU 7.6.11R does not replace a *firm's* obligations under:

(a) *Principle* 11 to disclose appropriately to the *FCA* anything relating to the *firm* of which the *FCA* would reasonably expect notice; or

(b) the general notification requirements in ■ SUP 15.3.

(2) Where a *firm* has submitted a notification under ■ MIFIDPRU 7.6.11R, the notification will generally discharge a *firm's* obligations under *Principle* 11 and the general notification requirements in ■ SUP 15.3 in relation to the matters contained in the notification. However, a *firm* must still consider whether the *FCA* should be notified of developments before any of the notification indicators in ■ MIFIDPRU 7.6.11R occur. In addition, *Principle* 11 and ■ SUP 15.3 may require a firm to notify the *FCA* of additional material information that is not specifically referenced in ■ MIFIDPRU 7.6.11R.

(3) A *MIFIDPRU investment firm* should notify the *FCA* at an early stage of any significant event which creates a material risk of a *firm* ceasing to hold adequate financial resources, even if the impact of that event has not yet fully materialised.

FCA approach to intervention in relation to own funds

7.6.14 G

(1) The table in ■ MIFIDPRU 7.6.15G explains the interventions that the *FCA* would generally expect to make where there is evidence that a *MIFIDPRU investment firm* may be at risk of breaching the requirements that apply to its *own funds*. The table sets out the points at which the *FCA* would normally intervene and what actions it would normally take.

(2) The *FCA* would generally expect that the interventions in the table would be cumulative – i.e. in a declining prudential situation, as the *firm* hits each intervention point in turn, the *FCA* would take some or all of the actions associated with that particular point. The actions are intended to be proportionate and progressively stronger responses to address the prudential concerns raised by each intervention point.

(3) However, if a *firm* experiences a sudden adverse event which causes the *firm* to hit multiple intervention points simultaneously, the *FCA* may immediately take the actions associated with the most severe point.

(4) The actions specified in the table do not prevent the *FCA* from taking alternative or additional actions in appropriate cases. The purpose of the table is to provide greater clarity for *firms* on the *FCA's* general expectations and approach to interventions, to assist *firms*' own planning and responses.

7.6.15 G This table belongs to ■ MIFIDPRU 7.6.14G.

Intervention point	Purpose	Potential FCA supervisory actions
Early warning indicator: When the *early warning indicator* is triggered, the *firm* must notify the *FCA* under MIFIDPRU 7.6.11R(1)(a)	This is intended as an early warning to the *FCA* that the *firm* may be at risk of breaching its *own funds threshold requirement*. This will allow the *firm* and the *FCA* to consider any preventative action that may be appropriate.	Where the notification is not the expected result of planned action by the *firm*, the *FCA* would normally expect the following to occur: (a) a dialogue between the *FCA* and the *firm* based on the information provided in the noti

Intervention point	Purpose	Potential FCA supervisory actions
		fication to understand the reason for the decline in the *firm's own funds* and the *firm's* future plans; and
		(b) enhanced monitoring and supervision of the *firm* by the *FCA*.
		After having considered the information provided by the *firm* about its proposed actions, if the *FCA* reasonably considers that the *firm* may breach its *own funds threshold requirement* in the foreseeable future, the *FCA* may consider the following additional actions:
		(c) requesting that the *firm* cease making discretionary distributions of capital, loans to affiliated entities, payments of dividends or payments of variable remuneration;
		(d) requesting that the *firm* take some or all of the recovery actions identified by the *firm* under MIFIDPRU 7.5.5R(2) and 7.5.6G;
		(e) requesting that the *firm* report additional information to the *FCA*;
		(f) requesting that the *firm* improve its internal risk management and systems and controls;
		(g) requesting that the *firm* cease making acquisitions; or

Intervention point	Purpose	Potential FCA supervisory actions
		(h) where appropriate, inviting the *firm* to apply for a requirement under section 55L(5) of the *Act*, or imposing a *requirement* on the *FCA's* own initiative under section 55L(3) of the *Act*, in relation to (c) – (g) above.
Threshold requirement notification: *Firm* holding insufficient *own funds* to meet its *own funds threshold requirement*	In the *FCA's* view, where a *firm* is failing to hold sufficient *own funds* to comply with its *own funds threshold requirement*, the *firm* will be failing to meet the appropriate resources *threshold condition*. This trigger is intended to prompt the *firm* and the *FCA* to address the breach of *threshold conditions* in a timely manner. Where appropriate, the focus should be on recovery of the *firm* (unless the *firm* chooses to exit the market by voluntarily winding down). However, any proposed actions for recovery must be credible and achievable within a reasonable and realistic timeframe.	The *FCA* would normally expect that: (a) the *firm* will have taken any relevant recovery actions identified by the *firm* under MIFIDPRU 7.5.5R(2)(a) and 7.5.6G before breaching its *own funds threshold requirement* and will be preparing to take, or will have taken, any relevant recovery actions identified under MIFIDPRU 7.5.5R(2)(b); and (b) the *firm* will cease making discretionary distributions of capital, loans to affiliated entities, payments of dividends or payments of variable remuneration. After having considered the information provided by the *firm* about its proposed actions, if the *FCA* reasonably considers that the *firm* may fail to restore its *own funds* to the level required by the *own funds threshold requirement* within a reasonable timeframe, the *FCA* may consider the following additional actions:

Intervention point	Purpose	Potential FCA supervisory actions
		(c) requesting that the *firm* cease taking on new business;
		(d) requesting that the *firm* report additional information to the *FCA*;
		(e) requesting that the *firm's parent undertaking* provides additional *own funds* for the *firm*;
		(f) where appropriate, inviting the *firm* or its *parent undertaking* to apply for a *requirement* under section 55L(5) or section 143K(1) of the *Act*, or imposing a requirement on the *FCA's* own initiative under section 55L(3) or section 143K(2) of the *Act*, in relation to (a) – (e) above; or
		(g) where appropriate, inviting the *firm* to apply for variation or cancellation of *permission* under section 55H of the *Act*, or varying or cancelling the *firm's permission* on the *FCA's* own initiative under section 55J of the *Act*.
		The *FCA* would also expect the *firm* to consider whether it is appropriate to trigger the *firm's* wind-down plan under MIFIDPRU 7.5.7R to ensure an orderly wind-down of its business. This may be the case where the *firm's* identified wind-down actions will require a reasonable length of time to execute, such as where the *firm* will need to transfer

Intervention point	Purpose	Potential FCA supervisory actions
		customers or close out its own positions.
Wind-down trigger notification: *Firm's own funds* fall below its *own funds wind-down trigger*	The *own funds wind-down trigger* is intended to specify a level of *own funds* that is sufficient to ensure an orderly wind-down of the *firm*. Where the *firm's own funds requirement* is determined by the *fixed overheads requirement* and the *firm* has not identified that it needs to hold additional *own funds* to comply with the *overall financial adequacy rule*, the *own funds wind-down trigger* may be equal to the *firm's own funds threshold requirement*. In that case, the *FCA* may proceed directly to applying the interventions in this row, rather than those specified for a breach of the *own funds threshold requirement* above. In order to maximise the po	The *FCA* would normally expect the following to occur: (a) the *firm's governing body* will make a formal decision to initiate the *firm's* wind-down plan, unless the *governing body* has a reasonable basis for determining that there is an imminent and credible likelihood of the *firm's* recovery; and (b) where the *firm* decides to initiate its wind-down plan, the *FCA* will invite the *firm* to apply for a *requirement* under section 55L(5) of the *Act*, or will impose a *requirement* on the *FCA's* own initiative under section 55L(3) of the *Act*, that prevents the *firm* from taking on any new business. The *FCA* may consider the following additional actions if it has concerns that without such actions, the po-

Intervention point	Purpose	Potential FCA supervisory actions
	tential for an orderly wind-down, the *FCA* expects that *firms* that breach this trigger should normally commence winding down immediately, unless the *firm's governing body* and the *FCA* determine that there is an imminent and credible likelihood of recovery.	tential risk of harm to consumers or the markets is likely to increase: (c) taking appropriate action to protect any *client money* or *client assets*, including, where appropriate, inviting the *firm* to apply for a *requirement* under section 55L(5) of the *Act*, or imposing a *requirement* on the *FCA's* own initiative under section 55L(3) of the *Act*, to achieve any necessary protection; and (d) where appropriate, inviting the *firm* to apply for variation or cancellation of *permission* under section 55H of the *Act*, or varying or cancelling the *firm's permission* on the *FCA's* own initiative under section 55J of the *Act*. If a *firm* refuses to commence an orderly wind-down despite its *governing body* or the *FCA* having concluded that there is no imminent and credible likelihood of recovery, the *FCA* will consider the full range of its supervisory powers. In particular, the *FCA* may use a combination of its own initiative powers under section 55L(3) and section 55J of the *Act* to: (e) prevent the *firm* from continuing to carry on any *regulated activities*; and (f) require the *firm* to take appropriate actions to en-

Intervention point	Purpose	Potential FCA supervisory actions
		sure the fair treatment and appropriate protection of *clients* and counterparties during any run-off period for its existing regulated business.

7.7 ICARA process: assessing and monitoring the adequacy of liquid assets

7.7.1 R This section applies to a *MIFIDPRU investment firm*.

7.7.2 R (1) As part of its *ICARA process*, a *firm* must produce a reasonable estimate of the maximum amount of *liquid assets* that the *firm* would require to:

(a) fund its ongoing business operations during each quarter over the next 12 *months*; and

(b) ensure that the *firm* could be wound down in an orderly manner.

(2) The assessment in (1) must take into account any potential material harms that the *firm* has identified under ■ MIFIDPRU 7.4.9R and been unable to reduce appropriately through its systems and controls.

(3) Without prejudice to the ongoing nature of the *ICARA process*, the *firm* must update the analysis in (1) immediately following any material change in the *firm's* business model or operating model.

(4) To produce the estimate in (1), the *firm* must ensure that it has in place reliable management information systems to provide timely and forward-looking information on its liquidity position.

7.7.3 G (1) The *overall financial adequacy rule* requires a *firm* to hold adequate *liquid assets* to ensure that:

(a) the *firm* is able to remain financially viable throughout the economic cycle, with the ability to address any potential harm that may result from its ongoing activities; and

(b) the *firm's* business can be wound down in an orderly manner.

(2) To comply with the *overall financial adequacy rule*, a *firm* must therefore hold the sum of the *basic liquid assets requirement* and the higher of:

(a) the amount of *liquid assets* that the *firm* requires to fund its ongoing business operations, taking into account potential periods of financial stress during the economic cycle; or

(b) the additional amount of *liquid assets* that a *firm* would need to hold when commencing its wind-down process to ensure that the *firm* could be wound down in an orderly manner.

(3) The *firm* should use the analysis it produces under ■ MIFIDPRU 7.7.2R to ensure that it complies with the *overall financial adequacy rule*.

(4) The *liquid assets threshold requirement* is the amount of *liquid assets* that a *firm* needs to hold at any given time to comply with the *overall financial adequacy rule*.

7.7.4 G

(1) When considering the *liquid assets* that are required to fund its ongoing business operations under ■ MIFIDPRU 7.7.2R(1), a *firm* should consider, among other factors:

(a) the ordinary level of *liquid assets* that would typically be required to operate the *firm's* underlying business, taking into account any seasonal variations;

(b) any material harms that may realistically occur during the next 12 *months* and their potential impact on the *firm's* liquidity position;

(c) any *liquid assets* that a *firm* may need to use as collateral or to meet margining requirements; and

(d) any estimated gaps in funding, including during periods of severe but plausible stress.

(2) The *liquid assets* that a *firm* requires at any given time during the 12-*month* period in ■ MIFIDPRU 7.7.2R(1) may fluctuate, depending on the timing of a *firm's* expected liabilities and the nature of its business. Therefore, a *firm* should divide the 12-*month* period into quarters and assess the highest amount of *liquid assets* that it would require in each quarter. The *FCA* accepts that forecasts of the *liquid assets* that a *firm* requires may become less accurate for later quarters, but expects *firms* to use a 12-*month* time horizon to ensure that adequate attention is given to potential harms and significant liquidity outflows that may occur during that period.

(3) As a *firm's* liquidity requirements are typically dynamic in nature, ■ MIFIDPRU 7.7.2R requires a *firm* to update its *liquid assets* assessment where there has been a material change in the *firm's* business model or operating model. This ensures that the *firm* updates its liquidity analysis to reflect material changes in its circumstances that may affect the availability of *liquid assets* or the *firm's* liquidity requirements, while also assessing future needs over a rolling 12-*month* time horizon.

(4) As part of its reporting obligations under ■ MIFIDPRU 9, a *firm* must report liquidity information to the *FCA* on a regular basis. The *FCA* will use this information to monitor both the *liquid assets* that the *firm* is holding and the *firm's* assessment of its *liquid assets threshold requirement*.

7.7.5 G

(1) A *firm's basic liquid assets requirement* provides a minimum level of *core liquid assets* that the *firm* must maintain at all times. The purpose of the *basic liquid assets requirement* is to ensure that the *firm* always has a minimum stock of *liquid assets* to fund the initial stages of its wind-down process if wind-down becomes necessary. The *firm* cannot, therefore, use the value of the *core liquid assets* that it holds to meet the *basic liquid assets requirement* as *liquid assets* for the liquidity needs of its ongoing business.

(2) The *basic liquid assets requirement* may, however, be insufficient to provide the *liquid assets* that the *firm* has assessed would be necessary to facilitate an orderly wind-down as part of its wind-down planning under ■ MIFIDPRU 7.5.7R. Therefore, the *firm* may identify that it needs to hold an additional amount of *liquid assets* to meet its funding needs as part of the wind-down process. This is not necessarily the whole amount of the *liquid assets* that would be required to fund the entire wind-down process, because in some circumstances, the *firm* may reasonably expect to generate additional *liquid assets* during wind-down. However, the *firm* should identify if it could have a funding gap during the wind-down process that the *firm* needs to cover by holding more liquid assets at the point that wind-down begins.

(3) The following diagram summarises the process that a *firm* should undertake to determine its *liquid assets threshold requirement*:

*When a *firm* assesses the amount of *liquid assets* it needs for ongoing operations, it cannot use the value of the *core liquid assets* held to meet the *basic liquid assets requirement* to fund those operations.

**The *basic liquid assets requirement* may be insufficient to provide the *liquid assets* that the *firm* has assessed would be necessary to facilitate an orderly wind-down. Therefore, the *firm* may identify that it needs to hold an additional amount of *liquid assets* (above the *basic liquid assets requirement*) to meet its funding needs to commence its wind-down process.The amount of additional *liquid assets* under assessment (B), therefore, does not include the amount of the *basic liquid assets requirement* (as explained in ■ MIFIDPRU 7.7.3G(2)(b)).

***Unless otherwise specified by the *FCA*.

(4) The following example illustrates how to determine the *firm's liquid assets threshold requirement* once assessment (A) and assessment (B) have been calculated:

(a) A *firm* has a *basic liquid assets requirement* of £1,000,000 under ■ MIFIDPRU 6.

(b) Through its *ICARA process*, the *firm* assesses that it needs a total amount of *liquid assets* of:

(i) £1,500,000 for ongoing operations under assessment (A); and

(ii) £5,000,000 for an orderly wind-down, which means that the *firm's* additional amount of *liquid assets* (above the *basic liquid assets requirement*) under assessment (B) is £4,000,000.

(c) As assessment (B) (£4,000,000) is higher than assessment (A) (£1,500,000), assessment (B) (£4,000,000) is added to the *firm's basic liquid assets requirement* of £1,000,000.

(d) The *firm's liquid assets threshold requirement* would, therefore, be £5,000,000 (the sum of the *basic liquid asset requirement* (£1,000,000) and assessment (B) (£4,000,000)).

7.7.6 R

(1) Subject to (2) and (3), a *firm* may hold the *liquid assets* necessary to comply with its *liquid assets threshold requirement* in any combination of:

(a) any *core liquid asset*, except trade receivables under ■ MIFIDPRU 6.3.3R; or

(b) any *non-core liquid asset*, as defined in ■ MIFIDPRU 7.7.8R, provided that the *firm* applies an appropriate haircut in accordance with ■ MIFIDPRU 7.7.10R.

(2) This *rule* does not apply in relation to the *liquid assets* that a *firm* is holding to meet its *basic liquid assets requirement*, which must be *core liquid assets*.

(3) A *firm* may only use a *non-core liquid asset* for the purpose in (1) if the *firm* is satisfied that the asset can easily and promptly be converted into cash, even in stressed market conditions.

7

7.7.7 G

When considering whether a *non-core liquid asset* meets the requirement in ■ MIFIDPRU 7.7.6R(3), a *firm* should take into account the following principles:

(1) low risk: assets that are less risky tend to have higher liquidity. High credit standing of the issuer and a low degree of subordination tends to increase an asset's liquidity. Low duration, low legal risk, low inflation risk and denomination in a convertible currency with low foreign exchange risk all tend to enhance an asset's liquidity;

(2) ease and certainty of valuation: an asset's liquidity tends to increase if market participants are more likely to agree on its valuation. Assets with more standardised, homogenous and simple structures tend to be more fungible, promoting liquidity. The pricing formula of a high-quality liquid asset should be easy to calculate and not depend on strong assumptions. The inputs into the pricing formula should also be publicly available. In practice, this should rule out the inclusion of most structured or exotic products;

(3) low correlation with risky assets: the stock of assets should not be subject to wrong-way (highly correlated) risk. For example, assets issued by financial institutions are more likely to be illiquid in times of liquidity stress in the financial sector;

(4) listed on a developed and recognised exchange: being listed tends to increase an asset's transparency and liquidity;

(5) active and sizable market: the asset should have an active market at all times. This means that:

(a) there should be historical evidence of market breadth and market depth. This could be demonstrated by low bid-ask spreads, high trading volumes, a large and diverse number of market participants, and the existence of a repo market. Diversity of market participants reduces market concentration and increases the reliability of the liquidity in the market; and

(b) there should be robust market infrastructure in place. The presence of multiple committed market makers increases liquidity as quotes will most likely be available for buying or selling the asset;

(6) low volatility: assets whose prices remain relatively stable and are less prone to sharp price declines over time will have a lower probability of triggering forced sales to meet liquidity requirements. Volatility of traded prices and spreads are simple proxy measures of market volatility. There should be historical evidence of relative stability of market terms (e.g. prices and haircuts) and volumes during stressed periods; and

(7) flight to quality: historically, the market has shown tendencies to move into these types of assets in a systemic crisis. The correlation between proxies of market liquidity and financial system stress is one simple measure that could be used.

7.7.8 R

(1) Except as specified in (2), the following assets are eligible as *non-core liquid assets*:

(a) short-term deposits at a *credit institution* that does not have a *Part 4A permission* in the *UK* to *accept deposits*;

(aa) short-term non-sterling deposits at a *UK credit institution*;

(b) assets representing claims on, or guaranteed by, multilateral development banks and international organisations;

(c) assets representing claims on, or guaranteed by, any *third country* central bank or government;

(d) financial instruments; and

(e) any other instrument eligible as collateral against the margin requirement of an *authorised central counterparty*.

(2) A *firm* must not treat any of the following as a *non-core liquid asset*:

(a) any asset that belongs to a *client*;

(b) any other asset that is encumbered; or

(c) any asset issued by the *firm* or any of its affiliated entities, except a short-term deposit with an affiliated *credit institution*.

7.7.9 R

(1) For the purposes of MIFIDPRU 7.7.8R(2)(a), an asset may belong to a *client* even if the asset is held in the *firm's* own name. Examples of assets belonging to a *client* include money or other assets held under the *FCA's client asset rules*.

(2) For the purposes of MIFIDPRU 7.7.8R(2)(b), an asset may be encumbered if it is pledged as security or collateral, or subject to some other legal restriction (for example, due to regulatory or contractual requirements) which affects the *firm's* ability to liquidate, sell, transfer, or assign the asset.

7.7.10 R

A *firm* must apply an appropriate haircut to the value of a *non-core liquid asset* to reflect the potential loss of value when converting the asset into cash during stressed market conditions.

7.7.11 G The *FCA* considers that a minimum haircut of no less than that in the range specified in the table in ■ MIFIDPRU 7.7.12G is likely to be appropriate for the purposes of ■ MIFIDPRU 7.7.10R.

7.7.12 G This table belongs to ■ MIFIDPRU 7.7.11G.

Non-core liquid asset	Haircut
Short-term deposits at a *credit institution* that does not have *permission* in the *UK* to *accept deposits*	0%
Short-term non-sterling deposits at a *UK credit institution*	0%
Assets representing claims on, or guaranteed by, multilateral development banks or international organisations	0%
Assets representing claims on, or guaranteed by, any *third country* central bank or government	0% - 50%
Regulated covered bonds, or comparable covered bonds regulated in a *third country*	7% - 30%
Asset-backed securities eligible for 'STS' designation under the *Securitisation Regulation*, and backed by residential loans, personal loans, leases or commercial loans for purposes other than commercial real estate development, or comparable asset-backed securities regulated in a *third country*	25% - 35%
High quality corporate debt securities	15% - 50%
Shares that form part of a major stock index	50%
Financial instruments not covered above for which there is a liquid market as defined in article 42(1)(17) of *MiFIR* or article 42(1)(17) of *EU MiFIR*	55%
Other instruments eligible as collateral against the margin requirement of an *authorised central counterparty*	25% - 55%

7.7.13 G For the purposes of applying ■ MIFIDPRU 7.7.10R and ■ 7.7.11G to shares or units in a *CIU*:

(1) where a *firm* is aware of the exposures underlying the *CIU*, it may look through to the underlying exposures to assign an appropriate haircut;

(2) where a *firm* is not aware of the exposures underlying the *CIU*, it should assume that the *CIU* invests, up to the maximum amount allowed under its mandate, in the highest risk assets permissible; and

(3) in either case, a *firm* should consider applying an additional haircut to reflect any additional loss of value that could result from the underlying exposures being held through a *CIU*.

Requirement to notify the FCA of certain levels of liquid assets

7.7.14 R

(1) A *firm* must notify the *FCA* immediately in each case where:

(a) its *liquid assets* fall below its *liquid assets threshold requirement*; or

(b) its *liquid assets* fall below its *liquid assets wind-down trigger* or the *firm* considers that there is a reasonable likelihood that its *liquid assets* will fall below its *liquid assets wind-down trigger* in the foreseeable future.

(2) A notification under (1) must include the following information:

(a) a clear statement of the current level of the *firm's liquid assets* in comparison to:

(i) the *firm's liquid assets threshold requirement*; and

(ii) in the case of a notification under (1)(b), the *firm's liquid assets wind-down trigger*;

(b) an explanation of why the *firm's liquid assets* have reached the current level;

(c) in the case of a notification under (1)(a), an explanation of the recovery actions specified for the purposes of ■ MIFIDPRU 7.5.5R(2)(b) and ■ 7.5.6G that the *firm* has already taken or will take to restore compliance with its *liquid assets threshold requirement*; and

(d) in the case of a notification under (1)(b), the *firm's* intentions in relation to activating its wind-down plan.

(3) A *firm* must submit the notification in (1) through the *online notifications and applications system* using the form in ■ MIFIDPRU 7 Annex 5R.

7.7.15 G

(1) The notification requirement in ■ MIFIDPRU 7.7.14R does not replace a *firm's* obligations under:

(a) *Principle* 11 to disclose appropriately to the *FCA* anything relating to the *firm* of which the *FCA* would reasonably expect notice; or

(b) the general notification requirements in ■ SUP 15.3.

(2) Where a *firm* has submitted a notification under ■ MIFIDPRU 7.7.14R, the notification will generally discharge a *firm's* obligations under *Principle* 11 and the general notification requirements in ■ SUP 15.3 in relation to the matters contained in the notification. However, a *firm* must still consider whether the *FCA* should be notified of developments before any of the notification indicators in ■ MIFIDPRU 7.7.14R occur. In addition, *Principle* 11 and ■ SUP 15.3 may require a *firm* to notify the *FCA* of additional material information that is not specifically referenced in ■ MIFIDPRU 7.7.14R.

(3) A *MIFIDPRU investment firms* should notify the *FCA* at an early stage of any significant event which creates a material risk of a *firm* ceasing to hold adequate financial resources, even if the impact of that event has not yet fully materialised.

FCA approach to intervention in relation to liquid assets

7.7.16 G

(1) The table in ■ MIFIDPRU 7.7.17G explains the interventions that the *FCA* would generally expect to make where a *MIFIDPRU investment firm* has breached, or there is evidence that the *firm* may be at risk of breaching, its *liquid assets* requirements. The table sets out the points at which the *FCA* would normally intervene and what actions it would normally take. Note that unlike for *own funds*, there is no *early warning indicator* requirement in relation to *liquid assets*.

(2) The *FCA* would generally expect that the interventions in the table would be cumulative – i.e. in a declining prudential situation, as the *firm* hits each intervention point in turn, the *FCA* would take some or all of the actions associated with that particular point. The actions are intended to be proportionate and progressively stronger responses to address the prudential concerns raised by each intervention point.

(3) However, if the *firm* experiences a sudden adverse event which causes the *firm* to hit multiple intervention points simultaneously, the *FCA* may immediately take the actions associated with the most severe point.

(4) The actions specified in the table do not prevent the *FCA* from taking alternative or additional actions in appropriate cases. The purpose of the table is to provide greater clarity for *firms* on the *FCA's* general expectations and approach to interventions, to assist *firms*' own planning and responses.

7.7.17 G

This table belongs to ■ MIFIDPRU 7.7.16G.

Intervention point	Purpose	Potential FCA supervisory actions
Threshold requirement notification: *Firm* holding insufficient *liquid assets* to meet its *liquid assets threshold requirement*	The *liquid assets threshold requirement* is the amount of *liquid assets* that the *firm* needs at any point in time to comply with the *overall financial adequacy rule*. The *FCA* will monitor a *firm's* assessment of its *liquid assets threshold requirement* through the information that the *firm* provides under MIFIDPRU 9. This notification is intended to prompt the *firm* and the *FCA* to address the breach of *threshold conditions* in a timely manner. Where a *firm* has ceased to hold sufficient *liquid assets* to meet its *liquid assets threshold requirement*, the focus should be on restoring *liquid assets* to at least the level of the *liquid assets threshold requirement* and recovery of the *firm* (unless the *firm* chooses to exit the market	The *FCA* would normally expect that: (a) the *firm* will have considered taking the recovery actions identified under MIFIDPRU 7.5.5R(2)(a) and MIFIDPRU 7.5.6G before breaching its *liquid assets threshold requirement* and will be considering whether to take, or will have taken, any relevant recovery actions identified under MIFIDPRU 7.5.5R(2)(b); (b) the *firm's governing body* will regularly evaluate whether the *firm* should take additional actions to restore its level of *liquid assets* to at least the level of the *liquid assets threshold requirement*; and (c) the *FCA* will consider whether to request the *firm* to report additional information to the *FCA*. If, having considered the information provided by the *firm* about its proposed actions, the *FCA* reasonably considers that the *firm* may fail to restore its *liquid assets* to the level required by the *liquid assets threshold requirement* within a reas-

Intervention point	Purpose	Potential FCA supervisory actions
	by voluntarily winding down). However, any proposed actions for recovery must be credible and achievable within a reasonable and realistic timeframe.	onable timeframe, the *FCA* may consider the following actions: (d) requesting that the *firm* cease making discretionary payments; (e) requesting that the *firm* cease taking on new business; (f) requesting that the *firm's parent undertaking* provides additional *liquid assets* for the *firm*; (g) where appropriate, inviting the *firm* or its *parent undertaking* to apply for a *requirement* under section 55L(5) or section 143K(1) of the *Act*, or imposing a *requirement* on the *FCA's* own initiative under section 55L(3) or section 143K(2) of the *Act*, in relation to (a) – (f) above; or (h) where appropriate, inviting the *firm* to apply for variation or cancellation of *permission* under section 55H of the *Act*, or varying or cancelling the *firm's permission* on the *FCA's* own initiative under section 55J of the *Act*. The *FCA* would also expect the *firm* to consider whether it is appropriate to trigger the *firm's* wind-down plan under MIFIDPRU 7.5.7R to ensure an orderly wind-down of its business. This may be the case where

Intervention point	Purpose	Potential FCA supervisory actions
		the *firm's* identified wind-down actions will require a reasonable length of time to execute, such as where the *firm* will need to transfer customers or close out its own positions.
Wind-down trigger notification: *Firm's liquid assets* fall below its *liquid assets wind-down trigger*	The *liquid assets wind-down trigger* is an absolute minimum level of *liquid assets* that a *firm* must maintain at all times to provide the necessary financial resources to commence wind-down. This is equal to the *firm's basic liquid assets requirement* (or such higher amount as the *FCA* may have imposed for these purposes in a *requirement*).	The *FCA* would normally expect the following to occur: (a) the *firm's governing body* will make a formal decision to initiate the *firm's* wind-down plan, unless the *governing body* has a reasonable basis for determining that there is an imminent and credible likelihood of the *firm's* recovery; and (b) where the *firm* decides to initiate its wind-down plan, the *FCA* will invite the *firm* to apply for a *requirement* under section 55L(5) of the *Act*, or will impose a *requirement* on the *FCA's* own initiative under section 55L(3) of the *Act*, that prevents the *firm* from taking on any new business.
	In order to maximise the potential for an orderly wind-down, the *FCA* expects that *firms* that breach this trigger should normally commence winding down immediately unless the *firm's governing body* and the *FCA* determine that there is an imminent and credible likelihood of recovery.	The *FCA* may consider the following additional actions if it has concerns that without these actions, the potential risk of harm to consumers or the markets is likely to increase:

7

Intervention point	Purpose	Potential FCA supervisory actions
		(c) taking appropriate action to protect any *client money* or *client assets*, including, where appropriate, inviting the *firm* to apply for a *requirement* under section 55L(5) of the *Act*, or imposing a requirement on the *FCA's* own initiative under section 55L(3) of the *Act*, to achieve any necessary protection; and
		(d) where appropriate, inviting the *firm* to apply for variation or cancellation of *permission* under section 55H of the *Act*, or varying or cancelling the *firm's permission* on the *FCA's* own initiative under section 55J of the *Act*.
		If a *firm* refuses to commence an orderly wind-down despite its *governing body* or the *FCA* having concluded that there is no imminent and credible likelihood of recovery, the *FCA* will consider the full range of its supervisory powers. In particular, the *FCA* may use a combination of its own initiative powers under section 55L(3) and section 55J of the *Act* to:
		(e) prevent the *firm* from continuing to carry on any *regulated activities*; and
		(f) direct the *firm* to take appropriate actions to ensure the fair treatment and appropriate protection of *clients* and coun

Intervention point	Purpose	Potential FCA supervisory actions
		terparties during any run-off period for its existing regulated business.

7.8 Reviewing and documenting the ICARA process

7.8.1 R This section applies to a *MIFIDPRU investment firm*.

7.8.2 R A *firm* must review the adequacy of its *ICARA process*:

(1) at least once every 12 *months*; and

(2) irrespective of any review carried out under (1), following any material change in the *firm's* business model or operating model.

7.8.3 G The effect of ■ MIFIDPRU 7.8.2R(2) is that if there is a significant change in the *firm's* business model or operating model, the *firm* should not wait until the next scheduled review of its *ICARA process*, but should carry out a review promptly. For example, if a *firm* launches a material new product or business line or merges with another business, the *firm* should, as part of its preparation for that event, analyse the impact on the *firm's ICARA process*. Similarly, if a *firm's* business undergoes a significant change due to external factors (for example, significant changes in the structure of a market sector), the *firm* should consider the effects on the *firm's ICARA process* in a timely manner.

7.8.4 R (1) A *firm* must notify the *FCA* of the date on which the *firm* will submit *data item* MIF007 (ICARA assessment questionnaire) in accordance with:

(a) in the case of a *non-SNI MIFIDPRU investment firm*, ■ MIFIDPRU 9.2.2R; and

(b) in the case of an *SNI MIFIDPRU investment firm*, ■ MIFIDPRU 9.2.4R.

(2) The submission date that the *firm* notifies under (1) continues to apply unless the *firm* notifies the *FCA* of a change of the submission date in accordance with (3).

(3) A *firm* may notify the *FCA* of a revised submission date for the purpose of (1), provided that the revised date will not result in the *firm* not submitting *data item* MIF007 to the *FCA* for more than 12 *months*.

(4) The notifications in (1) and (3) must be submitted through the *online notification and application system* using the form in ■ MIFIDPRU 7 Annex 6R.

(5) The *FCA* may direct a *firm* to submit *data item* MIF007 on a different date from the date in (2) to ensure that the *FCA* has access to appropriate and timely information on the *firm's* financial position.

(6) If the *FCA* gives a direction to a *firm* in accordance with (5), the *firm* must submit data item MIF007 to the *FCA* on the date specified in that direction until the *FCA* directs otherwise.

7.8.5 G

(1) *Firms* may operate different internal arrangements for reviewing the adequacy of their *ICARA process*. When considering the timetable for a review, a *firm* should take into account the following 3 dates:

(a) the date on which the underlying data used to carry out the review of the *ICARA process* was prepared (the "reference date");

(b) the date on which the *firm's* review of the *ICARA process* is carried out (the "review date"); and

(c) the date on which the *firm* will submit *data item* MIF007 to report on its review of the *ICARA process* (the "submission date"), as notified to the *FCA* under ■ MIFIDPRU 7.8.4R.

(2) When deciding on a submission date under ■ MIFIDPRU 7.8.4R, a *firm* should consider the following:

(a) the period between the reference date and the review date should be reasonable, taking into account the time that the *firm* is likely to need to carry out a robust assessment of its *ICARA process* to meet the requirements in this section and the importance of using relevant data for these purposes; and

(b) the period between the review date and the submission date should also be reasonable, taking into account the importance of the *FCA* receiving timely information in relation to the *firm* and the time that is required for the *firm* to complete *data item* MIF007 accurately and completely.

(3) A *firm* should design its internal timetable for the review of its *ICARA process* and the submission of *data item* MIF007 in a reasonable way, reflecting the importance of proper internal risk management. The *FCA* has provided *firms* with flexibility under ■ MIFIDPRU 7.8.4R to adopt a review and reporting timetable that fits best with the *firm's* internal processes. However, under ■ MIFIDPRU 7.8.4R(5), the *FCA* may direct a *firm* to report on an alternative date if the *FCA* considers that the *firm's* proposed review and reporting timetable would not result in the *FCA* receiving the necessary information in an appropriate and timely manner.

(4) A *firm* may change the date on which it submits *data item* MIF007 by notifying the *FCA* in accordance with ■ MIFIDPRU 7.8.4R(3). However, a *firm* is not permitted to specify a revised date that would result in the *firm* not submitting *data item* MIF007 to the *FCA* for more than 12 *months*. For example, a *firm* has a submission date of 1 April each year. The *firm* submits *data item* MIF007 on 1 April 2023. On 1 March 2024, the *firm* wishes to change its submission date to 31 December. The *firm* would not be permitted to change the submission date in this way, as the next submission date would be 31 December 2024, which would be more than 12 *months* after 1 April 2023. However, the *firm* could have notified the *FCA* on, for example, 1 December

2023 that it intended to change its submission date to 31 December. This is because the next submission of *data item* MIF007 would then have occurred on 31 December 2023, which would be within 12 *months* of the previous submission on 1 April 2023.

7.8.6 R Where a *firm* carries out a review of its *ICARA process* in accordance with ■ MIFIDPRU 7.8.2R(2) following a change in its business model or operating model:

(1) the *firm* must submit *data item* MIF007 to the *FCA* within 20 *business days* of the *governing body* having approved the *ICARA document* resulting from that review in accordance with ■ MIFIDPRU 7.8.8R; and

(2) the requirement in ■ MIFIDPRU 7.8.4R to notify the *FCA* of the submission date of *data item* MIF007 does not apply to a *data item* submitted under (1).

7

7.8.7 R (1) A *firm* must document any review carried out under ■ MIFIDPRU 7.8.2R.

(2) The documentation produced by the *firm* to comply with (1):

(a) may consist of multiple documents, provided that the relationship between them is clear, they are prepared on a consistent basis and they can all be provided to the *FCA* promptly if requested; and

(b) is collectively referred to as the *ICARA document*.

(3) The *ICARA document* must include the following:

(a) a clear description of the *firm's* business model and strategy and how it aligns with the *firm's* risk appetite;

(b) an explanation of the activities carried on by the *firm*, with a focus on the most material activities;

(c) where the *firm* has concluded that the *ICARA process* is fit for purpose, a clear explanation of why the *firm* reached this conclusion;

(d) where the *firm* has concluded that the *ICARA process* requires further improvement, a clear explanation of:

(i) the improvements needed;

(ii) the steps needed to make those improvements and the timescale for taking them; and

(iii) who within the *firm* is responsible for taking the steps in (ii);

(e) a clear explanation of any other changes to the *firm's ICARA process* that have occurred following the review and the reasons for those changes;

(f) an analysis of the effectiveness of the *firm's* risk management processes during the period covered by the review;

(g) a summary of the material harms identified by the *firm* under ■ MIFIDPRU 7.4.13R and any steps taken to mitigate them;

(h) an overview of the business model assessment and capital and liquidity planning undertaken by the *firm* under ■ MIFIDPRU 7.5.2R;

(i) a clear explanation of how the *firm* is complying with the *overall financial adequacy rule*, including a clear breakdown of the following as at the review date:

(i) available *own funds*;

(ii) available *liquid assets*; and

(iii) the *firm's* assessment of its *threshold requirements*;

(j) a summary of any stress testing and reverse stress testing carried out by the *firm*;

(k) the levels of *own funds* and *liquid assets* that, if reached, the *firm* has identified under ■ MIFIDPRU 7.5.5R(1) may indicate that there is a credible risk that the *firm* will breach its *threshold requirements*;

(l) the potential recovery actions that the *firm* has identified under ■ MIFIDPRU 7.5.5R(2) and ■ 7.5.6G; and

(m) an overview of the *firm's* wind-down planning under ■ MIFIDPRU 7.5.7R, including:

(i) any required actions;

(ii) the anticipated timelines for actions to be taken; and

(iii) any key assumptions or qualifications.

Senior management responsibility for the ICARA process

7.8.8 R

(1) The content of the *ICARA document* must be reviewed and approved by the *firm's governing body* within a reasonable period after the review under ■ MIFIDPRU 7.8.2R has been completed.

(2) As part of its review under (1), the *governing body* must specifically review and approve the key assumptions underlying the *ICARA document*.

7.8.9 G

(1) Under ■ COCON 2.2.2R, *senior conduct rules staff members* must take reasonable steps to ensure that the business of the *firm* for which they are responsible complies with the relevant requirements and standards of the *regulatory system*.

(2) In particular, ■ COCON 4.2.12G explains that *senior conduct rules staff members* should take reasonable steps to ensure that the business for which they are responsible:

(a) has operating procedures and systems with well-defined steps for complying with the detail of relevant requirements and standards of the *regulatory system*; and

(b) is run prudently.

(3) The *FCA* considers that the *ICARA process* is a key requirement of the *regulatory system* for *MIFIDPRU investment firms* and is an essential part of a *firm's* internal systems and procedures for ensuring that the *firm's* business is run prudently. Accordingly, *senior conduct rules staff members* should take an active role in contributing to the analysis required under the *ICARA process* in respect of the business areas for

which they are responsible and in embedding its requirements into those business areas.

(4) *Firms* and *senior conduct rules staff members* should refer to the provisions in *COCON*, and in particular the guidance in ■ COCON 3 and ■ COCON 4, for further information on the *FCA's* general approach to assessing compliance with the relevant conduct rules.

Record keeping requirements

7.8.10 R (1) A *firm* must keep adequate records of the following:

(a) its *ICARA document*; and

(b) the review and approval of the *ICARA document* by the *firm's governing body* under ■ MIFIDPRU 7.8.8R.

(2) A *firm* must retain the records in (1) for at least 3 years from the date on which the relevant document was approved.

7.9 ICARA process: firms forming part of a group

7.9.1 G This section contains:

(1) a requirement for individual *MIFIDPRU investment firms* to take into account group risk as part of their *ICARA process*;

(1A) *guidance* on the extent to which an *investment firm group* may operate an *ICARA process* on a *consolidated basis*;

(2) *rules* and *guidance* on the extent to which an *investment firm group* may manage risks on a *group* basis and may operate a *group ICARA process*; and

(3) *rules* and *guidance* on the extent to which the position of multiple *MIFIDPRU investment firms* may be combined with a single *ICARA document*.

Analysis of group risk by individual firms

7.9.2 R Where a *MIFIDPRU investment firm* is a part of a *group*, the *firm's ICARA process* must take into account any material risks or potential harms that may result from the *firm's* relationship with other members of that *group* or the *group* as a whole.

7.9.3 G The requirement in MIFIDPRU 7.9.2R applies in relation to:

(1) any *group*, irrespective of whether that *group* is an *investment firm group*; and

(2) any relationship that the *firm* has with any member of that *group*, irrespective of whether the other entity is an *authorised person*.

Consolidated ICARA process

7.9.4 G (1) An *investment firm group* to which MIFIDPRU 2.5 (Prudential consolidation) applies is not normally required to operate an *ICARA process* on a *consolidated basis*.

(2) However, on a case-by-case basis, the *FCA* may determine that a particular *investment firm group* should operate an *ICARA process* on a *consolidated basis* (ie, as if the *overall financial adequacy rule* applied to the *consolidated situation*, so that the *UK parent entity* and the *relevant financial undertakings* in the *investment firm group*

were treated as a single *MIFIDPRU investment firm*). (2A) includes examples of such cases. Therefore, in appropriate cases, the *FCA* may:

(a) invite a *UK parent entity* to apply for the imposition of a *requirement* to operate a consolidated *ICARA process* under section 55L(5) or section 143K(1) of the *Act*; or

(a) impose a *requirement* on the *FCA's* own initiative on a *UK parent entity* to operate a consolidated *ICARA process* under section 55L(3) or section 143K(3) of the *Act*.

(2A) For the purposes of (2), examples of such cases may include where the *FCA* concludes that:

(a) the individual *ICARA process* operated by a *MIFIDPRU investment firm* within an *investment firm group*, or the *group ICARA process* operated by an *investment firm group*, does not adequately reflect certain material risks that arise in the context of the *investment firm group* as a whole;

(b) the operation of a group or an individual *ICARA process* does not enable the *FCA* to effectively supervise the compliance of the *investment firm group*, or any of the individual *MIFIDPRU investment firms* within it, with the obligations in ■ MIFIDPRU 7, due to the structure of the *investment firm group*;

(c) *authorised persons* (other than *MIFIDPRU investment firms*) within the *investment firm group* conduct a material amount of business and the individual or group *ICARA process* does not adequately reflect the impact of this business;

(d) a *MIFIDPRU investment firm* within the *investment firm group* is materially dependent on a *relevant financial undertaking* (other than a *MIFIDPRU investment firm*) within the *investment firm group* for either revenue or services;

(e) the financial resilience of the *investment firm group* could adversely affect the ongoing financial resilience of the *MIFIDPRU investment firms* within the *investment firm group* (for example, due to significant levels of goodwill); and

(f) there are significant amounts of on- and off-balance sheet claims or liabilities (excluding *own funds*) between one or more *MIFIDPRU investment firms* and other *relevant financial undertakings* within the *investment firm group*, and they are not short-term or non-recurring.

(3) Where the *FCA* decides to impose a *requirement* on a *UK parent entity* to operate an *ICARA process* on a *consolidated basis*, it will normally discuss its expectations around the operation of that *ICARA process* in further detail with the *UK parent entity*.

(4) In appropriate cases, the *FCA* may specify that a particular entity (whether or not it is an *authorised person*) should be excluded from the *consolidated situation*. Where this is the case, the consolidated *ICARA process* should reflect the modified scope of the *consolidated situation*. The *FCA* may adopt this approach where, for example, the inclusion of the entity within the *consolidated situation* would result in a misleading assessment of the financial resources available to, or the harms posed by, the relevant *investment firm group*.

(5) An *ICARA process* operated by an *investment firm group* on a *consolidated basis* is in addition to the individual *ICARA process* operated by a *MIFIDPRU investment firm* within an *investment firm group*, or to the *group ICARA process* operated by an *investment firm group*.

Group ICARA process

7.9.5 R Subject to ■ MIFIDPRU 7.9.7R, an *investment firm group* (whether it is subject to ■ MIFIDPRU 2.5 or not) may operate a *group ICARA process*, provided that the following conditions are satisfied:

the *group ICARA process* is consistent with the manner in which the business of the *investment firm group*, and the risks arising from it, are operated and managed in practice;

any assessment under the *group ICARA process* of *own funds* or *liquid assets* that are required to cover the identified risks is allocated between individual *firms* within the *investment firm group* on a reasonable basis and that basis is properly documented;

each *MIFIDPRU investment firm* covered by the *group ICARA process* complies with the *overall financial adequacy rule* on an individual basis;

each *MIFIDPRU investment firm* covered by the *group ICARA process* maintains a separate wind-down plan for the purposes of ■ MIFIDPRU 7.5.7R and applies the *wind-down triggers* on an individual basis;

the notification requirements in ■ MIFIDPRU 7.6.11R and ■ 7.7.14R apply in relation to each individual *MIFIDPRU investment firm* included within the *group ICARA process*, using the amounts determined in accordance with (2) to (4);

the management of any risks on a *group* basis takes place within one of the following entities:

(a) a *MIFIDPRU investment firm* within the *investment firm group*; or

(b) the *UK parent entity* of the *investment firm group*;

the *governing body* of the relevant entity in (6) has accepted overall responsibility for the *group ICARA process* and for ensuring compliance with this *rule*;

the requirement in ■ MIFIDPRU 7.8.8R for the *governing body* of an individual *MIFIDPRU investment firm* to approve the content of the *ICARA document* applies to the *governing body* of the relevant entity in (7); and

each individual *MIFIDPRU investment firm* included within the *group ICARA process* submits *data item* MIF007 (ICARA assessment questionnaire) to the *FCA* on an individual basis, reflecting the position of that *firm* as it results from the conclusions of the *group ICARA process*.

7.9.6 R Except as specified in ■ MIFIDPRU 7.9.5R, a *MIFIDPRU investment firm* that is included within a *group ICARA process* is not required to comply with the requirements in ■ MIFIDPRU 7.4 to ■ MIFIDPRU 7.8 on an individual basis.

7.9.7 R (1) An *investment firm group* must not:

(a) operate a *group ICARA process* if the *FCA* has directed the *investment firm group* to manage or assess the risks arising from its business on a different basis because one or more of the conditions in (2) applies in relation to that *investment firm group*; or

(b) include within a *group ICARA process* any *MIFIDPRU investment firm* that the *FCA* has directed to manage or assess the risks arising from its business on a different basis because one or more of the conditions in (2) applies in relation to that *firm*.

(2) The relevant conditions are that:

(a) there is a material risk that potential harms arising in relation to the *firm* or *investment firm group* would not be adequately captured through a *group ICARA process*;

(b) there is a material risk that a *group ICARA process* would result in excessive complexity that would interfere with the *FCA's* ability to supervise the compliance of the *investment firm group*, or any of the individual *MIFIDPRU investment firms* within it, with its obligations under ■ MIFIDPRU 7; or

(c) the *investment firm group* previously operated, or the *firm* was previously included within, a *group ICARA process* that did not meet the requirements in ■ MIFIDPRU 7.9.

7.9.8 R Except as otherwise specified in ■ MIFIDPRU 7.9.5R, a *group ICARA process* must comply with the requirements in ■ MIFIDPRU 7.4 to ■ MIFIDPRU 7.8 as if the references in those sections to a "*MIFIDPRU investment firm*" are references to the *investment firm group* operating that *group ICARA process*.

7.9.8A G (1) As explained in ■ MIFIDPRU 7.9.6R, a *MIFIDPRU investment firm* that is included within a *group ICARA process* does not generally need to comply with the requirements in ■ MIFIDPRU 7.4 to ■ MIFIDPRU 7.8 on an individual basis.

(2) However, as ■ MIFIDPRU 7.9.5R explains, an *investment firm group* can operate a group *ICARA process* only if each *MIFIDPRU investment firm* within it complies with certain provisions of ■ MIFIDPRU 7.4 to ■ MIFIDPRU 7.8 on an individual basis.

(3) The following table explains which provisions a *MIFIDPRU investment firm* must comply with on an individual basis in order to meet the relevant conditions in ■ MIFIDPRU 7.9.5R:

Relevant condition in MIFIDPRU 7.9.5R	Main rules and related guidance that must be met on an individual basis to comply with the conditions in MIFIDPRU 7.9.5R
(3) – each *MIFIDPRU investment firm* must comply with the *overall financial adequacy rule*	MIFIDPRU 7.4.7R and provisions relating to the *overall financial adequacy rule*
(4) – each *MIFIDPRU investment firm* must maintain a separate wind-down plan and apply the *wind-down triggers* on an individual basis	MIFIDPRU 7.5.7R to MIFIDPRU 7.5.10G
(5) – each *MIFIDPRU investment firm* must comply with the requirements to notify the *FCA* of certain levels of *own funds* and *liquid assets*	MIFIDPRU 7.6.11R to MIFIDPRU 7.6.13G MIFIDPRU 7.7.14R to MIFIDPRU 7.7.15G
(9) – each *MIFIDPRU investment firm* must submit *data item* MIF007	MIFIDPRU 7.8.4R MIFIDPRU 7.8.5G MIFIDPRU 9.2

(4) The effect of ■ MIFIDPRU 7.9.8R is that all the *rules* and *guidance* in ■ MIFIDPRU 7.4 to ■ MIFIDPRU 7.8 (except those specified in the table in ■ MIFIDPRU 7.9.8AG(3)) apply at the level of the *investment firm group*.

(5) Where a *MIFIDPRU investment firm* is included in a *group ICARA process* in accordance with ■ MIFIDPRU 7.9.5R, the *firm* is reminded that, under ■ MIFIDPRU 9.2.1R and ■ MIFIDPRU 9.2.3R (as applicable), it must still submit *data item* MIF007 to the *FCA* on an individual basis. *Data item* MIF007 will provide information about the *firm* that has been derived from that *group ICARA process*.

7.9.9 G This *guidance* provision covers the following practical aspects in relation to the *group ICARA process*:

(1) Under ■ MIFIDPRU 7.9.7R, if an *investment firm group* is operating a *group ICARA process* that is inadequate to address the potential harms arising from its business, the *FCA* may direct all members of the *investment firm group*, or individual *MIFIDPRU investment firms* within it, to apply the *ICARA process* on an individual basis.

(2) In addition, a *group ICARA process* must satisfy the requirements in■ MIFIDPRU 7.9.5R on an ongoing basis. If any of the conditions in that *rule* for the use of the *group ICARA process* are not met, all *MIFIDPRU investment firms* covered by that *group ICARA process* must operate individual *ICARA processes* instead.

(3) Under a *group ICARA process*, the risk management and analysis of the financial impact of the risks is carried out at the level of the *investment firm group* (either by the *UK parent entity* or by a *MIFIDPRU investment firm* (■ MIFIDPRU 7.9.5R(6)). Each *firm* in the *investment firm group* is then allocated on a reasonable basis the assessment of *own funds* or *liquid assets* that are required to cover identified risks.

(3A) Where the assessment of *own funds* or *liquid assets* uses a methodology that includes intra-group netting or offsets, the amount allocated from such assessment of *own funds* and *liquid assets* to each *firm* should be adjusted to remove any benefit which may otherwise have been applied at the level of the *investment firm group*.

(3B) In addition, each *MIFIDPRU investment firm* in the *investment firm group* must comply with the *overall financial adequacy rule* on an individual basis.

(3C) An *investment firm group* that wishes to operate a *group ICARA process* must therefore ensure that its risk management processes are sufficiently robust to satisfy the requirements in ■ MIFIDPRU 7.9.5R and that there is appropriate accountability of the responsible *governing body* in accordance with the requirements of that *rule*.

(4) The *FCA* considers that it is important that there is a proper analysis of how the *overall financial adequacy rule* and wind-down planning arrangements apply to each individual *MIFIDPRU investment firm* within the *investment firm group*. This reflects the fact that the solvency of *firms* must be assessed on an individual basis and legal entities must be wound down separately.

7

Combined ICARA documents covering multiple group entities

7.9.10 R Where an *investment firm group* contains multiple *MIFIDPRU investment firms*, the *ICARA document* for each *firm* may be combined within a single document, provided that:

(1) to the extent that any risks are managed under a *group ICARA process*, this is clearly documented and explained; and

(2) for any risks that are managed on an individual basis, and for any requirements that ■ MIFIDPRU 7.9.5R specifies must always apply on an individual basis under a *group ICARA process*, the combined *ICARA document* clearly explains the position of each individual *firm* and how it complies with the relevant requirements.

7.9.11 G The effect of ■ MIFIDPRU 7.9.10R is that even where an *investment firm group* does not operate a *group ICARA process*, a single *ICARA document* can be used to document the individual *ICARA processes* operated by multiple *MIFIDPRU investment firms* within that *investment firm group*. However, the single *ICARA document* must clearly explain how each *MIFIDPRU investment firm* meets the applicable requirements on an individual basis.

7.10 Supervisory review and evaluation process

Application

7.10.1 G

(1) This section contains *guidance* on the *FCA's* approach to the *supervisory review and evaluation process* (*SREP*) of the *ICARA process*.

(2) Although there are no *rules* in this section that impose direct obligations on *MIFIDPRU investment firms* or *UK parent entities*, these entities may find the *guidance* in this section helpful in understanding the *FCA's* general approach to considering whether *MIFIDPRU investment firms* are complying with the *overall financial adequacy rule* and the other requirements of the *ICARA process*.

(3) The *guidance* in this section relates only to the *FCA's* approach to the *SREP*. It does not apply to any other supervisory action that the *FCA* may take, except where stated.

Purpose

7.10.2 G

The *own funds* and *liquid assets* necessary to comply with the *overall financial adequacy rule* need to be assessed by the *firm* and, where appropriate, the *FCA*. This involves:

(1) the *ICARA process* applied by the *firm*, or, in the circumstances set out in ■ MIFIDPRU 7.9, by the *investment firm group*;

(2) the *FCA's* monitoring of the information provided by a *firm* under its ongoing reporting obligations in ■ MIFIDPRU 9; and

(3) in appropriate cases, a *SREP*, which is conducted by the *FCA*.

Decision to conduct a SREP

7.10.3 G

(1) There is no mandatory frequency with which the *FCA* will conduct a *SREP* on a particular *MIFIDPRU investment firm* or *investment firm group*. Instead, the *FCA* will prioritise its resources to conduct *SREPs* by taking into account a range of factors, which include:

(a) the nature, scale and complexity of the business carried on by a *firm* or *investment firm group*;

(b) the *FCA's* analysis of the risks associated with the *firm* or *investment firm group* and its potential to cause harm to *consumers* or to the financial markets;

(c) the information provided by a *firm* or other members of its *group* to the *FCA* under any notification and reporting obligations under *MIFIDPRU* or other obligations in the *Handbook*;

(d) the history of the *firm's* or *investment firm group's* interactions with the *FCA*;

(e) any broader concerns about the types of products or services offered by the *firm* or the *investment firm group*, or the markets in which it operates; and

(f) any concerns relating to the *firm* or *investment firm group* which may be notified to the *FCA* by other regulators (including non-financial services regulators).

(2) In appropriate cases, the *FCA* may conduct a review of a particular population of *MIFIDPRU investment firms* or *investment firm groups* that share common features (for example, because they are all active in a particular market sector). As a result, the *FCA* may issue *guidance* on a sectoral basis or impose additional *requirements* on all, or only a subset of, the entities included within that review.

(3) The scale of a *SREP* that the *FCA* carries out on an individual *MIFIDPRU investment firm* or *investment firm group* may vary, depending on the nature of the *FCA's* concerns and the potential degree of risk posed by the *firm* or *investment firm group*. In certain cases, the *FCA* may limit its review to only a subset of the information and factors that it would normally consider under the general approach described in ■ MIFIDPRU 7.10.4G and ■ MIFIDPRU 7.10.5G.

Information and factors considered by the FCA when conducting a SREP

7.10.4 G When conducting a *SREP*, the *FCA* will take into the following:

(1) the *firm's* or *investment firm group's ICARA document*;

(2) any relevant information provided by the *firm* or other members of its *group* as part of its reporting obligations under ■ MIFIDPRU 9 or other obligations in the *Handbook*;

(3) any other information or documents requested by the *FCA* for the purposes of the *SREP*;

(4) interviews with members of the *firm's governing body*, or its employees, advisers, service providers, and auditors;

(5) information shared by other authorities; and

(6) any other relevant information that the *FCA* holds.

7.10.5 G The following is a non-exhaustive list of factors that the *FCA* will normally consider when conducting its *SREP*:

(1) the extent to which the *firm's* or *investment firm group's* risk management framework includes a clearly defined risk appetite;

(2) the governance arrangements operated by the *firm* or *investment firm group*, including whether there are clear lines of accountability and evidence of appropriate senior management involvement;

(3) whether the *firm* or *investment firm group* has appropriately identified and assessed the materiality of:

(a) the harms that may arise from the ongoing operation of the *firm's* or *group's* business;

(b) the harms that may result from a disorderly wind-down of the *firm* or other members of its *group*;

(4) whether the *firm* or *investment firm group* has adequate systems and controls in place to monitor and manage the risks arising from its business;

(5) whether the *firm* or *investment firm group* has properly integrated its *ICARA process* into day-to-day decision making within its business;

(6) whether the *firm*, and where applicable, other individual members of its *investment firm group*, have adequate *own funds* and *liquid assets* to comply with the *overall financial adequacy rule*;

(7) whether the capital and liquidity planning and business model analysis (and, where applicable, stress testing and reverse stress testing) conducted by the *firm* or *investment firm group* is based on plausible scenarios that are relevant to the business it undertakes; and

(8) whether the wind-down planning assessment conducted by the *firm*, and where applicable, other individual members of its *investment firm group*, is adequate, contains a clear explanation of the key steps needed to ensure an orderly wind-down and is based on realistic assumptions.

Examples of actions that the FCA may take following a SREP

7.10.6 G

(1) Once the *FCA* has completed a *SREP*, it will consider whether any corrective action is necessary to ensure that (among other outcomes) a *firm*:

(a) complies with the *overall financial adequacy rule*;

(b) has an appropriate plan in place to ensure an orderly wind-down; and

(c) appropriately identifies and manages the material potential harms that may result from the ongoing operation of the *firm's* business.

(2) When considering the action that it may take, the *FCA* will consider its powers and the potential harms that it has identified during the *SREP*. The following is a non-exhaustive list of actions that the *FCA* may take:

(a) requiring a *firm* to hold additional *own funds* or *liquid assets*;

(b) requiring a *firm* to implement new risk management or governance arrangements;

(c) requiring a *firm* to provide to the *FCA*, within a specified period, an improvement plan to ensure that the *firm* complies with the applicable requirements in the *Handbook* or other legislation;

(d) requiring a *firm* to apply a particular policy for provisioning or for the treatment of assets when calculating its *own funds* or *own funds requirement*;

(e) restricting the activities that a *firm* may undertake as part of its business (which may be on a permanent basis, for a specified period of time, or until certain specified conditions are met);

(f) requiring a *firm* to reduce the level of risk involved in the products or services it provides, including in relation to activities that it has outsourced to third parties;

(g) requiring a *firm* to reduce or limit the amount of variable remuneration it pays;

(h) requiring a *firm* to reduce or limit its distributions of profits;

(i) imposing additional or more frequent reporting requirements on a *firm*;

(j) requiring a *firm* to hold an *own funds* or *liquid assets* buffer in excess of the amounts necessary to comply with the *overall financial adequacy rule*;

(k) requiring a *firm* to make additional public disclosures;

(l) requiring a *firm* to strengthen its data security, confidentiality or data protection processes;

(m) requiring a *firm* to provide additional information to *clients* or counterparties;

(n) withdrawing a permission previously granted under *MIFIDPRU* to apply a specific treatment (such as a *K-CMG permission*, or a permission to use an internal model for the purposes of the *K-NPR requirement*);

(o) requiring a *firm* to use a different *wind-down trigger*;

(p) requiring a *firm* to modify its legal structure or the structure of its *group*, where doing so would improve the *FCA's* ability to supervise the *firm*;

(q) giving individual *guidance* to the *firm* on any of the above matters or on any other matter that the *FCA* considers is relevant.

7.10.7 G The *FCA* would normally expect to take the actions described in ■ MIFIDPRU 7.10.6G by using one or more of the following approaches:

(1) exercising the powers under section 55J of the *Act* permitting the *FCA* to vary or cancel a *firm's permission* on the *FCA's* own initiative;

(2) inviting a *firm* to make a voluntary application for the imposition of a *requirement* under section 55L(5) of the *Act*;

(3) imposing a *requirement* on a *firm* on the *FCA's* own initiative under section 55L(3) of the *Act*;

(4) withdrawing a *MIFIDPRU* permission in accordance with the *rules* in *MIFIDPRU*;

(5) imposing a *requirement* on a *parent undertaking* in accordance with section 143K of the *Act*;

(6) requiring a *firm* or *parent undertaking* to provide additional information to the *FCA* under section 165 of the *Act*;

(7) requiring a report by a *skilled person* in accordance with section 166 of the *Act*; or

(8) giving individual *guidance* to a *firm* under section 139A of the *Act*, as further described in ■ SUP 9.3.

General FCA approach to requiring a firm to hold additional own funds or liquid assets

7.10.8 G

(1) Following a *SREP*, the *FCA* may conclude that a *firm* should hold an additional amount of *own funds* or *liquid assets* to comply with the *overall financial adequacy rule*.

(2) In this case, the *FCA* will normally specify an amount of *own funds* and/or *liquid assets* that the *firm* should hold by:

(a) issuing individual *guidance*; or

(b) imposing a *requirement* on the *firm*.

(3) The amount in (2) normally represents the *FCA's* assessment of the *firm's* overall *own funds threshold requirement* or *liquid assets threshold requirement*. However, in some cases, it may be specified on a different basis (such as by reference to a specific component of the *threshold requirement* or to a particular risk or harm).

(4) Where the *FCA* has undertaken a sectoral review, as described in ■ MIFIDPRU 7.10.3G(2), it may issue *guidance* to, or impose a *requirement* on, some or all *firms* that are active in that sector, without conducting an individual *SREP* in relation to each *firm*. The *guidance* or *requirement* may relate to:

(a) additional amounts of *own funds* or *liquid assets* that the *firms* must hold; or

(b) other actions that the *firms* must undertake.

7.10.9 G

(1) The *FCA* will determine whether a *requirement* or *guidance* is more appropriate. Where the *FCA* issues *guidance*, this will normally explain how the *FCA* will approach supervising the *overall financial adequacy rule* in relation to the *firm*. The *FCA* expects that the *firm* would normally confirm to the *FCA* that the *firm* will treat the amounts specified in that *guidance* as its *threshold requirements* going forward (and will therefore hold the relevant of *own funds* and *liquid assets* to comply with the *overall financial adequacy rule*), unless the *firm* subsequently determines under its *ICARA process* that higher amounts are required.

(2) Where the *FCA* applies a *requirement* in connection with the *overall financial adequacy rule*, it may invite a *firm* to make a voluntary application under section 55L(5) of the *Act* to impose a *requirement*

on the *firm* to hold the level of *own funds* or *liquid assets* that the *FCA* has assessed as being the *firm's threshold requirements*.

(3) If a *firm* declines to make a voluntary application to impose the relevant *requirement*, the *FCA* may use its powers under section 55L(3) of the *Act* to impose the *requirement* on the *firm* on the *FCA's* own initiative.

(4) The *FCA* may also consider whether it is appropriate to invite a *parent undertaking* of the *firm* to make a voluntary application under section 143K(1) of the *Act*, or to impose a *requirement* on the *parent undertaking* on the *FCA's* own initiative under section 143K(3) of the *Act*. This *requirement* may operate by reference to the status of the *investment firm group* as a whole. Examples of when the *FCA* may choose to apply this approach include where:

(a) an *investment firm group* is operating an *ICARA process* that covers multiple *firms* in accordance with ■ MIFIDPRU 7.9; or

(b) the *FCA* considers that the potential harms arising from a *firm's* membership of its *group* can be addressed more effectively by imposing a *requirement* on the *parent undertaking*.

(5) *Guidance* on a *threshold requirement* issued by the *FCA* (or, where applicable, a *requirement* to hold a minimum level of *own funds* or *liquid assets* imposed on a *firm* by the *FCA*) will apply until the *FCA* issues *guidance* on a revised *threshold requirement* (or varies or removes the *requirement* relating to *own funds* or *liquid assets*) in relation to the *firm*.

(6) If a *firm* subsequently determines, as a result of its *ICARA process*, that it needs to hold a higher level of *own funds* or *liquid assets* to satisfy the *overall financial adequacy rule*, it must hold that higher level. This is because the *FCA's* assessment of a *firm's threshold requirement* (or a *requirement* applied to the *firm* by the *FCA*) reflects an assessment carried out at that point in time and does not relieve the *firm* of its obligation to comply with the *overall financial adequacy rule* at all times.

(7) A *firm's* business model or operating model may change significantly, with the result that the *firm* considers that the *threshold requirement* specified in the *guidance* issued by, or the *requirement* applied by, the *FCA* exceeds the amount of *own funds* or *liquid assets* that the *firm* requires to comply with the *overall financial adequacy rule*. In this case, the *firm*:

(a) should undertake its own assessment of the amounts that the *firm* requires to comply with the *overall financial adequacy rule* or, where applicable, to address the risks in relation to which the *requirement* was imposed; and

(b) having undertaken the determination in (a), may contact the *FCA* to request a review of the existing *guidance* or *requirement*.

7.10.10 G The following is a non-exhaustive list of situations in which the *FCA* may assess that a *firm* must hold additional *own funds* to comply with the *overall financial adequacy rule*:

(1) the business of the *firm* or *investment firm group* may result in material harm that is not sufficiently covered by the *firm's* assessment of its *own funds threshold requirement* and has not otherwise been adequately mitigated;

(2) the *firm* or *investment firm group* does not comply with the governance requirements in ■ MIFIDPRU 7.2 or ■ 7.3;

(3) the *firm's* or *investment firm group's ICARA process* does not comply with the relevant requirements in ■ MIFIDPRU 7;

(4) the adjustments in relation to the prudent valuation of the *firm's* or *investment firm group's trading book* are insufficient to enable the *firm* or *investment firm group* to sell out or hedge its positions within a short period without incurring material losses under normal market conditions;

(5) the review of the *firm's* use of internal models or own estimates of delta for the purposes of the *K-NPR requirement* or *K-TCD requirement* indicates that non-compliance with the requirements for applying those models is likely to lead to inadequate levels of *own funds*;

(6) the manner in which the *firm* or *investment firm group* operates its business suggests that there is a significant risk that it will fail to comply with the *overall financial adequacy rule* in the foreseeable future; or

(7) the *firm's* wind-down plan does not identify realistic and credible actions for ensuring an orderly wind-down or is based on unreasonable or unrealistic assumptions.

7.10.11 G The *FCA* may provide *guidance* on a *firm's own funds threshold requirement* (or, where applicable, impose a *requirement*) by reference to:

(1) a percentage of the *firm's own funds requirement*;

(2) the requirement that would result from applying a modified co-efficient to one or more *K-factor metrics* for the purposes of the *firm's K-factor requirement*; and/or

(3) a fixed amount.

7.10.12 G A *firm* must meet any *own funds threshold requirement* with *own funds* that satisfy the conditions in ■ MIFIDPRU 7.6.5R unless the *FCA* applies an alternative *requirement* to the *firm*.

7.10.13 G The following is a non-exhaustive list of situations in which the *FCA* may assess that a *firm* needs to hold additional *liquid assets* to comply with the *overall financial adequacy rule*:

(1) the business of the *firm* or *investment firm group* may result in material harm that is not sufficiently covered by the *liquid assets threshold requirement* as assessed by the *firm* and has not otherwise been adequately mitigated;

(2) the *firm* or *investment firm group* does not comply with the governance requirements in ■ MIFIDPRU 7.2 or ■ 7.3 in one or more material respects;

(3) the *firm's* or *investment firm group's ICARA process* does not comply with the requirements in ■ MIFIDPRU 7;

(4) the *firm* or *investment firm group's* funding profile indicates that there may be a significant liquidity mismatch between amounts payable and receivables;

(5) the manner in which the *firm* or *investment firm group* operates its business suggests that there is a significant risk that it will fail to comply with the *overall financial adequacy rule* in the foreseeable future; or

(6) the *firm's* wind-down plan does not identify realistic and credible actions for ensuring an orderly wind-down or is based on unreasonable or unrealistic assumptions.

7

7.10.14 G

(1) A *firm* can normally meet its *liquid assets threshold requirement* with any type of *liquid assets*. This is subject to the overriding requirement that in all cases, a *firm* must meet its *basic liquid assets requirement* with *core liquid assets*.

(2) However, in appropriate cases, the *FCA* may require a *firm* to meet all or part of its *liquid assets threshold requirement* with a more limited subset of *liquid assets*. For example, in certain cases, the *FCA* may require a *firm* to hold *core liquid assets* to cover particular risks or may disallow the use of certain *non-core liquid assets*.

(3) The *FCA* may also:

(a) require a *firm* to apply modified haircuts to *non-core liquid assets*; or

(b) impose certain requirements relating to a *firm's* funding profile and the matching of expected liquidity outflows and inflows.

(4) Where the *FCA* wishes to apply the approaches in (2) or (3), it will normally invite the *firm* to apply for the imposition of a *requirement* to that effect under section 55L(5) of the *Act*. In appropriate cases, the *FCA* may impose such a *requirement* on its own initiative in accordance with section 55L(3) of the *Act*.

Guidance on assessing potential harms that is potentially relevant to all firms

Purpose

1.1 G (1) This annex contains *guidance* on how a *MIFIDPRU investment firm* can assess the potential harms arising from its business as part of the *ICARA process*.

(2) This *guidance* is designed to be of relevance to all *firms*, but not every aspect of this *guidance* will be relevant to every *firm*. A *firm* should consider this *guidance* in light of its particular business model.

(3) A *firm's ICARA process* must be proportionate to the nature, scale and complexity of its activities. This *guidance* should be interpreted by reference to what is proportionate and appropriate for a particular *firm*.

General approach to assessing material potential harms

1.2 G (1) For the purposes of its *ICARA process*, a *firm* should identify potential harms by considering plausible hypothetical scenarios that may occur in relation to the activities that the *firm* carries on. The *firm* should also consider the possibility that certain scenarios may occur at the same time or that there may be a correlation between connected scenarios.

(2) A *firm* should generally estimate the nature and size of potential harms by using its own knowledge and experience.

(3) Where appropriate, a *firm* may use peer analysis to estimate potential harms. In this case, the *firm* should take into account any material differences between the *firm's* business and the business carried on by its peer, and to the extent that it is aware of them, any material differences in their respective systems and controls.

(4) A *firm* may, but is not required to, use statistical models to identify potential harms, but where it does, the *firm* should consider the following factors:

(a) the importance of ensuring that the statistical model is properly integrated into the *firm's* wider approach to mitigating risk under the *ICARA process* and appropriately takes into account the *guidance* on assessing harm in MIFIDPRU 7;

(b) the *FCA's* expectation that relevant *individuals* within the *firm* who are responsible for the *firm's* risk management function or for the oversight of that function should fully understand how the model operates, including any relevant assumptions or limitations and should be able to explain how this contributes to compliance with the *overall financial adequacy rule*;

(c) the accuracy of the model depends on ensuring that the inputs into the model are appropriate and properly reflect the *firm's* business;

(d) the importance of periodically checking that the outputs of the model remain appropriate. This includes model validation; and

(e) the fact that excessive reliance on the model may result in the *firm* failing to operate wider risk management systems and controls.

(5) In some cases, it may be reasonable for a *firm* to take into account the impact of insurance when assessing potential harms and considering how the *firm* manages risks. However, *firms* should note that in many cases, insurance may not be an adequate substitute for financial resources that are required to address harm immediately. *Firms* should also consider the terms of any insurance, including any limitations or exclusions, when assessing the extent to which insurance may be an appropriate and effective risk mitigant.

Examples of situations that may result in material harm to clients

1.3 G The following are non-exhaustive examples of risks to *clients* or to the market that may arise from a *firm's* business:

(1) breach of an investment mandate, resulting in *clients* being exposed to risks outside of their specified tolerance or to investments which are otherwise unsuitable for their objectives;

(2) trading or dealing errors that result in losses to *clients*;

(3) outages in, or other problems with, the *firm's* systems that cause disruption to the continuity of the *firm's* services (for example, by preventing the *firm's clients* from being able to see the value of their investments or from being able to issue trading instructions), leading to financial losses for *clients*;

(4) corporate finance advice which results in a legal claim against the *firm*;

(5) losses to *clients* caused by the activities of the *firm's tied agents* or *appointed representatives* (including in respect of any business which is not *MiFID business* for which the *firm* may be liable as principal) for which the *firm* is responsible;

(6) provision of unsuitable *investment advice*, for example in relation to pension transfers or investments, resulting in *clients* suffering losses;

(7) failure to comply with any applicable provisions of *CASS*, resulting in potential losses to *clients*; and

(8) the inability to return money received by the *firm* by way of *title transfer collateral arrangement* promptly to a *client* when required.

Examples of situations that may result in harm to the firm

1.4 G (1) Events that result in material harm to a *firm* may affect the viability of the *firm's* business. In turn, that may affect the *firm's* ability to meet its obligations to *clients* or to its other counterparties and may increase the risk of a disorderly wind-down.

(2) The following are non-exhaustive examples of situations that may result in material harm to a *firm*:

(a) claims on *tied agents* or *appointed representatives* that result in the *firm* being liable as principal;

(b) the failure of significant *clients* or counterparties upon which the *firm* relies to generate a significant proportion of its revenue;

(c) significant operational events, such as the failure of key systems or internal fraud; and

(d) obligations of the *firm* relating to liabilities under a defined benefit pension scheme.

Assessing the harm that may result from insufficient liquidity

1.5 G When assessing potential harms that may occur in connection with its business, a *firm* should consider any potential impact on its *liquid assets*. Where a *firm* has insufficient *liquid assets* to cover the relevant harm, it may find itself unable to pay

its debts as they fall due. In turn, this could trigger an unexpected insolvent wind-down, which has the potential to cause harm to *clients*, counterparties and the wider markets.

1.6 G (1) The systems that the *firm* uses to identify and monitor liquidity risk should be tailored to its business lines, the currencies in which it operates and its structure (taking into account, for example, whether it operates *branches* or supports *subsidiaries* or other *group* entities). In addition, those systems should consider liquidity costs, benefits and risks, including intra-day *liquidity risk*.

(2) The systems that a *firm* uses to identify and monitor *liquidity risk* should be proportionate to the complexity, size, structure and risk profile of the *firm* and the scope of its operations.

1.7 G When a *firm* is assessing the quality and amount of *liquid assets* that it has available, the following is a non-exhaustive list of factors that may be relevant:

(1) the extent to which assets held by the *firm* can be converted into cash within a reasonable time period;

(2) any legal or operational restrictions that may apply to the *firm* or to particular assets, which may affect the *firm's* ability to realise assets or to access cash in a timely manner;

(3) the extent to which *liquid assets* may be held, or the proceeds of the *firm's* assets may be received, in currencies other than the expected currency of the *firm's* liabilities and the ease with which those currencies can be converted (including in stressed market conditions); and

(4) any legal or practical restrictions on the transferability of funds between the *firm* and other members of its *group*, including in stressed market conditions.

1.8 G When a *firm* is assessing the amount of *liquid assets* it may need to address potential harms, the following is a non-exhaustive list of factors that may be relevant:

(1) any concentration of the *firm's* funding arrangements, including in relation to:

(a) counterparties (or groups of connected counterparties) providing funding;

(b) products or facilities used to provide funding; and

(c) currencies;

(2) the extent to which the *firm* may be exposed to mismatches between the maturity of its assets and its liabilities;

(3) whether stressed market conditions could lead to accelerated cash outflows from the *firm* or longer-term reductions in the availability of *liquid assets*;

(4) whether intra-day obligations could affect the *firm's* ability to meet its payment and settlement obligations in a timely manner (including potential margin calls in relation to the *firm's* own positions, or positions of the *firm's clients* in respect of which the *firm* has an obligation to meet the relevant margin call);

(5) any requirements on the *firm* (whether or not they are legally binding) arising from any off-balance sheet arrangements, including:

(a) commitments under any credit or liquidity facilities (including those which may be cancelled at any time) or guarantees;

(b) obligations under any liquidity facilities supporting securitisation programmes; or

(c) obligations in relation to *client money*;

		(6)	payments that the *firm* may make to maintain its franchise, reputation or brand or to ensure the continued viability of its business, even though the *firm* may be under no legal obligation to make the payments; and
		(7)	the possibility of other unexpected payment obligations, such as:
			(a) direct or indirect costs arising from litigation;
			(b) redress payments; or
			(c) fines or penalties.
1.9	G	(1)	When considering *liquidity risk* and potential harms, a *firm* should consider whether it has sufficient diversification in funding sources.
		(2)	A *firm* should consider whether there may be a correlation between different market conditions and the *firm's* ability to access funding from different sources.
		(3)	When analysing what level of funding diversification is appropriate for its business, a *firm* should consider the following:
			(a) the maturity date of any funding arrangements;
			(b) the nature of the counterparty providing the funding;
			(c) whether the funding arrangement is secured or unsecured;
			(d) if the funding arrangement is in the form of a *financial instrument*, the relevant type of instrument;
			(e) the currency of the funding arrangement; and
			(f) the geographical market of the funding arrangement.
		(4)	A *firm* should regularly assess whether its ability to raise short, medium and long-term liquidity is sufficient for its ongoing requirements.
1.10	G	(1)	A *firm* should consider whether it has appropriately addressed potential harms arising from *liquidity risk* in relation to the following aspects of the *firm's* significant business activities:
			(a) product pricing;
			(b) performance measurement and incentives; and
			(c) the approval process for new products.
		(2)	A *firm* should take into account the *liquidity risk* arising from any significant business activities and product lines, whether or not they are accounted for on the *firm's* balance sheet.
		(3)	A *firm* should clearly identify the liquidity costs and benefits attributable to particular significant business and product lines and relevant *individuals* within business line management for those areas should have an appropriate understanding of such costs and benefits.
		(4)	A *firm* should address all significant business activities, including those that involve the creation of contingent exposures which may not have an immediate balance sheet impact.
		(5)	Incorporating liquidity pricing into a *firm's* processes may assist in aligning the risk-taking incentives of individual business lines within a *firm* with the *liquidity risk* and potential harms that may result from the activities of those business lines.
1.11	G	(1)	*Firms* should consider intra-day liquidity positions when considering the *liquidity risk* and potential harms that may result from their operations.
		(2)	As part of their *ICARA process*, a *firm* should identify:
			(a) any significant time-critical payment or settlement obligations and any arrangements that are in place to prioritise the payments;

(b) any significant payment or settlement obligations that the *firm* may have as a result of acting as a custodian or a settlement agent;

(c) any potential net funding shortfalls that the *firm* may have at different points during the *day*;

(d) potential significant disruptions to its intra-day liquidity flows and any arrangements in place to deal with these; and

(e) any arrangements necessary to ensure the proper management of collateral.

1.12 G When identifying *liquidity risk* and potential material harms that may result in relation to a *firm's* use and management of collateral, the following considerations are relevant:

(1) the *firm's* ability to distinguish clearly at any time between encumbered assets and assets that are unencumbered and available to meet the *firm's* liquidity needs, particularly in an emergency situation;

(2) the jurisdiction in which the assets are based or registered and any legal or regulatory restrictions that may apply to the availability or use of the assets as a result;

(3) any operational restrictions that may apply in relation to the assets;

(4) the extent to which collateral deposited by the *firm* with a counterparty or third party may have been rehypothecated;

(5) the extent to which the assets available to the *firm* to use as collateral are likely to be acceptable to the *firm's* major counterparties and liquidity providers;

(6) the impact of any existing financing or security arrangements entered into by the *firm* (which may contain financial covenants, warranties, events of default or negative pledge clauses) on the *firm's* ability to provide collateral; and

(7) the potential impact of severe but plausible stressed scenarios on the *firm's* ability to provide collateral where necessary and on any collateral received by the *firm*.

1.13 G A *firm* that has significant positions in foreign currencies should consider the *liquidity risk* and potential harms that may arise as a result of the positions.

1.14 G As part of its assessment under MIFIDPRU 7.9.2R, a *firm* that forms part of a *group* should consider the extent to which membership of that *group* may have an impact on the *firm's* own liquidity position.

In-depth stress testing and reverse stress testing

1.15 G The *guidance* in MIFIDPRU 7 Annex 1.16G to MIFIDPRU 7 Annex 1.20G is relevant to *firms* with more complex businesses or operating models.

1.16 G Stress testing carried out by a *firm* should involve the following:

(1) identifying severe but plausible adverse scenarios which are relevant to the *firm* and the market in which it operates;

(2) stating clear assumptions, when compared to the *firm's* business-as-usual projections, which are consistent with the scenarios identified in (1);

(3) considering the impact of the scenarios identified in (1) against the *firm's* own risk appetite, by reference to:

(a) individual business lines or portfolios; and

(b) the overall position of the *firm* as a whole;

(4) assessing the impact of the scenarios in (1) on the *firm's*:

(a) available *own funds* and *liquid assets*; and

(b) *own funds requirement* and *basic liquid assets requirement*;

(5) estimating the effects of scenarios identified in (1) on each of the following as they relate to the *firm*, both before and after taking into account any realistic management actions:

(a) profits and losses;

(b) cash flows;

(c) the liquidity position; and

(d) the overall financial position; and

(6) the *firm's governing body* regularly reviewing the scenarios identified in (1) to ensure that their nature and severity remain appropriate and relevant to the *firm*.

1.17 G When considering the impact of the scenarios in MIFIDPRU 7 Annex 1.16G(1) on a *firm's* available *liquid assets*, the *FCA* considers that the following factors are relevant:

(1) correlations between funding markets;

(2) the effectiveness of diversification across the *firm's* chosen sources of funding;

(3) any potential additional margin calls or collateral requirements;

(4) contingent claims, including potential draws on committed lines extended to third parties or other entities within the *firm's group*;

(5) *liquid assets* absorbed by off-balance sheet vehicles and activities (including conduit financing);

(6) the transferability of *liquid assets*;

(7) access to central bank market operations and liquidity facilities;

(8) estimates of future balance sheet growth;

(9) the continued availability of market liquidity in a number of currently highly liquid markets;

(10) the ability to access secured and unsecured funding;

(11) currency convertibility; and

(12) access to payment or settlement systems on which the *firm* relies.

1.18 G Reverse stress testing carried out by a *firm* should involve the following:

(1) identifying a range of adverse circumstances which would cause the *firm's* business model to become unviable;

(2) assessing the likelihood that the adverse circumstances in (1) will occur;

(3) determining whether the risk of the *firm's* business model becoming unviable is unacceptably high when compared with the *firm's* risk appetite or tolerance; and

(4) where the *firm* determines under (3) that the risk is unacceptably high, adopting effective arrangements, processes, systems or other measures to prevent or mitigate that risk. This may include making appropriate changes to the *firm's* business model or operating model.

1.19 G For the purposes of reverse stress testing, the following are non-exhaustive examples of when a *firm's* business model may become unviable:

(1) all or a substantial portion of the *firm's* counterparties are unwilling to continue transacting with the *firm* or seeking to terminate their contracts with it. In some circumstances, the failure of a single major counterparty or *client* may cause a *firm's* business to become unviable, particularly if this could result in wider market disruption;

(2) another member of the *firm's group* is unable or unwilling to provide the support which is necessary for the *firm* to continue its business (for example, by withdrawing access to shared services or funding arrangements);

(3) the *firm's* existing shareholders or owners are unwilling to provide new capital when required; or

(4) a sustained and continued reliance on income or revenue generated from a peripheral activity (for example, interest income derived from *client money*).

1.20 G The following table is a simple example of how a *firm* might analyse and record the outcome of stress testing using the *guidance* in MIFIDPRU 7 Annex 1.18G.

Example scenario	Likelihood	Mitigants
Failure of a significant counterparty leads to a liquidity shortfall that causes the *firm* to default on its own obligations	Medium – above *firm's* risk appetite	Contingency funding plan
30% drop in revenue over a 6-*month* period leads to sustained losses and management actions have little impact	Low – in line with *firm's* risk appetite	
Management actions after a stress event fail to rebuild capital and the *firm's group* and shareholders are unwilling to inject further capital	Low – in line with *firm's* risk appetite	
Large numbers of staff and outsourced providers are absent due to illness during a pandemic and the *firm* is not able to operate revenue-generating activities for a *month*	High – above *firm's* risk appetite	Identify back up outsourcing providers and enable staff to work from home
Cyber-attack results in the *firm* being unable to access systems and provide services for 3 weeks. This results in loss of revenue, a liquidity shortfall and fines from regulators	Medium – above *firm's* risk appetite	Improvements to cyber resilience

1.21 G A *firm's* business model may become unviable long before the *firm's* financial resources have been exhausted. The *FCA* recognises that not every business failure is the result of a lack of financial resources and individual *firms* may vary in their assessment of when they would be unwilling or unable to continue carrying on their activities. Examples of where a *firm's* business model may become unviable before its financial resources are exhausted include:

(1) the *firm* has a sustained and continued reliance on income or revenue generated from a peripheral or ancillary activity, such as interest income derived from *client money*; or

(2) the *firm* is reliant on *title transfer collateral arrangements* to meet its *basic liquid assets requirement* on a sustained basis.

Additional guidance on assessing potential harms that is relevant for firms dealing on own account or firms with significant investments on their balance sheet

Purpose

2.1 G (1) This annex contains *guidance* on how a *MIFIDPRU investment firm* should assess the potential harms arising from its business as part of its *ICARA process*. This *guidance* is primarily intended to be relevant to *firms* that *deal on own account* or hold significant investments on their balance sheets. It should be interpreted in light of the *firm's* individual business model.

(2) *Firms* are reminded that their *ICARA process* must be proportionate to the nature, scale and complexity of their activities. This *guidance* should be interpreted by reference to what is proportionate for a particular *firm*.

2.2 G A *firm* that *deals on own account* or holds significant investments on its balance sheets may be at increased risk of events that result in significant losses or other harm to the *firm*. In turn, this may increase the risk of a *firm* defaulting on its obligations to counterparties or becoming insolvent and entering a disorderly wind-down.

Examples of situations that may result in material harm to the firm

2.3 G The following are examples of situations that may result in harm to the *firm*:

(1) material adverse changes in the book value of the *firm's* assets;

(2) the failure of the *firm's clients* or counterparties; and

(3) losses incurred or payments due in connection with positions taken by the *firm* in *financial instruments*, foreign currencies and commodities (irrespective of whether those positions form part of the *firm's trading book* or not).

2.4 G When a *firm* is assessing potential harms connected with material changes in the book value of the *firm's* assets, the following non-exhaustive list of factors may be relevant:

(1) changes in the creditworthiness or the default of a *client* or counterparty, where that change or default may result in the *firm* realising assets below their book value or recording impairments, revaluations or write-downs;

(2) changes in market conditions which may affect relevant prices, indices or rates, including changes in equity, debt or foreign exchange markets or interest rates;

(3) operational events or natural disasters that may affect the value of the *firm's* assets;

(4) any concentration of the *firm's* assets in relation to a specific:

(a) *client* or counterparty (or group of connected *clients* or counterparties);

(b) economic sector or sub-sector; or

(c) geographical market.

This concentration assessment should not be limited to the particular

risks covered by the requirements in MIFIDPRU 5, but should involve a broader assessment of the risks that may arise in relation to the concentration;

(5) whether any of the *firm's* assets are, or have a value which depends on, complex products, such as interests in securitisations or structured products which are complex or opaque;

(6) the extent to which the *firm* has used leverage (including contingent leverage); and

(7) whether the *firm* has any exposures under off-balance sheet items, such as commitments or guarantees.

2.5 G When a *firm* is assessing potential harms arising from the failure of its *clients* or counterparties, the following non-exhaustive list of factors may be relevant:

(1) changes in the creditworthiness or the default of a *client* or counterparty, which may result in direct losses for the *firm* or the need to revalue or replace transactions;

(2) changes in market conditions which may result in the *firm* incurring greater costs to replace a transaction that the *client* or counterparty has failed to settle;

(3) the risk that collateral received from the *client* or counterparty may not be as effective as expected at covering the losses arising from that *client* or counterparty's failure or default; and

(4) any concentration of the *firm's* exposures in relation to the *client* or counterparty or the economic sector or geographical market in which that *client* or counterparty is active.

2.6 G Where a *firm* is subject to the *K-TCD requirement* or the *K-CON requirement*, the *FCA* would generally expect the *firm* to consider whether those requirements are sufficient to cover the harms that may result from the failure of its *clients* or counterparties to fulfil their obligations. In some cases, those requirements may not apply in relation to the *client*, counterparty or position in question, or may not adequately address the relevant risks. Where this is the case, the *firm* should consider other measures to address the potential harm.

2.7 G Where a *firm* is assessing potential harms arising from the *firm's* positions in *financial instruments*, foreign currencies and commodities, the following non-exhaustive list of factors may be relevant:

(1) the extent to which the relevant position may involve risks that are not adequately captured by the *firm's K-NPR requirement*, *K-CMG requirement* or *K-CON requirement*, such as:

(a) basis risk between certain products;

(b) risks arising from approximate valuations applied to non-linear products;

(c) the risk that large movements in pegged currencies may be underestimated; or

(d) risks arising from inadequate proxy market data;

(2) whether a position is illiquid or distressed, or whether it may become so under severe but plausible market conditions, and how this may affect the expected holding period for that position;

(3) the extent to which it is possible to hedge a position under both normal, and severe but plausible, market conditions;

(4) whether a position is difficult to value because of a lack of recent observable market data;

(5) whether the intra-day exposure associated with a position differs significantly from the end-of-day exposure;

(6) any known weaknesses in any model used by the *firm* to assess the risks arising from the position; and

(7)	the concentration of the portfolio in which the position is held, including by reference to:	
	(a)	issuers or counterparties;
	(b)	economic sectors or sub-sectors; and
	(c)	geographical markets.

Notification under MIFIDPRU 7.1 and SYSC 19G.1 on the requirements to establish certain committees or the additional remuneration requirements

[Editor's note: The form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 7 Annex 3R Notification under MIFIDPRU 7.6.11R in relation to level of own funds.pdf]

Notification under MIFIDPRU 7.6.11R in relation to level of own funds

[Editor's note: The form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 7 Annex 4R Notification under MIFIDPRU 7.6.11R in relation to level of own funds.pdf]

Notification under MIFIDPRU 7.7.14R in relation to level of liquid assets

[Editor's note: The form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 7 Annex 5R Notification under MIFIDPRU 7.7.14R in relation to level of liquid assets.pdf]

Notification under MIFIDPRU 7.8.4R in relation to revised ICARA assessment questionnaire (data item MIF007) submission date

[Editor's note: The form can be found at this address: https://www.handbook.fca.org.uk/form/MIFIDPRU 7 Annex 6R Notification under MIFIDPRU 7.8.4R in relation to revised ICARA assessment questionnaire.pdf]

Map of rules and guidance relating to the ICARA process

7.1	G	(1)	The table in this annex identifies the rules in MIFIDPRU 7 that impose obligations relating to the *ICARA process* and the *guidance* provisions corresponding to those *rules*.
		(2)	*MIFIDPRU investment firms* may find this annex helpful when designing and reviewing their *ICARA processes* to ensure that all mandatory requirements have been met.
		(3)	*Firms* should not use this table as a substitute for reading and applying the detailed *rules* and *guidance* in MIFIDPRU 7.

MIFIDPRU rule	Basic obligation	Associated guidance	Content of guidance
MIFIDPRU 7.4: **baseline ICARA obligations**			
MIFIDPRU 7.4.7R	The *overall financial adequacy rule*	MIFIDPRU 7.4.8G	Explanation of the link between the *overall financial adequacy rule* and the *ICARA process*
MIFIDPRU 7.4.9R	The requirement to operate an *ICARA process* to identify, monitor and, if proportionate, reduce all material potential harms relevant to the *firm*	MIFIDPRU 7.4.16G	*Guidance* on how *firms* should seek to mitigate the risk of potential harms
MIFIDPRU 7.4.10R	The requirement for the *ICARA process* to be proportionate to the nature, scale and complexity of the *firm's* business		
MIFIDPRU 7.4.11R	The requirement for the *ICARA process* to be internally consistent	MIFIDPRU 7.4.12G	Explanation of the *FCA's* expectations in relation to consistency and coherency of the *ICARA process*
MIFIDPRU 7.4.13R	The requirement to identify all material harms that may result from the *firm's* business	MIFIDPRU 7.4.14G	Explanation of the basic factors that will be relevant when identifying potential harms
		MIFIDPRU 7.4.15G	Cross-reference to additional *guidance* in MIFIDPRU 7 Annex 1R and MIFIDPRU 7 Annex 2R
		MIFIDPRU 7 Annex 1G	*Guidance* on assessing potential harms that is potentially relevant to all *firms*
		MIFIDPRU 7 Annex 2G	Additional *guidance* on assessing potential harms that is relevant for a *firm* that is

MIFIDPRU rule	Basic obligation	Associated guidance	Content of guidance
			dealing on own account or that has significant investments on its balance sheet
MIFIDPRU 7.5: **Capital and liquidity planning, stress testing, wind-down planning and recovery planning**			
MIFIDPRU 7.5.2R	Business model assessment and capital and liquidity planning requirements, including stress testing	MIFIDPRU 7.5.3G	*Guidance* referring to Finalised Guidance FG20/1
		MIFIDPRU 7.5.4G	*Guidance* on stress testing obligations and reverse stress testing for *firms* with more complex businesses or operating models
		MIFIDPRU 7 Annex 1.15G to 7 Annex 1.20G	Additional *guidance* on more in-depth stress testing and reverse stress testing
MIFIDPRU 7.5.5R	Recovery planning requirements	MIFIDPRU 7.5.6G	*Guidance* on issues that may be relevant when assessing potential recovery actions
MIFIDPRU 7.5.7R	Wind-down planning requirements	MIFIDPRU 7.5.8G	*Guidance* referring to the Wind-Down Planning Guide and Finalised Guidance FG20/1
MIFIDPRU 7.5.9R	Requirement to use wind-down analysis to assess levels of *own funds* and *liquid assets* required under *overall financial adequacy rule*	MIFIDPRU 7.5.10G	Explanation of the interaction between the *overall financial adequacy rule* and the *wind-down triggers*
MIFIDPRU 7.6: **Assessing and monitoring the adequacy of own funds**			
MIFIDPRU 7.6.2R	Requirement to produce a reasonable estimate of impact of potential harms on *own funds*	MIFIDPRU 7.6.4G	*Guidance* on how the assessment of potential harms interacts with the *own funds threshold requirement* and the *overall financial adequacy rule* and how the *firm* should conduct its assessment
MIFIDPRU 7.6.3R	Requirement to use assessment under MIFIDPRU 7.6.2R to assess if additional *own funds* required to meet *overall financial adequacy rule*		
		MIFIDPRU 7.6.6G	*Guidance* explaining the circumstances in which the *guidance* in MIFIDPRU 7.6.7G to MIFIDPRU 7.6.10G is relevant
		MIFIDPRU 7.6.7G	*Guidance* on how a *non-SNI MIFIDPRU investment firm* should assess whether harms may be covered by its *own funds requirement*

MIFIDPRU rule	Basic obligation	Associated guidance	Content of guidance
		MIFIDPRU 7.6.8G	*Guidance* on circumstances in which harms may not be covered by a *non-SNI MIFIDPRU investment firm's own funds requirement*
		MIFIDPRU 7.6.9G	*Guidance* on how an *SNI MIFIDPRU investment* should assess whether harms may be covered by its *own funds requirement*
		MIFIDPRU 7.6.10G	*Guidance* on how a *firm's* assessment of potential harms contributes to determining its *own funds threshold requirement*
MIFIDPRU 7.6.5R	Requirement to meet *own funds threshold requirement* with specified types of *own funds*		
MIFIDPRU 7.6.11R	Notification requirements when a *firm's own funds* reach certain levels	MIFIDPRU 7.6.12G	*Guidance* on the *FCA's* ability to set an alternative *early warning indicator*
		MIFIDPRU 7.6.13G	*Guidance* explaining how notifications under MIFIDPRU 7.6.11R interact with general notification obligations under *Principle* 11 or SUP 15.3
		MIFIDPRU 7.6.14G and MIFIDPRU 7.6.15G	Explanation of *FCA's* approach to intervention when *firm's own funds* reach certain levels
MIFIDPRU 7.7: **Assessing and monitoring the adequacy of** *liquid assets*			
MIFIDPRU 7.7.2R	Requirement to produce reasonable estimate of *liquid assets* required by the *firm*	MIFIDPRU 7.7.3G	*Guidance* on the interaction between the *overall financial adequacy rule* and the *liquid assets* that a *firm* must hold
		MIFIDPRU 7.7.4G	*Guidance* on how a *firm* should assess the *liquid assets* required for the ongoing operation of its business
		MIFIDPRU 7.7.5G	*Guidance* on the *basic liquid assets requirement* and how to determine the *firm's liquid assets threshold requirement*

MIFIDPRU rule	Basic obligation	Associated guidance	Content of guidance
MIFIDPRU 7.7.6R	Requirement to meet *liquid assets threshold requirement* with *core liquid assets* and *non-core liquid assets*	MIFIDPRU 7.7.7G	General principles applicable to *non-core liquid assets*
MIFIDPRU 7.7.8R	Basic definition of *non-core liquid assets*	MIFIDPRU 7.7.9G	*Guidance* on exclusions for *non-core liquid assets*
MIFIDPRU 7.7.10R	Requirement to apply appropriate haircut to *non-core liquid assets*	MIFIDPRU 7.7.11G and 7.7.12G	*Guidance* on minimum haircuts for *non-core liquid assets*
		MIFIDPRU 7.7.13G	*Guidance* on approach to applying haircuts to shares or units in collective investment undertakings
MIFIDPRU 7.7.14R	Notification requirements when a *firm's liquid assets* reach certain levels	MIFIDPRU 7.7.15G	*Guidance* explaining how notifications under MIFIDPRU 7.6.14R interact with general notification obligations under *Principle* 11 or SUP 15.3
		MIFIDPRU 7.7.16G and 7.7.17G	Explanation of *FCA's* approach to intervention when *firm's liquid assets* reach certain levels
MIFIDPRU 7.8: **Reviewing and documenting the** *ICARA process*			
MIFIDPRU 7.8.2R	Requirement to review the *ICARA process* at least annually	MIFIDPRU 7.8.3G	*Guidance* on reviewing the *ICARA process* following a material change in the *firm's* business
MIFIDPRU 7.8.4R	Requirement for *firm* to notify the *FCA* of the submission date of the *firm's* MIF007 (ICARA assessment questionnaire) return	MIFIDPRU 7.8.5G	*Guidance* on interaction between the *firm's ICARA review* and its submission date for its MIF007 return
MIFIDPRU 7.8.6R	Requirement to submit MIF007 return following review of *ICARA process* due to a material change in the *firm's* business		
MIFIDPRU 7.8.7R	Requirement to document review of the *ICARA process* and minimum contents of review document		
MIFIDPRU 7.8.8R	Requirement for *firm's governing body* to review and approve the *ICARA document*	MIFIDPRU 7.8.9G	*Guidance* on the interaction between the obligations in *COCON* and the *ICARA process*
MIFIDPRU 7.8.10R	Record keeping requirements in relation to the *ICARA process*		

MIFIDPRU rule	Basic obligation	Associated guidance	Content of guidance
MIFIDPRU 7.9: **Firms forming part of a *group***			
MIFIDPRU 7.9.2R	Requirement for any *firm* that forms part of a *group* to assess risks arising from that *group* or its other members	MIFIDPRU 7.9.3G	*Guidance* on the entities included within a *firm's* assessment of *group* risk
MIFIDPRU 7.9.5R	Ability of *investment firm group* to operate the *ICARA process* on a *group*-level basis	MIFIDPRU 7.9.4G	*Guidance* that an *investment firm group* is not required to operate an *ICARA process* on a *consolidated basis*
MIFIDPRU 7.9.6R	Disapplication of individual *ICARA process* requirement in relation to *MIFIDPRU investment firm* included in a *group ICARA process*		
MIFIDPRU 7.9.7R	Circumstances in which a *group ICARA process* cannot be used	MIFIDPRU 7.9.9G	*Guidance* on when the *FCA* may prohibit the use of a *group*-level *ICARA process* in relation to one or more *firms*
MIFIDPRU 7.9.8R	Application of requirements in MIFIDPRU 7.4 to MIFIDPRU 7.8 to an *investment firm group* operating a *group ICARA process*		
MIFIDPRU 7.9.10R	Ability to include multiple *firms* within one *ICARA document*	MIFIDPRU 7.9.11G	*Guidance* on when a single *ICARA document* can be used

Chapter 8

Disclosure

8.1 Disclosure

8.1.1 R

(1) Subject to (2) and (3), the requirements in this chapter apply to a *non-SNI MIFIDPRU investment firm*.

(2) ■ MIFIDPRU 8.2 (Risk management objectives and policies), ■ MIFIDPRU 8.4 (Own funds) and ■ MIFIDPRU 8.5 (Own funds requirements) also apply to an *SNI MIFIDPRU investment firm* that has *additional tier 1 instruments* in issue.

(3) ■ MIFIDPRU 8.6 (Remuneration policies and practices) applies to every *MIFIDPRU investment firm*.

(4) ■ MIFIDPRU 8.7 (Investment policy) applies only to a *non-SNI MIFIDPRU investment firm* that does not fall within ■ MIFIDPRU 7.1.4R(1).

8.1.2 G

The requirements in ■ MIFIDPRU 8.6 (Remuneration policies and practices) apply to all *MIFIDPRU investment firms*, with certain exceptions that are explained in that section.

8.1.3 G

The basic conditions to be classified as an *SNI MIFIDPRU investment firm* are set out in ■ MIFIDPRU 1.2.1R. ■ MIFIDPRU 1.2.13R explains the circumstances in which a *non-SNI MIFIDPRU investment firm* will be reclassified as an *SNI MIFIDPRU investment firm*.

8.1.4 R

Where a *non-SNI MIFIDPRU investment firm* is reclassified as an *SNI MIFIDPRU investment firm*, it must comply with the disclosure obligations that apply to a *non-SNI MIFIDPRU investment firm* in relation to the financial year in which it is reclassified.

8.1.5 R

Where an *SNI MIFIDPRU investment firm* is reclassified as a *non-SNI MIFIDPRU investment firm*, it must comply with the disclosure obligations that apply to an *SNI MIFIDPRU investment firm* in relation to the financial year in which it ceased to be an *SNI MIFIDPRU investment firm*.

8.1.6 G

Where an *SNI MIFIDPRU investment firm* is reclassified as a *non-SNI MIFIDPRU investment firm*, it may choose to comply with the higher disclosure requirements applicable to a *non-SNI MIFIDPRU investment firm* in relation to the financial year in which it is reclassified.

Application: Level of application

8.1.7 R A *MIFIDPRU investment firm* must comply with the *rules* in this chapter on an individual basis, unless the *firm* is exempt in accordance with ■ MIFIDPRU 2.3.1R.

Application: proportionality

8.1.8 R In complying with the *rules* in this chapter, a *MIFIDPRU investment firm* must provide a level of detail in its qualitative disclosures that is appropriate to its size and internal organisation, and to the nature, scope, and complexity of its activities.

8.1.9 G By way of example, applying a proportionate approach to the qualitative disclosure requirements in ■ MIFIDPRU 8.6 (Remuneration policies and practices) means that the *FCA* would expect a *non-SNI MIFIDPRU investment firm* with a detailed *remuneration* policy to disclose more information than an *SNI MIFIDPRU investment firm*.

Application: when?

8.1.10 R As a minimum, a *firm* must publicly disclose the information specified in this chapter annually on:

(1) the date it publishes its *annual financial statements*; or

(2) where it does not publish *annual financial statements*, the date on which its annual solvency statement is submitted to the *FCA* in accordance with requirements in ■ SUP 16.12.

8.1.11 G The *FCA* considers it would be appropriate for a *firm* to consider making more frequent public disclosure where particular circumstances demand it, for example, in the event of a major change to its business model or where a merger has taken place.

8.1.12 G A *MIFIDPRU investment firm* is reminded of the transitional provisions for disclosure requirements in ■ MIFIDPRU TP 12.

Application: how?

8.1.13 R A *firm* must publish the information required by this chapter in a manner that:

(1) is easily accessible and free to obtain;

(2) is clearly presented and easy to understand;

(3) is consistent with the presentation used for previous disclosure periods or otherwise allows a reader of the information to make comparisons easily; and

(4) highlights in a summary any significant changes to the information disclosed, when compared with previous disclosure periods.

8.1.14 G A *firm* should consider the best way to make the disclosed information easy to understand, for example, by using tables, charts or diagrams, or cross-references to other information where relevant.

8.1.15 R A *firm* is not required to comply with ■ MIFIDPRU 8.1.13R to the extent that compliance would breach the law of another jurisdiction.

8.1.16 E Making the disclosures required by this chapter available on a website will tend to establish compliance with the *rule* in ■ MIFIDPRU 8.1.13R.

8.1.17 G Whilst the *FCA's* expectation is that a *firm* will use a website for the purpose of complying with ■ MIFIDPRU 8.1.13R, if a *firm* does not maintain a website, or cannot use a website to publish some or all of the information required without breaching the law of another jurisdiction, it must nonetheless ensure that the alternative method of disclosure used complies with the overarching requirement in ■ MIFIDPRU 8.1.13R.

8.2 Risk management objectives and policies

8.2.1 R A *firm* must disclose its risk management objectives and policies for the categories of risk addressed by:

(1) MIFIDPRU 4 (Own funds requirements);

(2) MIFIDPRU 5 (Concentration risk); and

(3) MIFIDPRU 6 (Liquidity).

8.2.2 R The risk management objectives and policies for each of the items listed in MIFIDPRU 8.2.1R must include:

(1) a concise statement approved by the *firm's governing body* describing the potential for harm associated with the business strategy; and

(2) a summary of the strategies and processes used to manage each of the categories of risk listed in MIFIDPRU 8.2.1R and how this helps to reduce the potential for harm.

8.2.3 G In complying with MIFIDPRU 8.2.2R, a firm may consider that information drawn from the *ICARA process* is a relevant and useful way of disclosing:

(1) the *firm's* approach to risk management by reference to its risk management policies;

(2) details of the *firm's* risk management structure and operations, for example, the *senior management* responsible for each area of risk (where applicable), and any relevant committees and their responsibilities;

(3) how the *firm* sets its risk appetite; and

(4) a summary of how the *firm* assesses the effectiveness of its risk management processes.

8.3 Governance arrangements

8.3.1 R A *non-SNI MIFIDPRU investment firm* must disclose the following information regarding internal governance arrangements:

(1) an overview of how the *firm* complies with the requirement in ■ SYSC 4.3A.1R to ensure the *management body* defines, oversees and is accountable for the implementation of governance arrangements that ensure effective and prudent management of the *firm*, including the segregation of duties in the organisation and the prevention of conflicts of interest, and in a manner that promotes the integrity of the market and the interests of *clients*;

(2) subject to ■ MIFIDPRU 8.3.2R, the number of directorships (executive and non-executive) held by each member of the *management body*;

(3) where relevant, whether the *FCA* has granted a modification or *waiver* of ■ SYSC 4.3A.6R(1)(a) or ■ (b) in order to allow a member of the *management body* to hold additional directorships;

(4) a summary of the policy promoting diversity on the *management body*, including explanations of:

(a) the objectives of the policy and any target(s) set out in the policy; and

(b) the extent to which the objectives and any target(s) have been achieved; and

(c) where the objectives or target(s) have not been achieved:

(i) the reasons for the shortfall; and

(ii) the *firm's* proposed actions to address the shortfall; and

(iii) the proposed timeline for taking those actions;

(5) whether the *firm* has a risk committee; and

(6) whether the *firm*:

(a) is required by ■ MIFIDPRU 7.3.1R to establish a risk committee; or

(b) would have been required by ■ MIFIDPRU 7.3.1R to establish a risk committee, but that obligation has been removed as a result of a *waiver* or modification granted by the *FCA*.

8.3.2 R The following directorships are not within the scope of ■ MIFIDPRU 8.3.1R(2):

(1) executive and non-executive directorships held in organisations which do not pursue predominantly commercial objectives; and

(2) executive and non-executive directorships held within the same group or within an undertaking (including a *non-financial sector entity*) in which the *firm* holds a *qualifying holding*.

8.3.3 G When deciding what information to disclose to satisfy the obligations in ■ MIFIDPRU 8.3.1R(1), a *firm* may find it helpful to consider:

(1) the requirements in ■ SYSC 4.3A.1R(1) to ■ (7) regarding the responsibilities of the management body; and

(2) the requirements in ■ SYSC 4.3A.3R regarding the necessary skills and attributes of members of the *management body*.

8.4 Own funds

8.4.1 R

(1) Subject to (2), a *firm* must disclose the following information regarding its *own funds*:

(a) a reconciliation of common equity tier 1 items, additional tier 1 items, tier 2 items, and the applicable filters and deductions applied in order to calculate the *own funds* of the *firm*;

(b) a reconciliation of (a) with the capital in the balance sheet in the audited *financial statements* of the *firm*; and

(c) a description of the main features of the *common equity tier 1 instruments*, *additional tier 1 instruments* and *tier 2 instruments* issued by the *firm*.

(2) A *firm* that is not required to publish annual *financial statements* is only required to disclose the information specified at (1)(a) and (c).

8.4.2 R

A *firm* must use the template available at ■ MIFIDPRU 8 Annex 1R in order to disclose the information requested at ■ MIFIDPRU 8.4.1R.

8.5 Own funds requirements

8.5.1 R A *firm* must disclose the following information regarding its compliance with the requirements set out in ■ MIFIDPRU 4.3 (Own funds requirement):

(1) the *K-factor requirement*, broken down as follows:

(a) the sum of the *K-AUM requirement*, the *K-CMH requirement* and the *K-ASA requirement*;

(b) the sum of the *K-COH requirement* and the *K-DTF requirement*; and

(c) the sum of the *K-NPR requirement*, the *K-CMG requirement*, the *K-TCD requirement* and the *K-CON requirement*; and

(2) the *fixed overheads requirement*.

8.5.2 R A *firm* must disclose its approach to assessing the adequacy of its *own funds* in accordance with the *overall financial adequacy rule* in ■ MIFIDPRU 7.4.7R.

8.6 Remuneration policy and practices

Application: general

8.6.1 R The *rules* in this section apply to all *MIFIDPRU investment firms*, unless otherwise specified.

Qualitative disclosures

8.6.2 R A *MIFIDPRU investment firm* must disclose a summary of:

(1) its approach to *remuneration* for all staff ("staff" interpreted according to ■ SYSC 19G.1.24G);

(2) the objectives of its financial incentives;

(3) the decision-making procedures and governance surrounding the development of the *remuneration* policies and practices the *firm* is required to adopt in accordance with the *MIFIDPRU Remuneration Code*, to include, where applicable:

(a) the composition of and mandate given to the *remuneration* committee; and

(b) details of any external consultants used in the development of the *remuneration* policies and practices.

8.6.3 G In complying with ■ MIFIDPRU 8.6.2R(1), a *firm* may consider it appropriate to disclose:

(1) the principles or philosophy guiding the *firm's remuneration* policies and practices;

(2) how the *firm* links variable *remuneration* and performance;

(3) the *firm's* main performance objectives; and

(4) the categories of staff eligible to receive variable *remuneration*.

8.6.4 R A *non-SNI MIFIDPRU investment firm* must disclose the types of staff it has identified as *material risk takers* under ■ SYSC 19G.5, including any criteria in addition to those in ■ SYSC 19G.5.3R that the *firm* has used to identify *material risk takers*

8.6.5 R A *MIFIDPRU investment firm* must disclose the key characteristics of its *remuneration* policies and practices in sufficient detail to provide the reader with:

(1) an understanding of the risk profile of the *firm* and/or the assets it manages; and

(2) an overview of the incentives created by the *remuneration* policies and practices.

8.6.6 R For the purpose of MIFIDPRU 8.6.5R, a *firm* must disclose at least the following information:

(1) the different components of *remuneration*, together with the categorisation of those *remuneration* components as fixed or variable;

(2) a summary of the financial and non-financial performance criteria used across the *firm*, broken down into the criteria for the assessment of the performance of:

(a) the *firm*;

(b) business units; and

(c) individuals.

(3) for a *non-SNI MIFIDRU investment firm*:

(a) the framework and criteria used for ex-ante and ex-post risk adjustment of *remuneration*, including a summary of:

(i) current and future risks identified by the *firm*;

(ii) how the *firm* takes into account current and future risks when adjusting *remuneration*; and

(iii) how malus (where relevant) and clawback are applied;

(b) the policies and criteria applied for the award of guaranteed variable *remuneration*; and

(c) the policies and criteria applied for the award of severance pay.

(4) for a *non-SNI MIFIDPRU investment firm* not falling within SYSC 19G.1.1R(2):

(a) details of the *firm's* deferral and vesting policy, including as a minimum:

(i) the proportion of variable *remuneration* that is deferred;

(ii) the deferral period;

(iii) the retention period;

(iv) the vesting schedule; and

(v) an explanation of the rationale behind each of the policies referred to in (i) to (iv).

Where the *firm's* deferral and vesting policy differs for different categories of *material risk takers*, the information should be presented and sub-divided accordingly.

(b) a description of the different forms in which fixed and variable *remuneration* are paid, for example, whether paid in:

(i) *cash*;

(ii) share-linked instruments;

(iii) equivalent non-*cash* instruments;

(iv) *options*; or

(v) short or long-term incentive plans.

8.6.7 G In complying with ■ MIFIDPRU 8.6.6R(1), a *firm* is reminded of the *rules* and *guidance* in ■ SYSC 19G.4 on categorising fixed and variable *remuneration*.

Quantitative disclosures

8.6.8 R (1) Subject to (7), a *MIFIDPRU investment firm* must disclose the quantitative information required by (2) to (6) for the financial year to which the disclosure relates.

(2) An *SNI-MIFIDPRU investment firm* must disclose the total amount of *remuneration* awarded to all staff, split into:

(a) fixed *remuneration*; and

(b) variable *remuneration*.

(3) A *non-SNI MIFIDPRU investment firm* must disclose the total number of *material risk takers* identified by the *firm* under ■ SYSC 19G.5.

(4) A *non-SNI MIFIDPRU investment firm* must disclose the following information, split into categories for *senior management*, other *material risk takers*, and other staff:

(a) the total amount of *remuneration* awarded;

(b) the fixed *remuneration awarded*; and

(c) the variable *remuneration* awarded.

(5) A *non-SNI MIFIDPRU investment firm* must disclose the following information, split into categories for *senior management* and other *material risk takers*:

(a) the total amount of guaranteed variable *remuneration* awards made during the financial year and the number of *material risk takers* receiving those awards;

(b) the total amount of the severance payments awarded during the financial year and the number of *material risk takers* receiving those payments; and

(c) the amount of the highest severance payment awarded to an individual *material risk taker*.

(6) A *non-SNI MIFIDPRU investment firm* not meeting the conditions in ■ SYSC 19G.1.1R(2) must disclose the following information, split into categories for *senior management*, and other *material risk takers*:

(a) the amount and form of awarded variable *remuneration*, split into *cash*, shares, share-linked instruments and other forms of

remuneration, with each form of *remuneration* also split into deferred and non-deferred;

(b) the amounts of deferred *remuneration* awarded for previous performance periods, split into the amount due to vest in the financial year in which the disclosure is made, and the amount due to vest in subsequent years;

(c) the amount of deferred *remuneration* due to vest in the financial year in respect of which the disclosure is made, split into that which is or will be paid out, and any amounts that were due to vest but have been withheld as a result of performance adjustment;

(d) information on whether the *firm* uses the exemption for individual *material risk takers* set out in ■ SYSC 19G.5.9R, together with details of:

(i) the provisions in ■ SYSC 19G.5.9R(2) in respect of which the *firm* relies on the exemption;

(ii) the total number of *material risk takers* who benefit from an exemption from each provision referred to in (i); and

(iii) the total *remuneration* of those *material risk takers* who benefit from an exemption, split into fixed and variable *remuneration*.

(7) (a) For the purposes of (4), (5)(a), (5)(b) and (6), a *non-SNI MIFIDPRU investment firm* must aggregate the information to be disclosed for *senior management* and other *material risk takers*, where splitting the information between those two categories would lead to the disclosure of information about one or two people.

(b) Where aggregation in accordance with (a) would still lead to the disclosure of information about one or two people, a *non-SNI MIFIDPRU investment firm* is not required to comply with the obligation in (4), (5)(a), (5)(b) or (6).

8.6.9 R A *non-SNI MIFIDPRU investment firm* that relies on ■ MIFIDPRU 8.6.8R(7) must include a statement in the main body of its remuneration disclosure that:

(1) explains the obligations in relation to which it has relied on the exemption; and

(2) confirms that the exemption is relied on to prevent individual identification of a *material risk taker*.

8.6.10 G The purpose of the exemption referred to in ■ MIFIDPRU 8.6.8R(7) is to avoid *firms* having to disclose information:

(1) that would enable a *material risk taker* to be identified; or

(2) that could be associated with a particular *material risk taker*.

8.6.11 G (1) When considering the exemptions in ■ MIFIDPRU 8.6.8R(7), the *non-SNI MIFIDPRU investment firm* should apply the conditions to each information item separately. Where the information contained in at

least one of the categories of *senior management* and other material risk takers relates to one or two *material risk takers*, the *non-SNI MIFIDPRU investment firm* is exempt from the requirement to split the information into these categories, and should aggregate the information. Where the aggregated information still relates to only one or two individuals, the *non-SNI MIFIDPRU investment firm* is exempt from the requirement to disclose that information.

(2) The *guidance* in (1) is illustrated by the following example:

(a) Firm A does not meet the conditions in ■ SYSC 19G.1.1R(2). It has identified eight material risk takers under ■ SYSC 19G.5.

(b) In relation to the information items required in ■ MIFIDPRU 8.6.8R(4), five of the *material risk takers* are *senior management*, and three are other *material risk takers*. Firm A cannot rely on the exemption in ■ MIFIDPRU 8.6.8R(7) because neither of the categories of *senior management* and other *material risk takers* contains one or two individuals. It must disclose the *remuneration* information required at ■ MIFIDPRU 8.6.8R(4) broken down into the categories of *senior management*, other *material risk takers*, and other staff.

(c) In relation to the information items required in ■ MIFIDPRU 8.6.8R(5)(a), Firm A has awarded guaranteed *remuneration* to two material risk takers. Both are also *senior management*. The information in the category of *senior management* therefore relates to only two individuals. If Firm A aggregates the information from the *senior management* and other *material risk taker* categories in line with ■ MIFIDPRU 8.6.8R(7), the figure is still two. Therefore, Firm A can rely on the exemption in ■ MIFIDPRU 8.6.8R(7). It is exempt from the requirement to disclose the information on guaranteed *remuneration* required at ■ MIFIDPRU 8.6.8(5)(a).

(d) In relation to the information items required in ■ MIFIDPRU 8.6.8R(5)(b), Firm A has awarded severance payments to four *material risk takers*, of which three are members of *senior management* and one is another *material risk taker*. Because the category of other *material risk takers* relates only to one individual, Firm A can rely on the exemption in ■ MIFIDPRU 8.6.8R(7). It should aggregate the total for both categories and disclose the information on severance payments required at ■ MIFIDPRU 8.6.8(5)(b) as a single item. Firm A cannot rely on the exemption in ■ MIFIDPRU 8.6.8R(7) because the aggregated total of *senior management* and other *material risk takers* is more than two.

(e) Firm A is not in scope of the disclosure requirements in ■ MIFIDPRU 8.6.8R(6) because it meets the conditions in ■ SYSC 19G.1.1R(2).

8.7 Investment policy

8.7.1 R A *non-SNI MIFIDPRU investment firm* not meeting the conditions in ■ MIFIDPRU 7.1.4R must disclose:

(1) the proportion of voting rights attached to the shares held directly or indirectly by the *firm*, broken down by country or territory; and

(2) a complete description of voting behaviour in the general meetings of *companies* the shares of which are held in accordance with ■ MIFIDPRU 8.7.4R, including:

(a) an explanation of the votes; and

(b) the ratio of proposals put forward by the administrative or *governing body* of the *company* that the *firm* has approved; and

(3) an explanation of the use of proxy adviser firms; and

(4) a summary of the voting guidelines regarding the *companies* in which the shares referred to in (1) are held with links to supporting non-confidential documents where available.

8.7.2 R A *firm* must use the template available at ■ MIFIDPRU 8 Annex 2R in order to disclose the information requested at ■ MIFIDPRU 8.7.1R.

8.7.3 R The disclosure requirements in ■ MIFIDPRU 8.7.1R(2) do not apply if the contractual arrangements of all shareholders represented by the *firm* at the shareholders' meeting only authorise the *firm* to vote on their behalf when express voting orders are given by the shareholders after receiving the meeting's agenda.

8.7.4 R (1) To the extent that any data item required by ■ MIFIDPRU 8.7 is treated as proprietary information in accordance with (2), or confidential information in accordance with (3), a *firm* may refuse to disclose it, noting on the template available at ■ MIFIDPRU 8 Annex 2R which item has not been disclosed and why.

(2) A *firm* may only treat information as proprietary information if sharing that information with the public would have a material adverse effect upon its business.

(3) A *firm* may only treat information as confidential information if there are obligations to customers or other counterparty relationships binding the *firm* to confidentiality.

8.7.5 R Where a *firm* refuses to disclose information in reliance on ■ MIFIDPRU 8.7.4 R(2), the *firm* should record why the information is considered proprietary and make that information available to the *FCA* if requested.

8.7.6 R A *firm* referred to in ■ MIFIDPRU 8.7.1R must comply with that *rule*:

(1) only in respect of a *company* whose shares are admitted to trading on a *regulated market*;

(2) only where the proportion of voting rights that the *MIFIDPRU investment firm* directly or indirectly holds in that *company* is greater than 5% of all voting rights attached to the shares issued by the *company*; and

(3) only in respect of shares in that *company* to which voting rights are attached.

8.7.7 R The voting rights referred to in ■ MIFIDPRU 8.7.6R(2) must be calculated on the basis of all shares to which voting rights are attached, even if the exercise of any of those voting rights is suspended.

8.7.8 G For the purpose of complying with ■ MIFIDPRU 8.7.1R and ■ MIFIDPRU 8.7.6R:

(1) reference to "directly or indirectly" held shares means that:

(a) a *firm* directly holds the shares on its balance sheet or the balance sheet of another group member; or

(b) the *firm* may exercise a voting right attaching to a share in a fiduciary capacity;

(2) in the circumstances described in (1), the disclosure requirement will apply where the voting rights are attached to shares held in the name of the *firm* and to shares held by clients where the *firm* exercises those voting rights;

(3) the fact that a *firm* has voting rights but chooses not to exercise them doesn't remove its obligation to comply with ■ MIFIDPRU 8.7.1R and ■ MIFIDPRU 8.7.6R; and

(4) "greater than 5% of all voting rights" means that the *firm* holds at least 5% of shares with voting rights plus one share, and the requirement is triggered when the *firm* meets this threshold at any point during the course of the year.

Disclosure template for information required under MIFIDPRU 8.4.1R in respect of own funds

This annex consists of a template which can be found at the following link: MIFIDPRU8_Annex1R_20240402.pdf

Disclosure template for information required under MIFIDPRU 8.7.1R in respect of voting rights

[*Editor's note*: The form can be found at this address: MIFIDPRU8_Annex2R_20220101.pdf]

Chapter 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 *GCT parent undertaking* that is required to submit reports on its compliance with the *group capital test* in accordance with ■ MIFIDPRU 2.6.10R.

9

9.1.2 R (1) The provisions of ■ SUP 16.3 (General provisions on reporting) listed in (2) apply to reports submitted under this chapter as if the reports had been submitted under ■ SUP 16.

(2) The provisions are:

■ SUP 16.3.6R to ■ SUP 16.3.10G (How to submit reports);

■ SUP 16.3.11R to ■ SUP 16.3.12G (Complete reporting); and

■ SUP 16.3.14R to ■ SUP 16.3.16G (Failure to submit reports).

9.1.3 G 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 under 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 show the position on the relevant reporting reference date 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.

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*: (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

9

MIF003	Metrics monitoring	Quarterly	Last *business day*: (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*: (1) March; (2) June; (3) September; (4) December	20 *business days* after the reporting reference date
MIF005	K-CON concentration risk reporting	Quarterly	(1) The *firm's accounting reference date*; (2) The *firm's accounting reference date* plus 3 *months*; (3) The *firm's accounting reference date* plus 6 *months*; (4) The *firm's accounting reference date* plus 9 *months*;	20 *business days* after the reporting reference date
MIF007 (note 1)	ICARA assessment questionnaire	Annually (note 2)	The reference date according to which the *firm* reviews the adequacy of its *ICARA process* under MIFIDPRU 7.8.2R	The date notified to the *FCA* by the *firm* under MIFIDPRU 7.8.4R (or such other date as directed by the *FCA*)
Note 1	Where a *firm* is included in a *group ICARA process* in accordance with MIFIDPRU 7.9.5R, the *firm* must still submit *data item* MIF007 on an individual basis, containing information about the *firm* that has been derived from that *group ICARA process*. *Data item* MIF007 does not apply on a *consolidated basis*.			
Note 2	Under MIFIDPRU 7.8.2R, in certain circumstances, a *firm* may carry out a review of its *ICARA process* more frequently than the minimum required annual frequency. If so, the			

firm must submit *data item* MIF007 separately after each review.

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 show the position on 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.

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*: (1) March; (2) June; (3) September; (4) December	20 *business days* after the reporting reference date
MIF002 (Note 1)	Liquidity	Quarterly	Last *business day*: (1) March; (2) June; (3) September; (4) December	20 *business days* after the reporting reference date
MIF003	Metrics monitoring	Quarterly	Last *business day*: (1) March; (2) June; (3) September; (4) December	20 *business days* after the reporting reference date
MIF007	ICARA assess-	Annually	The refer-	The date no-

(note 2)	ment questionnaire	(note 3)	ence date according to which the *firm* reviews the adequacy of its *ICARA process* under MIFIDPRU 7.8.2R	tified to the *FCA* by the *firm* under MIFIDPRU 7.8.4R (or such other date as directed by the *FCA*)
Note 1	If, exceptionally, the *FCA* has exempted an *SNI MIFIDPRU investment firm* from the liquidity requirements in MIFIDPRU 6, the *firm* is not required to submit MIF002.			
Note 2	Where a *firm* is included in a *group ICARA process* in accordance with MIFIDPRU 7.9.5R, the *firm* must still submit *data item* MIF007 on an individual basis, containing information about the *firm* that has been derived from that *group ICARA process*. *Data item* MIF007 does not apply on a *consolidated basis*.			
Note 3	Under MIFIDPRU 7.8.2R, in certain circumstances, a *firm* may carry out a review of its *ICARA process* more frequently than the minimum required annual frequency. If so, the *firm* must submit *data item* MIF007 separately after each review.			

9

9.2.5 R Where a *firm* is required to submit any of the *data items* MIF001 to MIF005 under ■ MIFIDPRU 9.2.1R or ■ MIFIDPRU 9.2.3R, it must submit the *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*, the *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 *data items* under ■ MIFIDPRU 9.2.6R, A remains responsible for the timely submission and 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) submit *data items* in accordance with ■ MIFIDPRU 9.2.1R on the basis of its *consolidated situation* if it is treated as a *non-SNI MIFIDPRU investment firm* under ■ MIFIDPRU 2.5.21R; or

(b) submit *data items* in accordance with ■ MIFIDPRU 9.2.3R on the basis of its *consolidated situation* if it is treated as an *SNI MIFIDPRU investment firm* under ■ MIFIDPRU 2.5.21R.

(2) For the purposes of (1),■ MIFIDPRU 9.2 applies with the following modifications:

(a) a reference to a "*firm*" is 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 sets out guidance on how to apply the requirements in *MIFIDPRU* on the basis of the *consolidated situation* of a *UK parent entity*. The 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 *GCT 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 show the position on 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*: (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 *GCT 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*.

(2) Where this *rule* applies, the *responsible UK parent* must submit an additional *data item* under ■ MIFIDPRU 9.4.1R that shows the position of the *subsidiary* in (1)(b).

9.4.4 R Where a *GCT 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 Under MIFIDPRU 2.6.11R, a *GCT parent undertaking* may designate:

(1) a *parent undertaking* in the *UK* that is part of the *investment firm group*; or

(2) a *MIFIDPRU investment firm* that is part of the *investment firm group* and that is not a *parent undertaking*;

to submit *data items* to the *FCA* on behalf of all *GCT parent undertakings* within the same *investment firm group*. However, each *GCT parent undertaking* remains responsible for ensuring the timely submission and accuracy of any *data items* submitted on its behalf.

Data items for MIFIDPRU 9

This annex consists of forms which can be found through the following link: https://www.handbook.fca.org.uk/form/MIFIDPRU_9_Annex_1R_20230929.docx

Guidance notes on data items in MIFIDPRU 9 Annex 1R

This annex consists of guidance which can be found through the following link: MIFIDPRU_9_Annex_2G_20230929.pdf

Chapter 10

Firms acting as clearing members and indirect clearing firms

10.1 Application

10.1.1 R This chapter applies to a *MIFIDPRU investment firm* that is:

(1) a *clearing member*; or

(2) an *indirect clearing firm*.

10.1.2 R This chapter also applies to the *UK parent entity* of an *investment firm group* that contains a *clearing member* or an *indirect clearing firm*.

10.2 Categorisation of clearing firms as non-SNI MIFIDPRU investment firms

10.2.1 R

(1) A *MIFIDPRU investment firm* that is a *clearing member* or an *indirect clearing firm* is a *non-SNI MIFIDPRU investment firm*.

(2) The classification in (1) applies irrespective of whether the *firm* satisfies the conditions in ■ MIFIDPRU 1.2 (*SNI MIFIDPRU investment firms*) or not.

10.2.2 R

(1) This *rule* applies where:

(a) an *investment firm group* contains a *clearing member* or an *indirect clearing firm*; and

(b) the *UK parent entity* of the *investment firm group* in (a) is subject to prudential consolidation in accordance with ■ MIFIDPRU 2.5.

(2) Where this *rule* applies, the *UK parent entity* in (1) must comply with the relevant obligations in *MIFIDPRU* on a *consolidated basis* as if it were a *non-SNI MIFIDPRU investment firm*.

(3) The requirement in (2) applies irrespective of whether the *UK parent entity* satisfies the conditions in ■ MIFIDPRU 2.5.21R or not.

10.2.3 R

(1) The effect of ■ MIFIDPRU 10.2.1R is that a *firm* that acts as a *clearing member* or *indirect clearing firm* will always be a *non-SNI MIFIDPRU investment firm*. This is the case even where the *firm* may otherwise satisfy all the other criteria in ■ MIFIDPRU 1.2 to be classified as an *SNI MIFIDPRU investment firm*.

(2) The effect of ■ MIFIDPRU 10.2.2R is that where the consolidated situation of a *UK parent entity* includes a *clearing member* or *indirect clearing firm*, the *UK parent entity* will always be a *non-SNI MIFIDPRU investment firm* on a *consolidated basis*.

(3) ■ MIFIDPRU 10.2.1R applies equally to a *firm* that is a self-clearing *firm*.

10.3 Application of K-DTF requirement to clearing activities

10.3.1 R

(1) This *rule* applies to transactions in *financial instruments* in relation to which a *MIFIDPRU investment firm* provides clearing services in its capacity as a *clearing member* or an *indirect clearing firm*.

(2) Except where ■ MIFIDPRU 10.3.2R applies, a *firm* must include the transactions in (1) in its calculation of *DTF* for the purposes of the *K-DTF requirement* in accordance with the remainder of this *rule*.

(3) The transactions in (1) must be included in a *firm's DTF* on the following basis:

(a) where the order that gave rise to the clearing transaction was a *cash trade*, the clearing transaction must also be treated as if it were a *cash trade* (irrespective of whether it would otherwise meet that definition); and

(b) where the order that gave rise to the clearing transaction was a *derivatives trade*, the clearing transaction must also be treated as if it were a *derivatives trade* (irrespective of whether it would otherwise meet that definition).

10.3.2 R

(1) This *rule* applies where a *firm*:

(a) executes an order:

(i) in its own name (whether for its own account or on behalf of a *client*); or

(ii) in the name of a *client*; and

(b) also provides clearing services in its capacity as a *clearing member* or *indirect clearing firm* in relation to a transaction that results from the order in (a).

(2) Where this *rule* applies, the value of the relevant order in (1)(a) is not included in the *firm's* measurement of *DTF* attributable to clearing services under ■ MIFIDPRU 10.3.1R, provided that the value of the order has already been included in one of the following in relation to the *firm's* execution services:

(a) the calculation of the *firm's COH* under ■ MIFIDPRU 4.10 (K-COH requirement); or

(b) the calculation of the *firm's DTF* under ■ MIFIDPRU 4.15 (K-DTF requirement).

10.3.3 G

(1) ■ MIFIDPRU 10.3.1R requires a *MIFIDPRU investment firm* to calculate an additional *K-DTF requirement* for any clearing transactions it undertakes in relation to *financial instruments*.

(2) ■ MIFIDPRU 10.3.2R applies to a *MIFIDPRU investment firm* that both executes an order and subsequently provides clearing services in relation to the resulting transaction (including where the *firm* is acting as a self-clearing *firm*). In this case, the *firm* is not required to include the clearing transaction in its calculation of *DTF*, provided that the value of the original executed order has already been included in either the *firm's* measurement of its *DTF* or *COH*.

(3) The intention of ■ MIFIDPRU 10.3.2R is that a *firm* is not required to "double-count" the value of the original order and the resulting clearing transaction where the *firm* is involved in both executing and clearing the same trade.

10.3.4 R

Where prudential consolidation applies to a *UK parent entity* under ■ MIFIDPRU 2.5.7R, the *UK parent entity* must include within the calculation of its consolidated *K-DTF requirement* any transactions that are cleared by *clearing members* or *indirect clearing firms* that are included within its *consolidated situation*.

10

10.4 Own funds requirement for CCP default fund exposures

10.4.1 R This section applies to:

(1) a *MIFIDPRU investment firm* that is a *clearing member*; and

(2) a *UK parent entity* to which consolidation under ■ MIFIDPRU 2.5.7R applies, where the relevant *investment firm group* includes one or more *clearing members*.

10.4.2 R (1) A *MIFIDPRU investment firm* must include its pre-funded contributions to the default fund of a *CCP* in the calculation of its *K-TCD requirement* in accordance with the remainder of this *rule*.

(2) The *firm* must apply the *rules* and guidance in ■ MIFIDPRU 4.14 (K-TCD requirement) in relation to the relevant default contribution with the following modifications:

(a) the transactions specified in ■ MIFIDPRU 4.14.3R are deemed to include pre-funded contributions made by the *firm* to the default fund of a *CCP*;

(b) for the purposes of ■ MIFIDPRU 4.14.7R, the value of α shall be 1;

(c) for the purposes of ■ MIFIDPRU 4.14.9R, the replacement cost (RC) of the default fund contribution is the book value of that asset in accordance with the applicable accounting framework;

(d) for the purposes of ■ MIFIDPRU 4.14.29R, the applicable risk factor is:

(i) the value of a C-factor calculated in accordance with the methodology in ■ MIFIDPRU 10.4.3R where that C-factor has been published by an *authorised central counterparty* in relation to the default fund of the *CCP*;

(ii) in the case of an *authorised central counterparty* that has not published a C-factor relating to its default fund, 1.6%; and

(iii) where the *CCP* is not an *authorised central counterparty*, 8%; and

(e) for the purposes of ■ MIFIDPRU 4.14.30R, the credit valuation adjustment (CVA) is 1.

10.4.3 R

(1) For the purposes of ■ MIFIDPRU 10.4.2R(2)(d), a C-factor is:

(a) in the case of an *authorised central counterparty* that is subject to national rules implementing the requirements in BCBS 282 (Capital requirements for bank exposures to central counterparties) published by the Basel Committee on Banking Supervision in April 2014, a value determined in accordance with the formula in (2); or

(b) in the case of any other *authorised central counterparty*, a value determined in accordance with the formula in (3).

The relevant formula under (1)(a) is:

$$\text{C-factor} = \max\left(\frac{K_{CCP}}{DF_{CCP} + DF_{CM^{pref}}}; 8\% \cdot 2\%\right)$$

where, in each case, the values of K_{CCP}, DF_{CCP} and $DF_{CM^{pref}}$ are calculated in accordance with the methodology in BCBS 282.

(3) The relevant formula under (1)(b) is:

$$\text{C-factor} = \left(1 + \beta \cdot \frac{N}{N-2}\right) \cdot \frac{K_{CM}}{DF_{CM}}$$

where, in each case, the values of β, N, K_{CM} and DF_{CM} are calculated in accordance with the methodology in BCBS 227

(Capital requirements for bank exposures to central counterparties) published by the Basel Committee on Banking Supervision in July 2012.

10.4.4 G

An *authorised central counterparty* may publish C-factors for the purposes of national rules implementing both BCBS 227 and BCBS 282. In this case, the effect of ■ MIFIDPRU 10.4.3R(1)(a) is that the C-factor published for the purpose of BCBS 282 must be used. Where the default fund relates to derivatives, the C-factor published for the purposes of the Standardised Approach to Counterparty Credit Risk (SA-CCR) will normally be the relevant C-factor.

10.4.5 G

(1) Where a *MIFIDPRU investment firm* that is a *clearing member* or an *indirect clearing firm* has trade exposures to a *CCP*, it should consider whether the exposures arise from a transaction listed in ■ MIFIDPRU 4.14.3R as being within scope of the *K-TCD requirement*. ■ MIFIDPRU 4.14.3R(1)(a) and ■ MIFIDPRU 4.14.4R exclude from the scope of the *K-TCD requirement* derivatives contracts that are directly or indirectly cleared through an *authorised central counterparty*.

(2) However, the exclusion in (1) does not apply to a pre-funded contribution of a *clearing member* to the default fund of a *CCP*, as this exposure is not a contract cleared through the *authorised central counterparty*. ■ MIFIDPRU 10.4.2R explains how a *firm* should calculate the *K-TCD requirement* for the contribution.

10

10.4.6 R Where this section applies to a *UK parent entity* in accordance with ■ MIFIDPRU 10.4.1R(2), the requirement in ■ MIFIDPRU 10.4.2R and the modifications it makes to the *rules* and *guidance* in ■ MIFIDPRU 4.14 apply to the *UK parent entity* in relation to any pre-funded contributions to the default fund of a *CCP* made by any entities included within the *consolidated situation*.

Prudential sourcebook for MiFID Investment Firms

MIFIDPRU 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*; and
		(3)	a *parent undertaking* to which the *group capital test* applies.
	Purpose		
1.2	G	MIFIDPRU TP 1 contains transitional provisions relating to certain permissions granted by the *FCA* before 1 January 2022 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 continued eligibility of *additional tier 1 instruments* issued before 1 January 2022 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 a permission to which it relates, except to the extent that the *FCA* revokes, varies or replaces the 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 1 January 2022.
		(2)	Where this *rule* applies, a permission in column (A) of the table in MIFIDPRU TP 1.6R is deemed to have been granted for its remaining duration on equivalent terms by the *FCA* under the corresponding provision in column (B) of that table.
1.6	R	This table belongs to MIFIDPRU TP 1.5R.	

(A) UK CRR permission granted before 1 January 2022	(B) Deemed basis for permission on or after 1 January 2022
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 a 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 permission granted on 1 June 2021 for a one-year duration will be treated from 1 Jan-

uary 2022 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 1 January 2022

1.8 R (1) This *rule* applies where:

(a) a *firm* which became a *MIFIDPRU investment firm* on 1 January 2022 issued instruments before that date which satisfied the conditions to be classified as *additional tier 1 instruments* under the *UK CRR* in the form in which it stood immediately before 1 January 2022; and

(b) the instruments in (1) remain in issue on 1 January 2022.

(2) Where this *rule* applies, by no later than 1 February 2022, a *MIFIDPRU investment firm* must:

(a) notify the *FCA* using the form in MIFIDPRU TP 1 Annex 1R, submitted via the *online notification and application* system, to confirm whether:

(i) the relevant instruments satisfy the conditions in MIFIDPRU 3.4 to be classified as *additional tier 1 instruments*; or

(ii) the relevant instruments do not satisfy the relevant conditions in MIFIDPRU 3.4 and the *firm* has therefore ceased to recognise them as part of its *additional tier 1 capital* or has otherwise redeemed or replaced them; or

(b) apply 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* may have issued instruments that, immediately before 1 January 2022, met the conditions in the *UK CRR* (in the form in which it then stood) to be classified as *additional tier 1 instruments* and which remain in issue on 1 January 2022.

(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 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* is defined by reference to different criteria.

1.10 G An *additional tier 1 instrument* issued before 1 January 2022 under the *UK CRR* may satisfy 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 for existing *additional tier 1 instruments* issued under the *UK CRR* before 1 January 2022, to allow those instruments to be recognised as *additional tier 1 instruments* under *MIFIDPRU*.

(2) In the application, the *FCA* would expect a *firm* to 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 grant it on a temporary basis to facilitate the *firm's* orderly transition to the *MIFIDPRU* regime.
	Continuing validity of IFPRU own funds notifications		
1.12	R	(1)	This *rule* applies to any notification listed in column (A) of the table in MIFIDPRU TP 1.13R, where the notification was validly submitted by a *firm* or *parent undertaking* to the *FCA* for the purposes of the relevant *rule* in the *IFPRU* sourcebook before 1 January 2022.
		(2)	Where this *rule* applies, a notification in column (A) of the table in MIFIDPRU TP 1.13R is deemed to have been a valid notification for the purposes of the corresponding provision in column (B) in the same row of that table.
1.13	R	The table belongs to MIFIDPRU TP 1.12R.	

(A) IFPRU notification submitted before 1 January 2022	(B) Deemed notification for the purposes of MIFIDPRU on or after 1 January 2022
IFPRU 3.2.10R: notification of issuance of own funds instruments	MIFIDPRU 3.6.5R(1) (for a *MIFIDPRU investment firm*)
	MIFIDPRU 3.6.8R(1)(b) (for a *UK parent entity* to which consolidation under MIFIDPRU 2.5.7R applies)
	MIFIDPRU 3.7.4R(1)(b) (for a *parent undertaking* to which the *group capital test* applies)
IFPRU 3.2.13R: notification of issuance of ordinary *shares* or debt instruments under a debt securities programme	MIFIDPRU 3.6.5R(1) (for a *MIFIDPRU investment firm*)
	MIFIDPRU 3.6.8R(1)(b) (for a *UK parent entity* to which consolidation under MIFIDPRU 2.5.7R applies)
	MIFIDPRU 3.7.4R(1)(b) (for a *parent undertaking* to which the *group capital test* applies)

1.14	G	The effect of MIFIDPRU TP 1.12R and 1.13R is that a notification that was validly submitted for the purposes of the *rules* relating to the issuance of own funds in *IFPRU* is valid for the purposes of the notification requirements relating to the issuance of *own funds* in MIFIDPRU 3.6 or 3.7. This means that:	
		(1)	a *MIFIDPRU investment firm* or *parent undertaking* to which *IFPRU* applied is not required to submit another notification to the *FCA* in relation to pre-existing instruments to treat those instruments as *additional tier 1 instruments* or *tier 2 instruments* under *MIFIDPRU*; and
		(2)	where the *MIFIDPRU investment firm* or *parent undertaking* issues the same class of instruments on or after 1 January 2022, it can rely on the exemption from the notification requirement in MIFIDPRU 3.6.5R(2), provided that the instruments are identical in all material respects to the previous issuance notified to the *FCA* under *IFPRU*.
1.15	G	MIFIDPRU TP 1.12R and 1.13R do not affect the underlying criteria in MIFIDPRU 3 for classifying an instrument as *own funds*. Instead, the provisions deem existing notifications to be notifications for equivalent purposes under *MIFIDPRU*. This means that if the instruments that are the subject of the notifications do not meet the criteria in MIFIDPRU 3 to be classified as *own funds*, a *firm* or *parent undertaking* must not treat those instruments as such. It is the responsibility of the *firm* or *parent undertaking* relying on the transitional provisions in this annex to assess whether the relevant criteria are met in relation to any particular instrument.	

Notification under MIFIDPRU TP 1.8R – treatment of instruments formerly classified as AT1 under UK CRR		
Annex	1R	[*Editor's note*: The form can be found at this address: https://www.handbook.fca.org.uk/publication/form/mifidpru/MIFIDPRU_TP_1_Annex_1R_Notification_20211201.pdf

Prudential sourcebook for MiFID Investment Firms

MIFIDPRU TP 2
Own funds requirements: transitional provisions

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 smooth 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 for 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 alternative requirements for 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*" is as a reference to the *UK CRR* in the form in which it stood on 31 December 2021.

Duration of transitional arrangements

2.6 R MIFIDPRU TP 2 applies until 1 January 2027, except in the circumstances set out in MIFIDPRU TP 2.19R or MIFIDPRU TP 2.20R(4).

Transitional provisions 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 31 December 2021, was classified as:

(a) an *IFPRU investment firm* (other than an *exempt IFPRU commodities firm*); or

(b) a *BIPRU firm* (other than an *exempt BIPRU commodities firm*).

(2) A *firm* may substitute the alternative requirement in (3) for 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 (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* (other than a *collective portfolio management 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*;

(b) for a former *BIPRU firm* (other than a *collective portfolio management investment firm*), the base capital requirement that would have applied under GENPRU 2.1.47R and 2.1.48R; or

(c) for a *collective portfolio management investment firm*, the base *own funds requirement* that applies under IPRU(INV) 11.3.1R(1).

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. MIFIDPRU TP 2.13R to MIFIDPRU 2.18R set out the circumstances in which separate transitional arrangements may also apply to the *permanent minimum capital requirement* of a former *IFPRU investment firm* or *BIPRU firm*.

(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* must still 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* applies 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 have applied 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* under MIFIDPRU 9.

Transitional provisions 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 31 December 2021 was classified as an *exempt CAD firm*.

(2) A *firm* may substitute the alternative requirement in (3) for 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 1 January 2022 to 31 December 2022, 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 1 January 2023 to 31 December 2026:

(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 percent

age 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 1 January 2023 to 31 December 2023: 10%;

(b) from 1 January 2024 to 31 December 2024: 25%;

(c) from 1 January 2025 to 31 December 2025: 45%; and

(d) from 1 January 2026 to 31 December 2026: 70%.

Transitional provisions for K-factor requirement for firms not in existence before 1 January 2022

2.11 R (1) This *rule* applies to a *MIFIDPRU investment firm* that immediately before 1 January 2022:

(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) for 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* calculated in accordance with MIFIDPRU 4.5 from time to time.

Transitional provisions 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 31 December 2021 was classified as an *exempt CAD firm*.

(2) A *firm* may substitute the alternative requirement in (3) for its *permanent minimum capital requirement* under MIFIDPRU 4.4.

(3) The alternative requirement is as follows:

(a) from 1 January 2022 to 31 December 2022: £50,000;

(b) from 1 January 2023 to 31 December 2023: £55,000;

(c) from 1 January 2024 to 31 December 2024: £60,000;

(d) from 1 January 2025 to 31 December 2025: £65,000; and

(e) from 1 January 2026 to 31 December 2026: £70,000.

(4) This *rule* is subject to MIFIDPRU TP 2.19R.

Transitional provisions 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 31 December 2021 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) for its *permanent minimum capital requirement* under MIFIDPRU 4.4.

(4) The alternative requirement is as follows:

(a) from 1 January 2022 to 31 December 2022: £50,000;

(b) from 1 January 2023 to 31 December 2023: £55,000;

(c) from 1 January 2024 to 31 December 2024: £60,000;

(d) from 1 January 2025 to 31 December 2025: £65,000; and

(e) from 1 January 2026 to 31 December 2026: £70,000.

(5) This *rule* is subject to MIFIDPRU TP 2.19R.

2.14 R (1) Subject to (2), this *rule* applies to a *MIFIDPRU investment firm* that:

(a) under the *rules* in force on 31 December 2021 was classified as an *IFPRU 125K firm*; or

(b) is a *collective portfolio management investment firm* that would be subject to a *permanent minimum capital requirement* of £150,000 under MIFIDPRU 4.4.3R if this *rule* did not apply.

(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) for its *permanent minimum capital requirement* under MIFIDPRU 4.4.

(4) The alternative requirement is as follows:

(a) from 1 January 2022 to 31 December 2022: £125,000;

(b) from 1 January 2023 to 31 December 2023: £130,000;

(c) from 1 January 2024 to 31 December 2024: £135,000;

(d) from 1 January 2025 to 31 December 2025: £140,000; and

(e) from 1 January 2026 to 31 December 2026: £145,000.

(5) This *rule* is subject to MIFIDPRU TP 2.19R.

2.15 R (1) This *rule* applies to a *MIFIDPRU investment firm* that under the *rules* in force on 31 December 2021 was classified as an *IFPRU 730K firm*.

(2) A *firm* may substitute the alternative requirement in (3) for its *permanent minimum capital requirement* under MIFIDPRU 4.4.

(3) The alternative requirement is as follows:

(a) from 1 January 2022 to 31 December 2022: £730,000;

(b) from 1 January 2023 to 31 December 2023: £735,000;

(c) from 1 January 2024 to 31 December 2024: £740,000;

(d) from 1 January 2025 to 31 December 2025: £745,000; and

(e) from 1 January 2026 to 31 December 2026: £750,000.

(4) This *rule* is subject to MIFIDPRU TP 2.19R.

Transitional provisions 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 31 December 2021 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) for its *permanent minimum capital requirement* under MIFIDPRU 4.4.

(4) The alternative requirement is as follows:

(a) from 1 January 2022 to 31 December 2022: £50,000;

(b) from 1 January 2023 to 31 December 2023: £55,000;

(c) from 1 January 2025 to 31 December 2025: £65,000; and

(d) from 1 January 2024 to 31 December 2024: £60,000;

(e) from 1 January 2026 to 31 December 2026: £70,000.

(5) This *rule* is subject to MIFIDPRU TP 2.19R.

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 provisions 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 31 December 2021, 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) for its *permanent minimum capital requirement* under MIFIDPRU 4.4.

(3) The alternative requirement is as follows:

(a) from 1 January 2022 to 31 December 2022:

(i) for a former *BIPRU firm* or a former *IFPRU 50K firm*: £50,000; or

(ii) for a former *IFPRU 125K firm*: £125,000;

(b) from 1 January 2023 to 31 December 2023: £190,000;

(c) from 1 January 2024 to 31 December 2024: £330,000;

(d) from 1 January 2025 to 31 December 2025: £470,000; and

(e) from 1 January 2026 to 31 December 2026: £610,000.

Disapplication of permanent minimum capital requirement transitional provisions because of changes to a firm's permissions

2.19 R The transitional arrangements in MIFIDPRU TP 2.12R to 2.16R and MIFIDPRU TP 2.18R cease to apply if there is a change to the *permissions* of the relevant *MIFIDPRU investment firm*, or any *limitation* or *requirement* that applies to the *firm*, on or after 1 January 2022 that increases the *permanent minimum capital requirement* that would apply to the *firm* under MIFIDPRU 4.4.

Transitional provisions for own funds requirement: former local firms

2.20 R (1) Subject to (4), 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 31 December 2021, was classified as a *local firm*.

(2) A *firm* may substitute the alternative requirement in (3) for its *own funds requirement* under MIFIDPRU 4.3.

(3) The alternative requirement is as follows:

(a) from 1 January 2022 to 31 December 2022: £250,000;

(b) from 1 January 2023 to 31 December 2023: £350,000;

(c) from 1 January 2024 to 31 December 2024: £450,000;

(d) from 1 January 2025 to 31 December 2025: £550,000; and

(e) from 1 January 2026 to 31 December 2026: £650,000.

(4) This *rule* ceases to apply to a *firm* where:

(a) there is a change to the *permissions* of the *firm*, or any *limitation* or *requirement* that applies to the *firm*, on or after 1 January 2022; and

(b) if the change in (a) had occurred immediately before 1 January 2022, the *firm* would have ceased to meet the definition of a *local firm*.

Transitional provisions 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 31 December 2021, 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) for 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 1 January 2022 to 31 December 2022: an amount equal to the *firm's permanent minimum capital requirement*;

(b) from 1 January 2023 to 31 December 2026:

(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 1 January 2023 to 31 December 2023: 10%;

(b) from 1 January 2024 to 31 December 2024: 25%;

(c) from 1 January 2025 to 31 December 2025: 45%; and

(d) from 1 January 2026 to 31 December 2026: 70%.

(5) Subject to (6), if the *firm* was subject to IPRU(INV) 3 on 31 December 2021, the alternative requirement can never be lower than the amount of the financial resources requirement that would have applied 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.

(6) When determining the amount of the financial resources requirement under IPRU(INV) 3 for the purposes of (5), a *firm* may determine the delta of an option as follows:

(a) if an option is traded on an exchange, the *firm* must use the delta provided by that exchange; or

(b) if the delta is not available from the exchange, or if the option is an over-the-counter option, the *firm* may use its own estimates of delta where the conditions in MIFIDPRU 4.12.10R are met.

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. The base requirement under IPRU(INV) 3-71R (in the form in which it stood on 31 December 2021) is calculated by reference to the highest of an absolute minimum requirement, an expenditure requirement and a volume of business requirement. The *firm* should therefore recalculate the alternative requirement under IPRU(INV) 3 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* under MIFIDPRU 9.

Transitional provisions 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) for 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 *MIFID-*

PRU 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*.

Interaction between alternative fixed overheads requirement and basic liquid assets requirement

2.24 R (1) This *rule* applies where:

(a) a *firm* is applying an alternative requirement for its *fixed overheads requirement* under any of the following:

(i) MIFIDPRU TP 2.7R(2)(a);

(ii) MIFIDPRU TP 2.10R(2)(a);

(iii) MIFIDPRU TP 2.21R(2)(a); or

(b) a *UK parent entity* is applying an alternative requirement for its consolidated *fixed overheads requirement* under MIFIDPRU TP 2.23R(2)(a).

(2) Where this *rule* applies to a *firm* in (1)(a), the requirement in MIFIDPRU 6.2.1R(1) applies as if the reference to the *fixed overheads requirement* is a reference to the alternative requirement.

(3) Where this *rule* applies to a *UK parent entity* in (1)(b), the requirement in MIFIDPRU 6.2.1R(1), as it applies on a *consolidated basis*, applies as if the reference to the *fixed overheads requirement* is a reference to the alternative requirement.

2.25 G (1) The effect of MIFIDPRU TP 2.24R is that where a *firm* is applying an alternative requirement for its *fixed overheads requirement* under a transitional provision in this annex, the amount of *core liquid assets* that it must hold under MIFIDPRU 6.2.1R(1) is calculated by reference to the alternative requirement. This does not affect any amount of *core liquid assets* that the *firm* must hold under MIFIDPRU 6.2.1R(2) in relation to guarantees provided to *clients*.

(2) MIFIDPRU TP 2.24R also applies on an equivalent basis to a *UK parent entity* that is applying an alternative requirement for its consolidated *fixed overheads requirement*.

(3) The following is an example of how MIFIDPRU TP 2.24R applies in practice:

(a) A former *exempt CAD firm* is calculating its *basic liquid assets requirement* under MIFIDPRU 6.2.1R after *MIFIDPRU* has been in force for 18 months. The *firm's fixed overheads requirement* (calculated without

any transitional relief) is 900. The *firm* has provided total guarantees to clients of 100.

(b) Under MIFIDPRU TP 2.10R(2)(a), the *firm* can apply an alternative requirement of 10% of its standard *fixed overheads requirement* in accordance with MIFIDPRU TP 2.10R(4)(a). The alternative requirement is therefore 90 (i.e. 10% of 900).

(c) Under MIFIDPRU TP 2.24R, the *firm* calculates the amount of core liquid assets that it requires under MIFIDPRU 6.2.1R(1) by reference to the alternative requirement. This means that the *firm* must hold *core liquid assets* of 30 for these purposes (i.e. one third of 90).

(d) Under MIFIDPRU 6.2.1R(2), the *firm* must also hold *core liquid assets* of 1.6% of the total amount of the guarantees it has provided to clients. In this case, that means that the *firm* must hold a further 1.6 in *core liquid assets* (i.e. 1.6% of 100). This amount is not affected by the transitional relief in MIFIDPRU TP 2.24R.

(e) The *firm* would therefore need to hold *core liquid assets* of 31.6 to satisfy its *basic liquid assets requirement*.

Interaction between alternative requirements under MIFIDPRU TP 2, own funds wind-down trigger and own funds threshold requirement

2.25A R (1) Where a *firm* is applying an alternative requirement for its:

(a) *fixed overheads requirement* under any of the following: MIFIDPRU TP 2.7R(2)(a), MIFIDPRU TP 2.10R(2)(a), or MIFIDPRU TP 2.21R(2)(a);

(b) *K-factor requirement* under any of the following: MIFIDPRU TP 2.7R(2)(b); MIFIDPRU TP 2.10R(2)(b); MIFIDPRU TP 2.11R(2); or MIFIDPRU TP 2.21R(2)(b);

(c) *permanent minimum capital requirement* under any of the following: MIFIDPRU TP 2.12R(2), MIFIDPRU TP 2.13R(3), MIFIDPRU TP 2.14R(3), MIFIDPRU TP 2.15R(2), MIFIDPRU TP 2.16R(3), or MIFIDPRU TP 2.18R(2); or

(d) *own funds requirement* under MIFIDPRU TP 2.20R(2);

that *firm* may substitute the alternative requirement for the corresponding requirement when calculating its *own funds threshold requirement* in accordance with MIFIDPRU 7.6.4G.

(2) Where a *firm* is applying an alternative requirement for its *fixed overheads requirement* under any of the provisions listed in (1)(a), the *firm's own funds wind-down trigger* is:

(a) the alternative requirement for its *fixed overheads requirement*; or

(b) another amount specified by the *FCA* in a *requirement* applied to the *firm*.

(3) Where a*firm*is applying an alternative requirement for its*own funds requirement*under MIFIDPRU TP 2.20R(2), the *firm's own funds wind-down trigger* is:

(a) the lower of its *fixed overheads requirement* and the alternative requirement for its*own funds requirement*; or

(b) another amount specified by the *FCA* in a *requirement* applied to the *firm*.

2.25B G (1) The effect of MIFIDPRU TP 2.25AR(1) is that a *firm* may substitute an alternative requirement under a transitional provision in this annex for its corresponding requirement when calculating its *own funds threshold requirement*. This is illustrated by the example in (2).

(2) MIFIDPRU TP 2.12R(2) permits a *MIFIDPRU investment firm* (that was classified under the rules in force on 31 December 2021 as an *exempt CAD firm*) to substitute the alternative requirement in TP2.12R(3) for its *permanent minimum capital requirement* under MIFIDPRU 4.4. MIFIDPRU TP 2.25AR(1) further allows such *firm* to substitute the alternative requirement for its *permanent min-*

imum capital requirement when determining its *own funds wind-down threshold requirement* in accordance MIFIDPRU 7.6.4G.

Continuing validity of UK CRR market risk permissions

2.26 R (1) This *rule* applies to any permission listed in column (A) of the table in MIFIDPRU TP 2.27R, where that permission was granted to a *firm* by the *FCA* for the purposes of the *UK CRR* before 1 January 2022.

(2) Where this *rule* applies, a permission in column (A) of the table in MIFIDPRU TP 2.27R is deemed to have the effect described in column (B) in the same row of that table.

2.27 R This table belongs to MIFIDPRU TP 2.26R.

(A) UK CRR permission granted before 1 January 2022	(B) Effect of permission under MIFIDPRU on or after 1 January 2022
Articles 329, 352(1) or 358 *UK CRR*: permission to use own estimates for delta for the purposes of the standardised approach for the market risk of options	The permission in column (A) is deemed to be a valid notification under MIFIDPRU 4.12.10R for equivalent purposes
Article 331 *UK CRR*: permission to use sensitivity models to calculate interest rate risk	The permission in column (A) is deemed to have been granted on equivalent terms for its remaining duration under MIFIDPRU 4.12.66R

2.28 G (1) MIFIDPRU 4.12.10R requires a *MIFIDPRU investment firm* that wishes to use its own estimates of delta for the purposes of the standardised approach for the market risk of options to notify the *FCA* that it meets certain minimum standards before doing so. Previously, *firms* that were subject to the *UK CRR* were required to seek the *FCA's* permission before using their own estimates of delta for these purposes. The effect of MIFIDPRU TP 2.25R and 2.26R is that any permission granted for these purposes to a former *CRR firm* that has subsequently become a *MIFIDPRU investment firm* will be treated as a valid notification for the purposes of MIFIDPRU 4.12.10R. This means that the *firm* does not need to submit a new notification under MIFIDPRU 4.12.10R to use its own estimates of delta under that *rule* for which the *firm* previously had permission.

(2) The effect of MIFIDPRU TP 2.26R and 2.27R is that a former *CRR firm* that was granted a permission to use interest rate sensitivity models under article 331 *UK CRR* and that has subsequently become a *MIFIDPRU investment firm* can treat that permission as having been granted on equivalent terms for the purposes of the corresponding requirement under *MIFIDPRU*. The duration of the original permission is not affected. For example, if a *firm* was granted permission to use an interest rate sensitivity model on 1 June 2021 for a one-year duration, that permission will be treated from 1 January 2022 as if it had been granted under *MIFIDPRU*, but will still expire on 1 June 2022.

Prudential sourcebook for MiFID Investment Firms

MIFIDPRU TP 3
Group capital test: transitional arrangements

Application

3.1 R MIFIDPRU TP 3 applies to:

(1) a *MIFIDPRU investment firm*;

(2) a *UK parent entity*; and

(3) a *GCT 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 under MIFIDPRU 2.4.17R, provided that certain conditions are met.

Temporary application of the group capital test

3.3 R (1) This *rule* applies 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* under MIFIDPRU 2.4.17R by no later than 1 February 2022; and

(b) the *management body* of the *UK parent entity* or *MIFIDPRU investment firm* 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 1 January 2022 until the earlier of the following:

(a) 1 January 2024; or

(b) the date 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, even though the *FCA* has not granted permission to use the *group capital test* under MIFIDPRU 2.4.17R.

3.4 G Under MIFIDPRU 2.4.18R(2)(g), an application submitted under MIFIDPRU 2.4.17R must demonstrate 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 explain the timeframe in which the *investment firm group* would expect to comply with the consolidated requirements. If the *FCA* does not grant the application, it will use this information to determine an appropriate date under MIFIDPRU TP 3.3R(2)(b) on which the transitional arrangements will end.

Prudential sourcebook for MiFID Investment Firms

MIFIDPRU TP 4
K-factor metric calculations: transitional

Application

4.1 R MIFIDPRU TP 4 applies to a *MIFIDPRU investment firm* where:

(1) immediately before 1 January 2022, 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 1 January 2022:

(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 of 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 average 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 average metric*.

(3) MIFIDPRU TP 4 is not relevant to the calculation of the following elements of the *K-factor requirement* because they do not use historical data:

(1) the *K-NPR requirement*;

(2) the *K-TCD requirement*; and

(3) the *K-CON requirement*.

Duration

4.4 G The duration of the transitional arrangements in MIFIDPRU TP 4 depends on the relevant *K-factor average metric*. Under MIFIDPRU TP 4.5.R(3), the transitional arrangements cease to apply when 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 average metric* in MIFIDPRU 4.

Missing historical data for K-factor calculations: transitional provisions 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 average 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

(f) its *K-CMG requirement*.

(2) Subject to MIFIDPRU TP 4.13R(2)(a), a *firm* may either:

(a) use reasonable estimates to fill any missing historical data points in the calculation of the relevant *K-factor average metric*; or

(b) as an exception to the standard calculation *rules* in MIFIDPRU 4, use the modified calculation in MIFIDPRU TP 4.11R to calculate the relevant *K-factor average 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 average metric* in accordance with the *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 average 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 average metric* will cease to apply and the *firm* must therefore use the standard calculation *rules* in MIFIDPRU 4 for that *K-factor average 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 *average 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 *average AUM*.

(3) MIFIDPRU TP 4.5R(3)(b) acts as a "long-stop" date for the transitional arrangements under MIFIDPRU TP 4. A *firm* must begin collecting data on its *K-factor metrics* no later than the date that *MIFIDPRU* begins to apply. Therefore, a *MIFIDPRU investment firm* 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

average 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 to the calculation of *average 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 for a specific *K-factor average metric*.

(2) A *firm* may apply different approaches under MIFIDPRU TP 4.5R(2) for different *K-factor average metrics*.

4.8 G MIFIDPRU TP 4.7R prevents a *firm* from changing its approach to missing historical data points for a particular *K-factor average metric*. 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 *average AUM*, it cannot subsequently decide to estimate the missing values for *average AUM* instead. However, a *firm* may choose, for example, to use reasonable estimates for missing values for *average AUM*, but to apply the modified calculation in MIFIDPRU TP 4.11R for the purposes of missing values for *average 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 If the *FCA* requests it, a *firm* that uses reasonable estimates in accordance with MIFIDPRU TP 4.5R(2)(a) must explain 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 for a *K-factor average 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 average metric*, other than for 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:

(i) zero; or

(ii) *n* minus *x*; and

(d) *x* is a fixed value, being:

(i) 12 for *average AUM*;

(ii) 6 for *average CMH*, *average ASA* or *average DTF*; and

(iii) 3 for *average COH*.

(2) A *firm* that uses 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 for *average AUM*. *MIFIDPRU* has been in force for 6 *months*. Firm A would calculate its *average AUM* as follows:

(a) the value of *n* is 6, being the length of time that *MIFIDPRU* has been in force;

(b) 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; and

(c) when calculating *average 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 for *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:

(a) the value of *n* is 4, being the length of time that *MIFIDPRU* has been in force;

(b) the value of *y* is 1, as *n* minus *x* (i.e. 4 minus 3) is greater than zero; and

(c) when calculating *average 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 for *average CMH*, under MIFIDPRU TP 4.5R(3)(b), this is not permitted. This is because the standard calculation of *average 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 provisions 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 MIFIDPRU TP 4.11R, as modified by MIFIDPRU TP 4.14R, when calculating *K-factor average 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) to calculate a specific *K-factor average metric* on an individual basis; and

(b) the *UK parent entity* must apply the same approach under MIFIDPRU TP 4.5R(2) to calculate a specific *K-factor average 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) a reference to a "*K-factor metric*" or a "*K-factor average metric*" is a reference to that *K-factor metric* or *K-factor average metric* as it applies on a *consolidated basis*;

(2) a reference to the "*K-AUM requirement*", "*K-COH requirement*", "*K-ASA requirement*", "*K-CMH requirement*", "*K-DTF requirement*" or "*K-CMG requirement*" is a reference to those requirements as they apply on a *consolidated basis*;

(3) a reference to MIFIDPRU 4 is a reference to that chapter as it applies on a *consolidated basis* in accordance with MIFIDPRU 2.5; and

(4) a reference to a "*firm*" is a reference to the *UK parent entity*.

4.15	G	(1)	Under MIFIDPRU 2.5, a *third country* entity that would be a *MIFIDPRU investment firm* if it 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, under MIFIDPRU 2.5.9R, a *UK parent entity* must ensure 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 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.

Prudential sourcebook for MiFID Investment Firms

MIFIDPRU 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 1 December 2021 until 1 January 2022 (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) for 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) for 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 carries on (or in the case of a *parent undertaking*, that relevant entities within its *investment firm group* carry on).	

Prudential sourcebook for MiFID Investment Firms

MIFIDPRU TP 6
Application of criteria to be classified as an SNI MIFIDPRU investment firm: transitional

Application

6.1 R MIFIDPRU TP 6 applies to the following:

(1) a *MIFIDPRU investment firm*; and

(2) a *UK parent entity*, in accordance with MIFIDPRU TP 6.9R.

Purpose

6.2 G (1) MIFIDPRU TP 6 explains how a *MIFIDPRU investment firm*, or a *UK parent entity* which is applying MIFIDPRU 1.2 on a *consolidated basis*, should determine whether it meets the conditions to be classified as an *SNI MIFIDPRU investment firm* on the date on which *MIFIDPRU* begins to apply.

(2) Under MIFIDPRU TP 6.4R, a *MIFIDPRU investment firm* or a *UK parent entity* may use either the reasonable estimates approach or the alternative calculation in MIFIDPRU TP 4.5R(2) to determine missing historical data points for the purposes of applying the *average AUM* or *average COH* conditions under MIFIDPRU 1.2.1R(1) and (2).

(3) Under MIFIDPRU TP 6.7R, a *MIFIDPRU investment firm* or a *UK parent entity* must use its best efforts to estimate any missing historical data points for the purposes of applying the condition relating to total annual gross revenue from *investment services and/or activities* in MIFIDPRU 1.2.1R(7).

(4) The transitional arrangements in MIFIDPRU TP 6 apply only to the extent that the *firm* has missing historical data points. If a *firm* has observed historical data covering any part of the relevant period, the *firm* should use those data points when applying the relevant calculations.

Duration

6.3 G The duration of the transitional arrangements in MIFIDPRU TP 6 depends on the relevant condition for classification as an *SNI MIFIDPRU investment firm* under MIFIDPRU 1.2. Under MIFIDPRU TP 6.4R(5) and MIFIDPRU TP 6.7R(3), the transitional arrangements cease to apply once a *firm* or *UK parent entity* has (or should have) collected sufficient historical information to apply the relevant condition in accordance with the applicable methodology in MIFIDPRU 1.2.

Missing historical data for application of SNI classification criteria: transitional for individual MIFIDPRU investment firms

6.4 R (1) This *rule* applies to the extent that a *MIFIDPRU investment firm* does not have the necessary historical data to determine whether the following conditions are met:

(a) the *average AUM* condition in MIFIDPRU 1.2.1R(1); or

(b) the *average COH* condition in MIFIDPRU 1.2.1R(2).

(2) If a *firm* decides to apply the alternative approach in MIFIDPRU 1.2.4R for the purposes of assessing whether a condition in (1) is met, this *rule* applies to the extent that the *firm* does not have the necessary historical data to apply that alternative approach to the relevant condition.

		(3)	Where this *rule* applies, a *firm* may (subject to (4) and MIFIDPRU TP 6.5R) use either of the approaches set out in MIFIDPRU TP 4.5R(2) to assess whether the relevant condition in (1) is met.
		(4)	A *firm's* choice of approach under (3) must be consistent with any choice that the *firm* has made under MIFIDPRU TP 4.5R(2) in relation to the same *K-factor average metric* for the purposes of applying the transitional arrangements in MIFIDPRU TP 4.
		(5)	This *rule* ceases to apply in relation to a condition in (1) on the earlier of the following:
			(a) the date on which the *firm* has collected sufficient historical information necessary to apply the condition in accordance with the applicable methodology under MIFIDPRU 1.2; or
			(b) the date that falls *n months* after the date on which *MIFIDPRU* began to apply, where *n* is the number of *months*' worth of data points required to apply that condition in accordance with the applicable methodology under MIFIDPRU 1.2.
6.5	R	(1)	This *rule* applies where a *firm* has chosen to apply both of the approaches below to determine whether the *average AUM* condition in MIFIDPRU 1.2.1R(1) or the *average COH* conditions in MIFIDPRU 1.2.1R(2) is met:
			(a) the alternative approach in MIFIDPRU 1.2.4R; and
			(b) the modified calculation under MIFIDPRU TP 4.5R(2)(b).
		(2)	Where this *rule* applies, the modified calculation applies as if:
			(a) in MIFIDPRU TP 4.11R(1)(a), the words "excluding the most recent *y months*" were deleted; and
			(b) MIFIDPRU TP 4.11R(1)(c) and (d) were omitted.
6.6	R	(1)	A *firm* must apply its chosen approach under MIFIDPRU TP 6.4R(2) consistently in relation to a specific condition in MIFIDPRU TP 6.4R(1).
		(2)	A *firm* may apply different approaches under MIFIDPRU TP 6.4R(2) in relation to different conditions in MIFIDPRU TP 6.4R(1).
6.7	R	(1)	This *rule* applies to the extent that a *MIFIDPRU investment firm* does not have the necessary historical data to determine if the condition relating to the total annual gross revenue from *investment services and/or activities* in MIFIDPRU 1.2.1R(7) is met.
		(2)	Where this *rule* applies, a *firm* must use its best efforts to estimate any missing historical data points for the calculation of the condition in (1).
		(3)	This *rule* ceases to apply in relation to a condition in (1) on the earlier of the following:
			(a) the date on which the *firm* has collected sufficient historical information necessary to apply the condition in accordance with the standard methodology under MIFIDPRU 1.2; or
			(b) the date on which two complete financial years for the *firm* have elapsed after the date that *MIFIDPRU* began to apply.
6.8	R	If the *FCA* requests, a *firm* must provide a reasonable explanation of how the *firm* has determined any estimate under MIFIDPRU TP 6.4R(3) or MIFIDPRU TP 6.7R(2).	
6.9	G	(1)	It is unnecessary to provide transitional arrangements for the following conditions:
			(a) the *average ASA* condition in MIFIDPRU 1.2.1R(3);
			(b) the *average CMH* condition in MIFIDPRU 1.2.1R(4);
			(c) whether the *firm* has *permission* to *deal on own account* in MIFIDPRU 1.2.1R(5);

(d) the condition relating to the balance sheet total of the *firm* in MIFIDPRU 1.2.1R(6);

(e) the *average DTF* condition in MIFIDPRU 1.2.1R(9); and

(f) the condition relating to acting as a depositary in MIFIDPRU 1.2.1R(10).

(2) The *average ASA* and *average CMH* conditions require that the *firm* has not held any *MiFID client money*, or any *client* assets in the course of *MiFID business*, during the preceding 9 *months*, excluding the most recent 3 *months*. A *firm* should already have information on whether it has held *client money* or *client* assets in the past. If the *firm* is unable to determine whether any amounts of *client money* or *client* assets were held in connection with *MiFID business*, it should apply MIFIDPRU 4.8.6R or MIFIDPRU 4.9.6R and treat the amounts as if they were held in connection with *MiFID business* for these purposes.

(3) The conditions in (1)(c), (1)(d) and (1)(f) do not rely on historical information and therefore can be assessed by the *firm* at the point at which *MIFIDPRU* first begins to apply without any need for transitional arrangements.

(4) The *average DTF* condition requires that the *firm* must not have entered into any transactions by *dealing on own account* or through the *execution of orders on behalf of clients* in the *firm's* own name during the preceding 9 *months*, excluding the most recent 3 *months*. The *FCA* considers that a *firm* should already know whether it executed any transactions in that capacity during the relevant period.

6.10 G (1) MIFIDPRU TP 6.4R(5) and MIFIDPRU TP 6.7R(3) specify the date on which the transitional arrangements for applying certain conditions under MIFIDPRU 1.2.1R will cease to apply. From that date onwards, the *firm* will need to apply the standard methodology for determining whether it meets the relevant condition. This date may vary depending on the position of the individual *firm* and the relevant condition.

(2) Under MIFIDPRU TP 6.4R(5)(a), if a *firm* has sufficient historical information to apply a condition in MIFIDPRU TP 6.4R(1), it is no longer permitted to rely on the transitional arrangements. The following are examples of how this requirement applies:

(a) Example 1: On the date on which *MIFIDPRU* begins to apply, Firm A already has historical data on its *AUM* covering the previous 10 *months*. Assuming that the *firm* is applying the standard criteria under MIFIDPRU 1.2.1R (and not the alternative approach in MIFIDPRU 1.2.4R), the *average AUM* condition under MIFIDPRU 1.2.1R(1) requires 15 *months* of historical data. Since the *firm* must be collecting *AUM* data once *MIFIDPRU* begins to apply, Firm A will have sufficient data to apply the standard calculation for the *average AUM* condition 5 *months* later. At that point, the *firm* will no longer be able to rely on the transitional arrangements under MIFIDPRU TP 6, but instead must use the observed historical data to determine whether the condition in MIFIDPRU 1.2.1R(1) is met.

(b) Example 2: Firm B has notified the *FCA* under MIFIDPRU 1.2.4R that it is using the alternative approach to applying the *average AUM* condition in MIFIDPRU 1.2.1R. Firm B has 13 *months* of historical data on its *AUM*. Under MIFIDPRU TP 6.4R(5)(a), Firm B may not rely on the transitional arrangements in MIFIDPRU TP 6. Although the standard calculation for the *AUM* condition in MIFIDPRU 1.2.1R(1) would require 15 *months* of historical data, the alternative approach under MIFIDPRU 1.2.4R(2) requires only 12 *months* of data. As Firm B has sufficient observed historical data to apply its chosen methodology, the transitional arrangements do not apply.

6.11	G	(1)	MIFIDPRU 6.4R(4) and 6.6R are designed to ensure consistency in a *firm's* approach to applying the transitional arrangements in MIFIDPRU TP 4 and MIFIDPRU TP 6.
		(2)	MIFIDPRU TP 6.4R(4) requires a *firm* to be consistent in its choice of approaches for the purposes of MIFIDPRU TP 4 and MIFIDPRU TP 6. For example, Firm A does not have sufficient information to calculate its *average AUM* for the purposes of the condition in MIFIDPRU 1.2.1R(1) and the *K-AUM requirement* under MIFIDPRU 4.7. If Firm A chooses to use the reasonable estimates approach under MIFIDPRU TP 4.5R(2) to calculate its *K-AUM requirement*, the *firm* must also use the reasonable estimates approach under MIFIDPRU TP 6.4R(3) to apply the *average AUM* condition in MIFIDPRU 1.2.1R(1). The estimates that Firm A uses for both purposes must be consistent.
		(3)	MIFIDPRU TP 6.6R prevents a *firm* from alternating between approaches for the purposes of MIFIDPRU TP 6. For example, Firm B chooses under MIFIDPRU TP 6.4R(3) to apply the alternative calculation in MIFIDPRU TP 4.11R for the purposes of the determining whether the *average COH* condition in MIFIDPRU TP 6.4R(1) is met. Firm B may not later decide to switch to applying the reasonable estimates approach to determine whether that condition is met.
6.12	G		Under MIFIDPRU TP 5, a *MIFIDPRU investment firm* is required to collect at least 1 *month* of *K-factor metrics* that are relevant to any *investment services and/or activities* it carries on before *MIFIDPRU* begins to apply in full. When determining any estimate for the purposes of MIFIDPRU TP 6.4R(3) or MIFIDPRU 6.7R(2), a *firm* should consider any observed historical data that is available. Where the observed historical data covers a short period, a *firm* should take into account possible seasonal variations in figures or other factors which may be relevant to the accuracy of the estimate.
	Missing historical data for application of SNI classification criteria: transitional for investment firm groups to which consolidation applies		
6.13	R	(1)	A *UK parent entity* to which consolidation under MIFIDPRU 2.5 applies may apply the transitional arrangements in MIFIDPRU TP 6.4R to 6.12G to its *consolidated situation* in accordance with this *rule*.
		(2)	Where a *UK parent entity* is applying MIFIDPRU TP 6.4R to 6.12G in accordance with (1), the following modifications apply: (a) a reference to a condition in MIFIDPRU 1.2.1R is a reference to that condition as it applies on a *consolidated basis*; and (b) a reference to a "*MIFIDPRU investment firm*" or a "*firm*" is a reference to the *UK parent entity*.
		(3)	Any estimate produced by the *UK parent entity* of an *investment firm group* under MIFIDPRU TP 6.4R(3) or MIFIDPRU TP 6.7R(2) for the purposes of its *consolidated situation* must be consistent with any estimates produced on an individual basis by any *MIFIDPRU investment firms* forming part of that *investment firm group*.

Prudential sourcebook for MiFID Investment Firms

MIFIDPRU TP 7
Transitional provision for own funds instruments without UK CRR approvals before 1 January 2022

Application

7.1 R (1) MIFIDPRU TP 7 applies to a *MIFIDPRU investment firm* that, immediately before 1 January 2022:

(a) was an *authorised person*; and

(b) either:

(i) was not classified as a *CRR firm* in accordance with the rules then in force; or

(ii) met all of the conditions in (2).

(2) The conditions referred to in (1)(b)(ii) are:

(a) the *firm* was classified as a *CRR firm* in accordance with the *rules* that applied immediately before 1 January 2022; and

(b) in relation to an instrument to which MIFIDPRU TP 7.4R(1) applies, the *firm* had not, before 1 January 2022:

(i) obtained *FCA* approval under article 26(3) of the *UK CRR* (in the form in which it stood immediately before 1 January 2022); or

(ii) notified the *FCA* of the issuance of the instrument under IFPRU 3.2 (as it applied immediately before 1 January 2022).

7.2 R (1) MIFIDPRU TP 7 also applies to the following if the conditions in (2) are met:

(a) a *UK parent entity* to which MIFIDPRU 3 applies on a *consolidated basis* in accordance with MIFIDPRU 2.5.7R; and

(b) a *parent undertaking* to which the *group capital test* applies.

(2) The conditions are that immediately before 1 January 2022 the *UK parent entity* or *parent undertaking*:

(a) formed part of the same *investment firm group* as a *firm*, which, on 1 January 2022 became a *MIFIDPRU investment firm*; and

(b) either:

(i) was not required to hold *own funds* on an individual or a consolidated basis in accordance with the *UK CRR*; or

(ii) met all of the conditions in (3).

(3) The conditions referred to in (2)(b)(ii) are:

(a) the *UK parent entity* or *parent undertaking* was required to hold *own funds* on an individual or a consolidated basis in accordance with the *UK CRR* (in the form in which it stood immediately before 1 January 2022); and

(b) the *UK parent entity* or *parent undertaking* has issued an instrument to which MIFIDPRU TP 7.4R(1) applies;

(c) in relation to the instrument in (b), the *UK parent entity* or *parent undertaking* had not, before 1 January 2022:

(i) obtained *FCA* approval under article 26(3) of the *UK CRR* (in the form in which it stood immediately before 1 January 2022); or

(ii) notified the *FCA* of the issuance of the instrument under IFPRU 3.2 (as it applied immediately before 1 January 2022).

(4) A reference in (3)(c) to a notification or approval includes a notification or approval that was granted to another member of the *UK parent entity* or *parent undertaking's group* in relation to an instrument issued by the *UK parent entity* or *parent undertaking*.

Purpose

7.3 G (1) Before *MIFIDPRU* applied, certain *firms* that subsequently became *MIFIDPRU investment firms* determined their available capital resources according to various provisions in *GENPRU* or *IPRU-INV*. In addition, certain other *firms* were not subject to a dedicated prudential sourcebook in the *FCA Handbook* that contained a detailed regime for recognising the eligibility of capital resources.

(2) The *rules* on *own funds* in MIFIDPRU 3 broadly replicate the approach to recognising capital resources under the *UK CRR*. The purpose of MIFIDPRU TP 7 is to permit *firms* that were not *CRR firms* immediately before *MIFIDPRU* began to apply to recognise instruments as *own funds* under *MIFIDPRU* without requiring separate permission from, or notification to, the *FCA* if those instruments:

(a) were issued before *MIFIDPRU* began to apply; and

(b) meet the conditions to be classified as *own funds* under MIFIDPRU 3 (other than the conditions relating to the requirements to seek prior *FCA* consent or to notify the *FCA*).

(3) Under MIFIDPRU TP 1, a permission recognising the issuance of capital instruments as *common equity tier 1 capital* under the *UK CRR* is deemed to be an equivalent permission under *MIFIDPRU*. A notification made before *MIFIDPRU* began to apply by a former *CRR firm* in relation to the issuance of *additional tier 1 instruments* and *tier 2 instruments* will will also continue to be valid under MIFIDPRU TP 1.

(3A) Where a former *CRR firm* did not obtain permission for an existing instrument under the *UK CRR* or make a notification under IFPRU 3.2 in relation to an instrument, there will be no existing permission or notification to carry forward under MIFIDPRU TP 1. In that case, the former *CRR firm* may make a notification under MIFIDPRU TP 7 in relation to any outstanding capital instruments issued before 1 January 2022, provided that those instruments meet the conditions to be recognised as the relevant type of *own funds* under MIFIDPRU 3.

(4) MIFIDPRU TP 7 also applies to *UK parent entities* to which MIFIDPRU 3 applies on a *consolidated basis* and *parent undertakings* to which the *group capital test* applies, where those entities were not required to hold *own funds* on an individual or consolidated basis under the *UK CRR* immediately before *MIFIDPRU* began to apply. This means that provided that the existing instruments issued by these entities meet the relevant conditions in MIFIDPRU 3, they can be treated as *own funds* for the purposes of the application of MIFIDPRU 3 on a *consolidated basis* or the *group capital test* as long as the entity complies with MIFIDPRU TP 7.

(5) MIFIDPRU TP 7 also applies to a *UK parent entity* or other *parent undertaking* that was required to hold *own funds* under the *UK CRR* (whether on an individual or consolidated basis) immediately before *MIFIDPRU* began to apply but did not:

(a) obtain permission for an existing common equity tier 1 instrument under the *UK CRR*; or

(b) make a notification in accordance with IFPRU 3.2 in relation to an existing additional tier 1 instrument or a tier 2 instrument.

(6) Where (5) applies, the *UK parent entity* or other *parent undertaking* may make a notification under MIFIDPRU TP 7 in relation to any outstanding capital instruments issued before 1 January 2022, provided that those instruments meet the conditions to be recognised as the relevant type of *own funds* under MIFIDPRU 3.

(7) In some cases, the *FCA* may have granted permission to, or accepted a notification from, another member of the *UK parent entity* or other *parent undertaking's group* in relation to an instrument issued by the *UK parent entity* or other *parent undertaking* that counted towards the *consolidated situation*. This is because the *UK CRR* previously applied only indirectly to unregulated *parent undertakings*. In that case, the existing *UK CRR* permission or notification will be treated as a permission or notification of the *UK parent entity* or *parent undertaking*. This means that it will convert into an equivalent deemed MIFIDPRU 3 permission or notification of the *UK parent entity* or *parent undertaking* under MIFIDPRU TP 1. A notification under MIFIDPRU TP 7 is not required in this situation.

Eligibility of pre-MIFIDPRU capital resources meeting requirements in MIFIDPRU 3 to qualify as own funds under MIFIDPRU without a separate permission or notification

7.4 R (1) This *rule* applies to any capital instrument that:

(a) was issued by a *firm*, *UK parent entity* or *parent undertaking* before 1 January 2022; and

(b) was still in issue on 1 January 2022.

(2) The *firm*, *UK parent entity* or *parent undertaking* in (1)(a) is deemed to have been granted the permission, or to have complied with the notification obligation, in column (A) of the table in MIFIDPRU TP 7.5R in relation to a capital instrument where the following conditions are met:

(a) the conditions in column (B) of the same row of the table in MIFIDPRU TP 7.5R are met in relation to that instrument; and

(b) the *firm* has submitted the notification in MIFIDPRU TP 7 Annex 1R using the *online notification and application system* by no later than 29 June 2022.

(3) A deemed permission or notification under (2) ceases to apply in relation to a capital instrument if the terms of the instrument are varied on or after 1 January 2022 and the instrument ceases to meet:

	(a)	in relation to an instrument being treated as *common equity tier 1 capital*, the conditions in MIFIDPRU 3.3 (other than the condition for prior *FCA* permission to classify the instrument as *common equity tier 1 capital*);
	(b)	in relation to an instrument being treated as *additional tier 1 capital*, the conditions in MIFIDPRU 3.4; and
	(c)	in relation to an instrument being treated as *tier 2 capital*, the conditions in MIFIDPRU 3.5.

7.5 R This table belongs to MIFIDPRU TP 7.4R.

(A) Requirement for permission or notification with which the *firm*, *UK parent entity* or *parent undertaking* is deemed to have complied	(B) Conditions for deemed compliance to apply
Individual *MIFIDPRU investment firms*	
Article 26(3) *UK CRR* (as applied and modified by MIFIDPRU 3.3.1R) and MIFIDPRU 3.3.3R: Requirement for prior *FCA* permission to classify an issuance of capital instruments by a *firm* as *common equity tier 1 capital*	Immediately before *MIFIDPRU* began to apply or, if later, on the date on which the notification in MIFIDPRU TP 7.4R(2)(b) was made, the capital instruments met the conditions to be classified as *common equity tier 1 capital* in MIFIDPRU 3.3, except for the requirement for prior *FCA permission* under article 26(3) of the *UK CRR* and MIFIDPRU 3.3.3R
MIFIDPRU 3.6.5R(1)(a): Requirement to notify the *FCA* of the intention to issue *additional tier 1 instruments*	Immediately before *MIFIDPRU* began to apply or, if later, on the date on which the notification in MIFIDPRU TP 7.4R(2)(b) was made, the capital instruments met the conditions to be classified as *additional tier 1 capital* in MIFIDPRU 3.4
MIFIDPRU 3.6.5R(1)(b): Requirement to notify the *FCA* of the intention to issue *tier 2 instruments*	Immediately before *MIFIDPRU* began to apply or, if later, on the date on which the notification in MIFIDPRU TP 7.4R(2)(b) was made, the capital instruments met the conditions to be classified as *tier 2 capital* in MIFIDPRU 3.5
UK parent entities to which consolidation under MIFIDPRU 2.5.7R applies	
Article 26(3) *UK CRR* (as applied and modified by MIFIDPRU 3.3.1R) and MIFIDPRU 3.6.8R, as they apply on a *consolidated basis* under MIFIDPRU 2.5.7R(1): Requirement for prior *FCA* permission to classify an issuance of capital instruments by a *UK parent entity* as *common equity tier 1 capital*	Immediately before *MIFIDPRU* began to apply or, if later, on the date on which the notification in MIFIDPRU TP 7.4R(2)(b) was made, the capital instruments met the conditions to be classified as *common equity tier 1 capital* in MIFIDPRU 3.3 (as it applies on a consolidated basis), except for the requirement for prior *FCA* permission under article 26(3) of the *UK CRR* and MIFIDPRU 3.3.3R
MIFIDPRU 3.6.5R(1)(a), as modified by MIFIDPRU 3.6.8R: Requirement to notify the *FCA* of the intention to issue *additional tier 1 instruments*	Immediately before *MIFIDPRU* began to apply or, if later, on the date on which the notification in MIFIDPRU TP 7.4R(2)(b) was made, the capital instruments met the conditions to be classified as *additional tier 1 capital* in MIFIDPRU 3.4 (as it applies on a consolidated basis)
MIFIDPRU 3.6.5R(1)(b), as modified by MIFIDPRU 3.6.8R: Requirement to notify the *FCA* of the intention to issue *tier 2 instruments*	Immediately before *MIFIDPRU* began to apply or, if later, on the date on which the notification in MIFIDPRU TP 7.4R(2)(b) was made, the capital instruments met the conditions to be classified as *tier 2 capital* in MIFIDPRU 3.5 (as it applies on a *consolidated basis*)
Parent undertakings to which the *group capital test* applies	
Article 26(3) *UK CRR* (as applied and modified by	Immediately before *MIFIDPRU* began to apply or,

(A) Requirement for permission or notification with which the *firm*, *UK parent entity* or *parent undertaking* is deemed to have complied	(B) Conditions for deemed compliance to apply
Individual *MIFIDPRU investment firms*	
MIFIDPRU 3.3.1R) and MIFIDPRU 3.3.3R, as they apply to a parent undertaking under MIFIDPRU 3.7.4R(1)(a): Requirement for prior *FCA* permission to classify an issuance of capital instruments by a *parent undertaking* as *common equity tier 1 capital*	if later, on the date on which the notification in MIFIDPRU TP 7.4R(2)(b) was made, the capital instruments met the conditions to be classified as *common equity tier 1 capital* in MIFIDPRU 3.3, except for the requirement for prior *FCA* permission under article 26(3) of the *UK CRR* and MIFIDPRU 3.3.3R
MIFIDPRU 3.6.5R(1)(a), as modified by MIFIDPRU 3.7.4R(1)(b): Requirement to notify the *FCA* of the intention to issue *additional tier 1 instruments*	Immediately before *MIFIDPRU* began to apply or, if later, on the date on which the notification in MIFIDPRU TP 7.4R(2)(b) was made, the capital instruments met the conditions to be classified as *additional tier 1 capital* in MIFIDPRU 3.4
MIFIDPRU 3.6.5R(1)(b), as modified by MIFIDPRU 3.7.4R(1)(b): Requirement to notify the *FCA* of the intention to issue *tier 2 instruments*	Immediately before *MIFIDPRU* began to apply or, if later, on the date on which the notification in MIFIDPRU TP 7.4R(2)(b) was made, the capital instruments met the conditions to be classified as *tier 2 capital* in MIFIDPRU 3.5

7.6	G	Where a *firm*, *UK parent entity* or *parent undertaking* is deemed under MIFIDPRU TP 7.3R and 7.4R to have notified the *FCA* of its intention to issue *additional tier 1 instruments* or *tier 2 instruments*, MIFIDPRU 3.6.5R(2)(a) will apply to a subsequent issuance of the same class of instruments. In practice, this means that provided that the subsequent issuance of the same class is on terms that are identical in all material respects to the existing class of those instruments, a notification to the *FCA* under MIFIDPRU 3.6.5R(1) is not required.

Notification under MIFIDPRU TP 7.4R(2)(b) on treating pre-MIFIDPRU capital instruments as own funds under MIFIDPRU 3		
TP 7 Annex 1	R	[Editor's note: The form can be found at this address: https://www.handbook.fca.org.uk/forms/

Prudential sourcebook for MiFID Investment Firms

MIFIDPRU TP 8
Commodity and emission allowance dealers

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into for
1.	MIFIDPRU 6	R	The *rules* and *guidance* in MIFIDPRU 6 do not apply to a *commodity and emission allowance dealer*.	Until 1 January 2027.	1 January 2022

Prudential sourcebook for MiFID Investment Firms

MIFIDPRU TP 9
IFPRU waivers: transitional

	Application	
9.1	R	MIFIDPRU TP 9 applies to a *non-SNI MIFIDPRU investment firm*.
9.2	R	MIFIDPRU TP 9 applies where, immediately before 1 January 2022, a *waiver* given in relation to a *rule* listed in column A of the table in MIFIDPRU TP 9.5R has effect.
	Duration of transition	
9.3	R	This section applies to each *waiver* in MIFIDPRU TP 9.2R, until the direction given in respect of that *waiver* ceases to have effect on its terms, or is revoked, whichever is the earlier.
	Transitional	
9.4	R	Each *waiver* given in relation to a *rule* listed in column A of the table in MIFIDPRU TP 9.5R is treated as a *waiver* given to the *firm* in relation to the *rule* listed in the same row in column B of the table.
	Table	
9.5	R	Table of FCA rules

Column A	Column B
SYSC 4.3A.8R	MIFIDPRU 7.3.5R
SYSC 7.1.18R	MIFIDPRU 7.3.1R
SYSC 19A.3.12R	MIFIDPRU 7.3.3R

Prudential sourcebook for MiFID Investment Firms

MIFIDPRU TP 10
Transitional capital and liquidity requirements for former IFPRU investment firms, BIPRU firms or their groups with ICG or ILG issued before 1 January 2022

	Purpose		
10.1	G	(1)	MIFIDPRU TP 10 contains transitional *rules* that explain how a *firm* or a *group* that was subject to *individual capital guidance* or *individual liquidity guidance* immediately before 1 January 2022 should take that guidance into account when first determining the *own funds threshold requirement* under *MIFIDPRU*.
		(2)	The general purpose of MIFIDPRU TP 10 is to ensure that a *firm* does not apply an inappropriately low *own funds threshold requirement* at the outset of the *MIFIDPRU* regime, before the *firm* has properly considered the outcome of its *ICARA process*. MIFIDPRU TP 10 is also designed to ensure that the *FCA* has sufficient opportunity to review a *firm's* conclusions from its *ICARA process*, if the *FCA* considers it necessary, before any pre-*MIFIDPRU individual capital guidance* or *individual liquidity guidance* ceases to be relevant to the *firm*.
		(3)	MIFIDPRU TP 10 also requires a *firm* for which pre-*MIFIDPRU individual capital guidance* or *individual liquidity guidance* is relevant to submit *data item* MIF007 (ICARA assessment questionnaire) for the first time by no later than 31 March 2023. This will ensure that the *FCA* can begin considering the *firm's* approach to the *firm's own funds threshold requirement* and any pre-*MIFIDPRU* guidance by no later than that date.
	Application		
10.2	R	(1)	MIFIDPRU TP 10 applies to an *undertaking* in (2) or (3) where the condition in (4) is met.
		(2)	This *rule* applies to a *MIFIDPRU investment firm* that, under the *rules* in force on 31 December 2021, was classified as: (a) an *IFPRU investment firm*; or (b) a *BIPRU firm*.
		(3)	This *rule* also applies to the following where they form part of an *investment firm group* containing a *MIFIDPRU investment firm* to which (2) applies: (a) a *UK parent entity*; and (b) an *authorised person*.
		(4)	The relevant condition is that on 31 December 2021, the *firm* in (2), or any *investment firm group* (or any larger *group* that included the *investment firm group*) of which it formed a part, was subject to either or both of the following: (a) *individual capital guidance* (including, for these purposes, any specified capital planning buffer and any other obligation to hold a capital buffer under IFPRU 10); or (b) *individual liquidity guidance*.

(5) For the purposes of MIFIDPRU TP 10:

(a) "pre-MIFIDPRU ICG" means the *individual capital guidance* in (4); and

(b) "pre-MIFIDPRU ILG" means the *individual liquidity guidance* in (4).

Requirement to submit an ICARA assessment questionnaire by 31 March 2023

10.3 R (1) A *MIFIDPRU investment firm* to which MIFIDPRU TP 10 applies must submit *data item* MIF007 for the first time by no later than the end of 31 March 2023.

(2) This *rule* applies notwithstanding any provision in MIFIDPRU 7.8 or in MIFIDPRU 9.2 that would otherwise permit the *firm* to submit *data item* MIF007 for the first time on a later date.

10.4 G (1) The effect of MIFIDPRU TP 10.3R is that where, on 31 December 2021, a *MIFIDPRU investment firm* was classified as an *IFPRU investment firm* or a *BIPRU firm* and the *firm* was subject to *individual capital guidance* or *individual liquidity guidance* (or both), the *firm* must submit *data item* MIF007 for the first time by no later than 31 March 2023. This requirement also applies where the *firm* forms part of an *investment firm group* and that *group* (or a larger *group* of which it forms part) was, on 31 December 2021, subject to *individual capital guidance* or *individual liquidity guidance* (or both) issued on a *consolidated basis*.

(2) Under MIFIDPRU 7.8, in order to submit *data item* MIF007, a *firm* must have carried out a review of its *ICARA process* and documented that review in an *ICARA document*. Therefore, a *firm* to which MIFIDPRU TP 10.3R applies must ensure that it has taken these steps to allow sufficient time to submit *data item* MIF007 by no later than 31 March 2023. When reviewing its *ICARA process*, the *firm* should consider the potential relevance of any pre-MIFIDPRU ICG or pre-MIFIDPRU ILG to which it is subject (including where it forms part of a *group* that is subject to such guidance on a *consolidated basis*).

(3) A *firm* may choose to submit *data item* MIF007 for the first time on an earlier date. *Firms* are reminded that under MIFIDPRU 7.8.2R, they must review the adequacy of their *ICARA process* at least once every 12 *months*. A *firm* may therefore wish to choose a review date during 2022 that aligns with the *firm's* preferred date for an annual review in subsequent years. The *FCA* has specified a deadline of 31 March 2023 for the submission of *data item* MIF007 by *firms* subject to MIFIDPRU TP 10.3R to allow *firms* flexibility about their choice of review date, while also allowing a sufficient period of time to complete and submit *data item* MIF007 if their chosen review date falls near the end of 2022.

Individual capital guidance

10.5 R (1) This *rule* applies to a *firm* that on 31 December 2021 was subject to pre-MIFIDPRU ICG that was issued to the *firm* on an individual basis.

(2) This *rule* applies from 1 January 2022 until the earliest of:

(a) 6 *months* after the date on which the *firm* submits *data item* MIF007 in accordance with MIFIDPRU TP 10.3R;

(b) the date on which the *FCA* first communicates to the *firm* the outcome of a *SREP* carried out on the *firm*; or

(c) the date on which the *FCA* first issues individual guidance to, or imposes a *requirement* on, the *firm* for the purposes of specifying the amount of *own funds* that the *firm* must hold to comply with the *overall financial adequacy rule*.

(3) During the period in (2), the *firm's own funds threshold requirement* must be at least equal to the transitional requirement in (4).

(4) A *firm* must calculate the transitional requirement by:

(a) determining the absolute amount of *own funds* that the *firm* was required to hold to comply with the pre-MIFIDPRU ICG on:

(i) in the case of an *IFPRU investment firm*, the following dates: 31 December 2020, 31 March 2021, 30 June 2021 and 30 September 2021; and

(ii) in the case of a *BIPRU firm*, the reporting reference dates of the two most recent FSA003 *data items* submitted on or before 31 December 2021; and

(b) calculating the arithmetic mean of the absolute values in (a).

10.6 G (1) As part of its *ICARA process*, a *firm* to which MIFIDPRU TP 10 applies must assess its *own funds threshold requirement* (i.e. the amount of *own funds* that the *firm* must hold to comply with the *overall financial adequacy rule*). The transitional requirement in MIFIDPRU TP 10.5R(4) is a "floor" to the amount of a *firm's own funds threshold requirement*, not a maximum amount and applies only during the transitional period specified in MIFIDPRU TP 10.5R(2).

(2) The transitional requirement is therefore relevant only to extent that the *firm* would otherwise have sought to apply an *own funds threshold requirement* during the transitional period that is lower than the transitional requirement.

(3) The transitional requirement is intended to ensure that a *firm* that is subject to pre-MIFIDPRU ICG does not apply an inappropriately low *own funds threshold requirement* as a result of its *ICARA process* before the *FCA* has been able to consider the *firm's* assessment. The transitional period will therefore allow the *FCA* sufficient time to understand the *firm's* approach to assessing its *own funds threshold requirement* under *MIFIDPRU*, during which the *firm* must ensure that it maintains *own funds* at least equal to the transitional requirement.

(4) Once the transitional period in MIFIDPRU TP 10.5R(2) has expired, the transitional requirement no longer applies. In its *ICARA document*, the *firm* should therefore explain what it considers its *own funds threshold requirement* will be when the "floor" under the transitional requirement is no longer applicable. The *FCA* can then review the *firm's* assessment during the transitional period to determine if the *firm* has formed a reasonable judgement about its *own funds threshold requirement*.

10.7 G (1) The reference dates in MIFIDPRU TP 10.5R(4)(a)(i) for an *IFPRU investment firm* are designed to be aligned to the reference dates of the *firm's* COREP – Own Funds reports.

(2) Under MIFIDPRU TP 10.5R(4)(a)(ii), the reference dates for a *BIPRU firm* are determined in accordance with the reference dates of its FSA003 (Capital adequacy) reports.

(3) In each case, this means that the *firm* can use its previous regulatory capital returns to assist in the calculation of its transitional requirement under MIFIDPRU TP 10.

10.8 G (1) The following is a worked example of the effect of MIFIDPRU TP 10.5R.

(2) An *IFPRU investment firm* has been issued with pre-MIFIDPRU ICG specifying that the *firm* should hold *own funds* of 200% of its Pillar 1 requirement under the *UK CRR*, plus a £50 million fixed add-on. The pre-MIFIDPRU ICG applies to the *firm* on 31 December 2021. From 1 January 2022, the *firm* will be a *MIFIDPRU investment firm*.

(3) Under MIFIDPRU TP 10.3R, the *firm* must submit *data item* MIF007 by no later than 31 March 2023. The *firm* chooses to review its *ICARA process* on 1 December 2022 and submits *data item* MIF007 for the first time on 15 January 2023.

(4) As part of its *ICARA process*, the *firm* assesses its *own funds threshold requirement* – i.e. the amount of *own funds* that the *firm* considers it will need to hold to comply with the *overall financial adequacy rule*. The *firm*

will then need to compare the *firm's* assessment with the transitional requirement under MIFIDPRU TP 10.5R and apply the higher of the two amounts. This is because under MIFIDPRU TP 10.5R(3), the *firm's own funds threshold requirement* must be at least equal to the transitional requirement in MIFIDPRU TP 10.5R(4). However, the *own funds threshold requirement* can still be higher than the transitional requirement if:

(a) the *firm's own funds requirement* under MIFIDPRU 4.3 (as limited by any applicable transitional provision) exceeds the transitional requirement under MIFIDPRU TP 10.5R; or

(b) the *firm* determines that it should hold a higher level of *own funds* to comply with the *overall financial adequacy rule*.

(5) The *firm's* Pillar 1 requirement on each of the reference dates in MIFIDPRU TP 10.5R(4)(a)(i) was as follows:

(a) 31 December 2020: £70 million

(b) 31 March 2021: £115 million

(c) 30 June 2021: £125 million

(d) 30 September 2021: £90 million

(6) The *firm* would calculate the absolute amounts required by its pre-MIFIDPRU ICG as follows:

(a) 31 December 2020:

£70m x 200% = £140m

£140m + £50m = £190m

(b) 31 March 2021:

£115m x 200% = £230m

£230m + £50m = £280m

(c) 30 June 2021:

£125m x 200% = £250m

£250m + £50m = £300m

(d) 30 September 2021:

£90m x 200% = £180m

£180m + £50m = £230m

(7) The *firm* would calculate the arithmetic mean of those absolute values as:

£190m + £280m + £300m + £230m = £1,000m

£1,000m / 4 = £250m

(8) Under MIFIDPRU TP 10.5R(3), the *firm's own funds threshold requirement* can therefore be no lower than £250m from 1 January 2022 until the earliest of:

(a) 15 July 2023 (i.e. 6 *months* after 15 January 2023, which was the date on which the *firm* first submitted *data item* MIF007);

(b) the date on which the *FCA* informs the *firm* of the outcome of a *SREP* carried out on the *firm*; or

(c) the date on which the *FCA* otherwise issues *individual guidance* to, or imposes a *requirement* on, the *firm* for the purposes of specifying the amount of *own funds* that the *firm* needs to hold to comply with the overall financial adequacy rule.

(9) However, the transitional requirement under MIFIDPRU TP 10.5R does not limit the *firm's own funds threshold requirement* during the period in (8). If the *firm's* own assessment of its *own funds threshold requirement* under its *ICARA process* results in a number that is higher £250m, the *firm*

must therefore hold *own funds* that are at least equal to the higher amount. If the *firm's* assessment results in a number than is lower than £250m, then the *firm* must hold *own funds* of at least £250m until the period in (8) has elapsed.

10.9 G The worked example in MIFIDPRU TP 10.8G is based on a simple example of pre-MIFIDPRU ICG that is based on a fixed percentage of the *firm's* Pillar 1 requirement and a simple fixed add-on. Many *firms* may have pre-MIFIDPRU ICG that is set by reference to a more complicated calculation. Where relevant, this may also include capital planning buffers and other capital buffers required under IFPRU 10. This may include the use of scalars, other add-ons and percentages of particular components of the Pillar 1 calculation. When determining the absolute amounts for the purpose of MIFIDPRU TP 10.5R(4)(a), the *firm* must follow whatever methodology was specified in the applicable pre-MIFIDPRU ICG.

10.10 R (1) This *rule* applies to the *UK parent entity* of, and *firms* forming part of, an *investment firm group* that on 31 December 2021 was subject to pre-MIFIDPRU ICG issued on a *consolidated basis*.

(2) This *rule* applies from 1 January 2022 until the earliest of:

(a) 6 *months* after the date on which all *firms* in the *investment firm group* have first submitted *data item* MIF007 in accordance with MIFIDPRU TP 10.3R;

(b) the date on which the *FCA* has first communicated to each *MIFIDPRU investment firm* in the *investment firm group* the outcome of a *SREP* carried out on the *firm*; or

(c) the date on which the *FCA* had first issued individual guidance to, or imposed a *requirement* on, each *MIFIDPRU investment firm* in the *investment firm group* for the purposes of specifying the amount of *own funds* that the *firm* must hold to comply with the *overall financial adequacy rule*.

(3) Where this *rule* applies, the *UK parent entity* of the *investment firm group* must:

(a) determine the absolute amount of *own funds* that was required on a *consolidated basis* to comply with the pre-MIFIDPRU ICG on:

(i) in the case of *individual capital guidance* set under *IFPRU*, the following dates: 31 December 2020, 31 March 2021, 30 June 2021 and 30 September 2021; and

(ii) in the case *individual capital guidance* set under *BIPRU*, the reporting reference dates of the two most recent consolidated FSA003 *data items* submitted on or before 31 December 2021;

(b) calculate the arithmetic mean of the absolute values in (a); and

(c) allocate the amount in (b) between the entities in the *investment firm group* on an equivalent basis to that used by the *group* to comply with the consolidated pre-MIFIDPRU ICG immediately before 1 January 2022.

(4) During the period in (2):

(a) the *own funds threshold requirement* of each *MIFIDPRU investment firm* included in the pre-MIFIDPRU ICG must be at least equal to the amount allocated to that *firm* under (3)(c); and

(a) any other *authorised person* included in the pre-MIFIDPRU ICG must hold financial resources that cover at least the amount allocated to that *authorised person* under (3)(c).

(5) The *UK parent entity* must record the basis for any allocation under (3)(c).

Individual liquidity guidance

10.11 R (1) This *rule* applies to a *firm* that on 31 December 2021 was subject to pre-MIFIDPRU ILG issued on an individual basis.

(2) This *rule* applies from 1 January 2022 until the earliest of:

(a) 6 *months* after the date on which the *firm* submits *data item* MIF007 in accordance with MIFIDPRU TP 10.3R;

(b) the date on which the *FCA* first communicates to the *firm* the outcome of a *SREP* carried out on the *firm*; or

(c) the date on which the *FCA* first issues individual guidance to, or imposes a *requirement* on, the *firm* for the purposes of specifying the amount of *liquid assets* that the *firm* must hold to comply with the *overall financial adequacy rule*.

(3) During the period in (2), the *firm's liquid assets threshold requirement* must be at least equal to the liquidity resources that the *firm* would need to hold to comply with the pre-MIFIDPRU ILG if the *firm* had continued to be subject to that *individual liquidity guidance*.

(4) The *ICARA document* that is the subject of *data item* MIF007 referred to in (2)(a) must explain any difference between the *firm's* assessment of its *liquid assets threshold requirement* and the transitional requirement that applies under (3).

10.12 G (1) MIFIDPRU TP 10.11R requires a *firm* that is subject to pre-MIFIDPRU ILG to apply a minimum transitional "floor" to its *liquid assets threshold requirement* from 1 January 2022 until the earlier of:

(a) 6 *months* after the *firm* has first submitted *data item* MIF007 to the *FCA* under MIFIDPRU TP2; or

(b) the date on which the *FCA* has either communicated to the *firm* the outcome of a *SREP* carried out on the *firm* or the *FCA* has otherwise issued the *firm* with *individual guidance* or imposed a *requirement* on the *firm* in connection with the amount of *liquid assets* that it must hold to satisfy the *overall financial adequacy rule*.

(2) Under MIFIDPRU TP 10.11R(4), the "floor" is determined as the amount of *liquid assets* that the *firm* would need to hold to comply with its pre-MIFIDPRU ILG if that guidance had continued to apply to the *firm*. This means that the *firm* should continue to calculate the impact of the pre-MIFIDPRU ILG and where appropriate, update the resulting required amount of liquidity resources during the transitional period in MIFIDPRU TP 10.11R(2).

(3) The purpose of MIFIDPRU TP 10.11R is to apply an equivalent approach in relation to the *liquid assets threshold requirement* to that described in MIFIDPRU TP 10.6G in relation to the *own funds threshold requirement*. This ensures that the *FCA* has sufficient time to understand the *firm's* approach to determining its *liquid assets threshold requirement* before the "floor" of the transitional requirement for liquidity ceases to apply.

(4) The transitional requirement under MIFIDPRU TP 10.11R(4) specifies a minimum level for the *liquid assets threshold requirement*. During the transitional period in MIFIDPRU TP 10.10R(2), the *firm* may nonetheless determine that its *liquid assets threshold requirement* is higher than the transitional requirement because:

(a) the *firm's basic liquid assets requirement* under MIFIDPRU 6 (as limited by any other applicable transitional provision) exceeds the transitional requirement; or

(b) the *firm* determines that it should hold a higher level of *liquid assets* to comply with the *overall financial adequacy rule*.

10.13 R (1) This *rule* applies to the *UK parent entity* of, and *firms* forming part of, an *investment firm group* that on 31 December 2021 was subject to pre-MIFIDPRU ILG issued on a *consolidated basis*.

(2) This *rule* applies from 1 January 2022 until the earliest of:

(a) 6 *months* after the date on which all *firms* in the *investment firm group* have first submitted *data item* MIF007 in accordance with MIFIDPRU TP 10.3R;

(b) the date on which the *FCA* has first communicated to each *MIFIDPRU investment firm* in the *investment firm group* the outcome of a *SREP* carried out on the *firm*; or

(c) the date on which the *FCA* has first issued individual guidance to, or imposed a *requirement* on, each *MIFIDPRU investment firm* in the *investment firm group* for the purposes of specifying the amount of *liquid assets* that the *firm* must hold to comply with the *overall financial adequacy rule*.

(3) Where this *rule* applies, the *UK parent entity* of the *investment firm group* must allocate the consolidated liquidity resources that would be required to comply with the pre-MIFIDPRU ILG if it continued to apply on an ongoing basis between the entities in the *investment firm group* in accordance with (4).

(4) The allocation in (3) must be on an equivalent basis to that used by the *group* to comply with the consolidated pre-MIFIDPRU ILG immediately before 1 January 2022.

(5) During the period in (2):

(a) the *liquid assets threshold requirement* of each *MIFIDPRU investment firm* included in the consolidated pre-MIFIDPRU ILG must be at least to the amount allocated to that *firm* by the *UK parent entity* under (3); and

(b) any other *authorised person* included in the consolidated pre-MIFIDPRU ICG must hold liquidity resources that cover at least the amount allocated to that *authorised person* under (3).

(6) The *UK parent entity* must record the basis for any allocation under (3).

(7) Each *ICARA document* that is the subject of *data item* MIF007 referred to in (2)(a) must explain any difference between the *firm's* assessment of its *liquid assets threshold requirement* and the transitional requirement that applies under (5).

Prudential reporting with a reference date before 1 January 2022

MIFIDPRU TP 11
Prudential reporting with a reference date before 1 January 2022

11.1	R	Except where the context otherwise requires, a reference in MIFIDPRU TP 11 to any provision of *SUP* is to that provision as it applied on 31 December 2021.	
11.2	R	MIFIDPRU TP 11 applies where the following conditions are met:	
		(1)	the reference date for a *data item* under SUP 16.12 was before 1 January 2022;
		(2)	the submission date under SUP 16.12 for the *data item* in (1) fell on or after 1 January 2022; and
		(3)	a *firm* is no longer required to submit the *data item* in (1) due to amendments to SUP 16.12 that took effect on 1 January 2022.
11.3	R	Where MIFIDPRU TP 11 applies to a *firm* in relation to a *data item*, the *firm* must submit the *data item* to the *FCA* in accordance with the provisions of SUP 16.12 (as applied under MIFIDPRU TP 11.1R).	
11.4	G	(1)	As a result of the introduction of the *MIFIDPRU* regime for *MIFIDPRU investment firms*, SUP 16.12 was amended with effect from 1 January 2022 to introduce updated prudential reporting requirements.
		(2)	The effect of MIFIDPRU TP 11 is that where the reference date for a report falls on or before 31 December 2021, but the submission date for that report falls on after 1 January 2022, the *firm* must still submit the report in accordance with the reporting and submission requirements that applied on 31 December 2021.
		(3)	The purpose of MIFIDPRU TP 11 is to ensure that the *FCA* receives appropriate information on the prudential position of *firms* during the transition from previous prudential regimes to the *MIFIDPRU* regime.
		(4)	MIFIDPRU TP 11 does not apply to remuneration reporting. This is because SYSC TP 11.4R(1) requires a *firm* that was subject to any of the remuneration codes listed in SYSC TP 11.4R(2) on 31 December 2021 to comply with any reporting requirements relating to *remuneration* awarded for performance periods before the performance period to which the *MIFIDPRU Remuneration Code* first applies.
11.5	G	(1)	The following is an example of how MIFIDPRU TP 11 applies in practice.

	(2)	A *BIPRU firm* is required to report *data item* FSA003 (Capital adequacy) under SUP 16.12.11R. The reporting reference date for FSA003 is determined by reference to the *firm's accounting reference date*. Under SUP 16.12.13R, the *firm* has 30 *business days* after the reporting reference rate to submit the relevant *data item* to the *FCA*. The *firm's accounting reference date* is 1 December 2021.
	(3)	The reporting reference date for the *firm's* FSA003 return (i.e. 1 December 2021) falls before 1 January 2022. The submission date for the return (which is 30 *business days* later on 17 January 2022) falls after 1 January 2022. SUP 16.12 was amended on 1 January 2022 to delete the requirement for *firms* to submit *data item* FSA003.
	(4)	Under MIFIDPRU TP 11, the firm must still submit *data item* FSA003 to the *FCA*, reflecting the *firm's* position as at 1 December 2021. The *data item* must be submitted in accordance with the relevant *rules* in SUP 16.12 that applied on 31 December 2021.

Disclosure requirements: transitional provisions

MIFIDPRU TP 12
Disclosure requirements: transitional provisions

12.1	R	MIFIDPRU TP 12 applies to a *MIFIDPRU investment firm*.			
12.2	R	For the purposes of MIFIDPRU TP 12, the "reference date" in relation to a set of disclosures means the date by reference to which those disclosures are prepared, being:			
		(1)	in relation to disclosures showing the position of a *firm* at a fixed point in time, that point in time; and		
		(2)	in relation to disclosures that must be prepared by reference to a period, the last day of that period.		
Delayed application of rules for a commodity and emission allowance dealer					
12.3	R	(1)	This *rule* applies until 31 December 2026.		
		(2)	A *commodity and emission allowance dealer* is exempt from the following requirements in this chapter:		
			(a)	MIFIDPRU 8.2 (Risk management objectives and policies);	
			(b)	MIFIDPRU 8.3 (Governance arrangements);	
			(c)	MIFIDPRU 8.4 (Own funds);	
			(d)	MIFIDPRU 8.5 (Own funds requirements), and	
			(e)	MIFIDPRU 8.6 (Remuneration policies and practices).	
12.4	R	(1)	This *rule* applies to disclosures required under either of the following, where the conditions in (2) are met:		
			(a)	BIPRU 11; or	
			(b)	Part Eight of the *UK CRR*.	
		(2)	The conditions referred to in (1) are that:		
			(a)	the reference date for the relevant disclosures in (1) is before 1 January 2022;	
			(b)	the deadline to publish the disclosures in (1) falls on or after 1 January 2022; and	
			(c)	as a result of one of the following, a *firm* is no longer required to publish the disclosures in (1):	
				(i)	the deletion of the *BIPRU* sourcebook

					with effect from 1 January 2022; or
				(ii)	changes to the scope of the *UK CRR* that took effect on 1 January 2022.
			(3)		Where this *rule* applies, a *firm* must publish the relevant disclosures by no later than the deadline that would have applied under BIPRU 11 or Part Eight of the *UK CRR* (as applicable) if the *firm* had continued to be subject to those *rules* or that legislation in the form in which it stood immediately before 1 January 2022.
			(4)		A *firm* may comply with this *rule* by being included within disclosures made on a *consolidated basis* where that would have been permitted by BIPRU 11 or Part Eight of the *UK CRR* (as applicable) in the form in which those *rules* or that legislation stood immediately before 1 January 2022.
12.5	G		The effect of MIFIDPRU TP 12.4R is that where a *firm* is required by BIPRU 11 or Part Eight of the *UK CRR* to makes disclosures with a reference date before 1 January 2022, it must still publish those disclosures even if the permitted deadline for publication falls on or after 1 January 2022. The deletion of BIPRU 11 or the removal of *MIFIDPRU investment firms* from the scope of the *UK CRR* with effect from 1 January 2022 does not relieve the *firm* of its obligation to make those disclosures in accordance with the original deadline.		
Disclosures under MIFIDPRU 8 with a reference date falling on or before 30 December 2022					
2.6	R	(1)	This *rule* applies to disclosures required under MIFIDPRU 8 for which the reference date falls on or before 30 December 2022.		
		(2)	Where this *rule* applies, a *firm* is not required to disclose the information required by the following:		
				(a)	MIFIDPRU 8.2 (Risk management objectives and policies);
				(b)	MIFIDPRU 8.7 (Investment policy).
12.7	G	(1)	The effect of MIFIDPRU TP 12.6R is that for disclosures that have a reference date under MIFIDPRU 8 that falls on or before 30 December 2022, a *firm* is not required to disclose the information about its risk management or its investment policy that would ordinarily be required by that chapter. The reference date under MIFIDPRU 8 is the *firm's accounting reference date*.		
		(2)	This means that for *firms* with an *accounting reference date* other than 31 December, their first disclosures under MIFIDPRU 8 in respect of the ac		

				counting year ending in 2022 do not need to include the information required under MIFIDPRU 8.2 or MIFIDPRU 8.7. Their disclosures for all subsequent accounting years must include all of the information required by MIFIDPRU 8.
		(3)		Conversely, for *firms* with an *accounting reference date* of 31 December, their first disclosures under MIFIDPRU 8 in respect of the accounting year ending on 31 December 2022 must include all of the information required by MIFIDPRU 8 (i.e. including the information required by MIFIDPRU 8.2 and MIFIDPRU 8.7), except for remuneration disclosures to which MIFIDPRU TP 12.8R applies. This is because *MIFIDPRU* will have been in force for an entire calendar year by that date and the *firm* should therefore have all of the information required to produce a complete disclosure reflecting the position as at 31 December 2022.
Remuneration disclosures that relate to a performance period that began before and ends after 1 January 2022				
12.8	R	(1)		This *rule* applies to remuneration disclosures required under either of the following, where the conditions in (2) are met:
			(a)	BIPRU 11.5.18R to BIPRU 11.5.20R;
			(b)	article 450 of the *UK CRR*.
		(2)		The conditions referred to in (1) are that:
			(a)	the performance period to which the relevant disclosures in (1) relate;
				(i) began before 1 January 2022, and
				(ii) ends on or after 1 January 2022; and
			(b)	as a result of one of the following, a *firm* is no longer required to publish the disclosures in (1):
				(i) the deletion of the *BIPRU* sourcebook with effect from 1 January 2022; or
				(ii) changes to the scope of the *UK CRR* that took effect on 1 January 2022.
		(3)		Where this *rule* applies, a *firm*:
			(a)	is not required to publish the information specified in MIFIDPRU 8.6 for the performance period in (2)(a); and

			(b) must publish the relevant disclosures that would have been required for that performance period under the rules in (1)(a) or (1)(b) (as applicable) if the *firm* had continued to be subject to those *rules* or that legislation in the form in which they stood immediately before 1 January 2022.
		(4)	A *firm* may comply with this *rule* by the remuneration disclosures required under (3)(b) being included within disclosures made on a *consolidated basis* where that would have been permitted by BIPRU 11 or article 450 of the *UK CRR* (as applicable) in the form in which those *rules* or that legislation stood immediately before 1 January 2022.
12.9	G	(1)	The effect of MIFIDPRU TP 12.8R is that for disclosures that relate to a remuneration performance period that begins before 1 January 2022 and ends on or after 1 January 2022, a *firm* is not required to disclose the information about its remuneration policies and practices that would ordinarily be required by MIFIDPRU 8.6. Instead, the *firm* must publish the remuneration information specified in the disclosure requirements that applied to the *firm* at the time at which the relevant performance period began (i.e. the remuneration information required either by BIPRU 11.5 or article 450 of the *UK CRR*, as applicable).
		(2)	For the first full performance period starting after 1 January 2022, a *MIFIDPRU investment firm* will be required to make its first disclosures under MIFIDPRU 8.6 (Remuneration policies and practices) on the next occasion following the end of the relevant performance period on which: (a) the *firm* publishes its annual *financial statements*; or (b) where it does not publish annual *financial statements*, the date on which its annual solvency statement is submitted to the *FCA* in accordance with the requirements in SUP 16.12.

Prudential sourcebook for MiFID Investment Firms

Schedule 1
Record-keeping requirements

Sch 1 G

MIFIDPRU Sch 1.1 G

(1) The aim of the *guidance* in the following table is to provide an overview of the relevant record keeping requirements in *MIFIDPRU*.

(2) It is not a complete statement of those requirements and should not be relied on as if it were.

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
MIFIDPRU 4.7.5R	Currency conversion rate	The market rate chosen to convert *AUM* amounts in foreign currencies into the *firm's* functional currency	At the time of the relevant measurement	Not specified
MIFIDPRU 4.10.19R(3)(b)	Currency conversion rate	The market rate chosen to convert *COH* amounts in foreign currencies into the *firm's* functional currency	At the time of the relevant measurement	Not specified
MIFIDPRU 4.10.23R(4)	Basis on which *firm* has applied the alternative approach in MIFIDPRU 4.10.23R to determine the value of an order when measuring *COH*	The basis in MIFIDPRU 4.10.23R(3) on which the *firm* is applying the alternative approach in MIFIDPRU 4.10.23R to determine the value of an order when measuring *COH*	At the time that the firm decides to apply the alternative approach	Not specified
MIFIDPRU 4.15.4R	Currency conversion rate	The market rate chosen to convert *DTF* amounts in foreign currencies into the *firm's*	At the time of the relevant measurement	Not specified

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
		functional currency		
MIFIDPRU 7.1.7R(4)	Currency conversion rate	The market rate chosen to convert the value of amounts in foreign currencies into pounds sterling for the purposes of determining the application of certain governance requirements under MIFIDPRU 7	At the time of the relevant measurement	Not specified
MIFIDPRU 7.8.10R	*ICARA document* approval	The *firm's ICARA document* and records of the *governing body* review and approval under MIFIDPRU 7.8.8R	At the time that the *governing body* approves the *ICARA document* under MIFIDPRU 7.8.8R	3 years from the date on which the *governing body* gave its approval under MIFIDPRU 7.8.8R

MIFIDPRU Sch 1.2 G

MIFIDPRU investment firms are also reminded of the general record keeping obligations that apply under SYSC 9 (Record keeping).

Prudential sourcebook for MiFID Investment Firms

Schedule 2
Notification requirements

Sch 2.1 G

(1) The aim of the *guidance* in the following table is to provide an overview of the relevant notification requirements in *MIFIDPRU*.

(2) It is not a complete statement of those requirements and should not be relied on as if it were.

Handbook reference	Subject of notification	Trigger events	Time allowed
MIFIDPRU 1.2.4R(3)	Applying alternative calculation for *AUM* or *COH* for *SNI MIFIDPRU investment firm* criteria	Decision to apply alternative approach	Not applicable
MIFIDPRU 1.2.4R(4)	Ceasing to apply alternative calculation for *AUM* or *COH* for *SNI MIFIDPRU investment firm* criteria	Decision to cease applying alternative approach	Not applicable
MIFIDPRU 1.2.7R(2)	Use of end-of-day value for calculating *average CMH* for *SNI MIFIDPRU investment firm* criteria	Record-keeping or reconciliation error as described in MIFIDPRU 1.2.7R(1)	Immediate notification
MIFIDPRU 1.2.13R(2)(b)	*Non-SNI investment firm* meeting criteria to be classified as an *SNI MIFIDPRU investment firm*	Meeting *SNI MIFIDPRU investment firm* criteria for at least 6 *months*	Not applicable
MIFIDPRU 1.2.16R	*Firm* ceasing to meet one of the criteria to be classified as an *SNI MIFIDPRU investment firm*	Ceasing to meet one or more of the *SNI MIFIDPRU investment firm* criteria	Prompt notification
MIFIDPRU 2.5.17R(2)(f)	Application of proportional consolidation to a *participation* meeting the conditions in MIFIDPRU 2.5.17R	Decision to apply proportional consolidation	Not applicable

Handbook reference	Subject of notification	Trigger events	Time allowed
MIFIDPRU 3.3.3R(2)	Notification of subsequent issuance of capital instruments qualifying as *common equity tier 1 capital*	Proposed issuance of capital instruments of an existing class of *common equity tier 1 capital*	No fewer than 20 *business days* before the issuance
MIFIDPRU 3.6.3R	Notification of proposed reduction, repurchase, call or redemption of *own funds instruments* where conditions in MIFIDPRU 3.6.4R are met	Proposed redemption of *own funds instruments* where conditions in MIFIDPRU 3.6.4R are met	No later than the 20th *business day* before the *day* on which the reduction, repurchase, call or redemption will occur
MIFIDPRU 3.6.5R	Notification of proposed issuance of *additional tier 1 instruments* or *tier 2 instruments*	Proposed issuance of *additional tier 1 instruments* or *tier 2 instruments*	At least 20 *business days* before the intended issuance date
MIFIDPRU 4.12.7R	Notification of non-material change or non-material extension in use of an internal model for the *K-NPR requirement*	Proposal to implement a non-material change to a model or to extend the use of a model in a non-material manner	Not applicable
MIFIDPRU 4.12.10R	Use of own estimates for delta for standardised approach to market risk of options	Decision to apply own estimates for delta where conditions in MIFIDPRU 4.12.10R are met	Not applicable
MIFIDPRU 4.13.10R	Notification that conditions for use of *K-CMG permission* are no longer met	*Portfolio* ceasing to meet conditions in MIFIDPRU 4.13.9R for use of a *K-CMG permission*	Immediate notification
MIFIDPRU 4.13.20R	Notification that *firm* will calculate the *K-NPR requirement* for a *portfolio* for which it previously had a *K-CMG permission*	Decision to calculate the *K-NPR requirement* for a *portfolio* where conditions in MIFIDPRU 4.13.19R are met	Not applicable
MIFIDPRU 5.6.3R	Notification that *concentration risk soft limit* has been exceede	Exceeding *concentration risk soft limit* for a *client* or *group of connected clients* as specified in MIFIDPRU 5.6.2R	Notification without delay
MIFIDPRU 5.9.3R	Notification that "hard" exposure limits in MIFIDPRU 5.9.1R have been exceeded	Exceeding limit in MIFIDPRU 5.9.1R	Notification without delay
MIFIDPRU 5.11.2R	Exemption from MIFIDPRU 5.2 to MIFIDPRU	Decision to apply exemption where condi-	Not applicable

Handbook reference	Subject of notification	Trigger events	Time allowed
	5.10 for *commodity and emission allowance dealers*	tions in MIFIDPRU 5.11.1R are met	
MIFIDPRU 7.1.9R	Notification that *firm* has met necessary conditions to fall within either MIFIDPRU 7.1.4R(1)(a) or (b) for a continuous period of at least 6 *months*	Meeting conditions in either MIFIDPRU 7.1.4R(1)(a) or (b) for a continuous period of at least 6 *months*	Not applicable
MIFIDPRU 7.1.12R	Notification that *firm* no longer meets the conditions necessary to fall within MIFIDPRU 7.1.4R(1)(a) or (b)	No longer meeting conditions in No longer meeting conditions in MIFIDPRU 7.1.4R(1)(a) or (b) when the firm previously did so when the firm previously did so	Prompt notification
MIFIDPRU 7.6.11R	Notification where *own funds* fall below certain specified levels	*Own funds* falling below levels specified in MIFIDPRU 7.6.11R	Immediate notification
MIFIDPRU 7.7.14R	Notification where *liquid assets* fall below certain specified levels	*Liquid assets* falling below levels specified in MIFIDPRU 7.7.14R	Immediate notification
MIFIDPRU 7.8.4R	*Firm's* choice of submission date(s) or change of submission date(s) for *data item* MIF007 (ICARA assessment questionnaire)	Initial choice of submission date or change of submission date for data item MIF007	Not applicable
MIFIDPRU TP 1.8R	Notification of *firm's* intentions in relation to *additional tier 1 instruments* issued before 1 January 2022	*Firm* has outstanding *additional tier 1 instruments* on 1 January 2022	By no later than 1 January 2022
MIFIDPRU TP 7.4R	Notification to treat capital instruments issued before 1 January 2022 as *own funds* under MIFIDPRU 3	*Firm* has issued capital instruments before 1 January 2022 that it wishes to treat as *own funds* under MIFIDPRU 3	By no later than 1 January 2022

Prudential sourcebook for MiFID Investment Firms

Schedule 3
Fees and other payment requirements

Sch 3.1 G
MIFIDPRU does not contain any *rules* that directly impose fees or other payments. However, ■ MIFIDPRU 9.1.2R(2)(c) applies the administrative fee in ■ SUP 16.3.14R for failure to submit reports by their due date to the late submission of any reports that are required under ■ MIFIDPRU 9.

Prudential sourcebook for MiFID Investment Firms

Schedule 4
Rights of action for damages

Sch 4.1 G

(1) The table below sets out the *rules* in *MIFIDPRU*, contravention of which by an *authorised person* may be actionable under section 138D of the *Act* (Actions for damages) by a *person* who suffers loss a result of the contravention.

(2) If "Yes" appears in the column headed "For private person", the *rule* may be actionable by a *private person* under section 138D (or, in certain circumstances, that *person's* fiduciary or representative: see regulation 6(2) and 6(3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001/2256)). If "Yes" appears in the column headed "Removed", this indicates that the *FCA* has removed the right of action under section 138D(3) of the *Act*. If so, a reference to the *rule* in which the right of action is removed is also given.

(3) The column headed "For other person" indicates whether the *rule* may be actionable by a *person* other than a *private person* (or that *person's* fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of *person* by whom the *rule* may be actionable is given.

	Rights of action under section 138D of the *Act*		
Chapter/Appendix	For private person	Removed	For other person
All *rules* in *MIFIDPRU*	No	Yes – MIFIDPRU 1.3.1R	No

Prudential sourcebook for MiFID Investment Firms

Schedule 5
Rules that can be waived or modified

Sch 5.1 G
The *rules* in *MIFIDPRU* may be waived or modified by the *FCA* under section 138A of the *Act* (Modification or waiver of rules) where the conditions in that section are met.

List of Part 9C rules

Schedule 6
List of Part 9C rules

Sch 6.1 G
This schedule contains a list of Part 9C rules (as defined in section 143F(1) of the *Act*) for the purposes of section 143F(2) of the *Act*.

Sch 6.2 G

(1) Except as specified in (2), each of the following is a Part 9C rule:

(a) every *rule* in *MIFIDPRU*; and

(b) every *rule* in ■ SYSC 19G (MIFIDPRU Remuneration Code).

(2) The following provisions are not Part 9C rules:

(a) ■ MIFIDPRU 4.4.1R(3);

(b) ■ MIFIDPRU 4.4.3R(2)(c);

(c) ■ MIFIDPRU 4.4.4R(2)(c); and

(d) ■ MIFIDPRU 4.4.6R.