

Chapter 4

Own funds requirements

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.

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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 *tiered 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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- (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.

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- (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.

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- (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

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- (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*.