

Chapter 4

Own funds requirements

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

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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

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- (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

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■ 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

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- (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

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- (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

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- (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*.

- 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

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