

Chapter 5

Concentration risk

5.1 Application and purpose

Application: Who?

- 5.1.1 R This chapter applies to:
 - (1) a MIFIDPRU investment firm; and
 - (2) a UK parent entity that is required by MIFIDPRU 2.5.7R to comply with MIFIDPRU 5 on the basis of its consolidated situation.
- 5.1.2 R Where this chapter applies on the basis of the consolidated situation of the UK parent entity, any 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 MIFIDPRU 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 MIFIDPRU 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 MIFIDPRU 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 MIFIDPRU 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:

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| | | <div><div>(1) engage in <i>matched principal trading</i> in certain types of <i>financial instruments</i> with <i>client</i> consent, in accordance with ■ MAR 5A.3.5R(1); and</div><div>(2) <i>deal on own account</i> in illiquid <i>sovereign debt instruments</i> in accordance with ■ MAR 5A.3.5R(2).</div></div> |
| | | <div><div>Purpose</div><div></div></div> |
| 5.1.10 | G | <div><div>This chapter contains:</div><div><div>(1) <i>Rules and guidance</i> on how a <i>MIFIDPRU investment firm</i> must monitor and control <i>concentration risk</i> (■ MIFIDPRU 5.2).</div><div>(2) <i>Rules and guidance</i> on the <i>concentration risk</i> requirements that apply to the <i>trading book</i> exposures of a <i>MIFIDPRU investment firm</i> that is <i>dealing on own account</i> (■ MIFIDPRU 5.3 to ■ MIFIDPRU 5.10). ■ MIFIDPRU 5.3 sets out an overview of these requirements.</div><div>(3) <i>Rules and guidance</i> on when a <i>commodity and emission allowance dealer</i> is exempt from the requirements of this chapter (■ MIFIDPRU 5.11).</div></div></div> |
| | | <div><div>Interpretation</div><div></div></div> |
| 5.1.11 | G | <div><div>In this chapter, references to <i>client</i> include any counterparty of the <i>firm</i>.</div></div> |
| 5.1.12 | R | <div><div>Subject to ■ MIFIDPRU 5.1.13R to ■ MIFIDPRU 5.1.16R, a <i>group of connected clients</i> means:</div><div><div>(1) two or more <i>persons</i> who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has <i>control</i> over the other or others; or</div><div>(2) two or more <i>persons</i> between whom there is no relationship of <i>control</i> 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.</div></div></div> |
| 5.1.13 | R | <div><div>Where a central government has direct <i>control</i> over, or is directly interconnected with, more than one <i>person</i>, they do not all have to be treated as a single <i>group of connected clients</i>. Instead, the existence of a <i>group of connected clients</i> may be assessed separately at the level of each <i>person</i> directly <i>controlled</i> by or directly interconnected with the central government, which must include all of the natural and legal <i>persons</i> which are <i>controlled</i> by or interconnected with that <i>person</i>, including the central government.</div></div> |
| 5.1.14 | R | <div><div>Regional governments and local authorities, whether in the <i>United Kingdom</i> or a <i>third country</i>, 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.</div></div> |

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| 5.1.15 | G | <div><div>(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.</div><div>(2) The <i>PRA</i> maintains a list of all regional governments and local authorities within the <i>United Kingdom</i> which it treats as exposures to the central government of the <i>United Kingdom</i>, in accordance with article 115 of the <i>UK CRR</i>. A <i>firm</i> may have regard to this list when applying the test in ■ MIFIDPRU 5.1.14R to regional governments and local authorities in the <i>United Kingdom</i>.</div></div> |
| 5.1.16 | R | Two or more <i>persons</i> do not constitute a single <i>group of connected clients</i> solely because of their direct exposure to the same <i>central counterparty</i> for clearing purposes. |
| 5.1.17 | R | <div>Exposures to trustees</div> <div>For the purposes of this chapter, if a <i>firm</i> has an exposure to a <i>person</i> ('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 "<i>fund</i>"), the <i>firm</i> may treat the latter exposure as if it was to the fund as a separate <i>client</i>, unless such treatment would be misleading.</div> |
| 5.1.18 | G | <div>When considering whether such treatment would be misleading, a <i>firm</i> should consider factors such as:</div> <div><div>(1) the degree of independence of control of the fund, including the relation of the fund's board and senior management to the <i>firm</i> or to other funds or to both;</div><div>(2) the terms on which the counterparty, when acting as trustee, is able to satisfy its obligation to the <i>firm</i> out of the fund of which it is trustee;</div><div>(3) whether the beneficial owners of the fund are connected to the <i>firm</i>, or related to other funds managed within the <i>firm's</i> group, or both; and</div><div>(4) for a counterparty that is connected to the <i>firm</i> itself, whether the exposure arises from a transaction entered into on an arm's length basis.</div></div> |
| 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.