Chapter 7

Governance and risk management

7

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*

7.1.4 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.

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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*.

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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

(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

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.

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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*.

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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

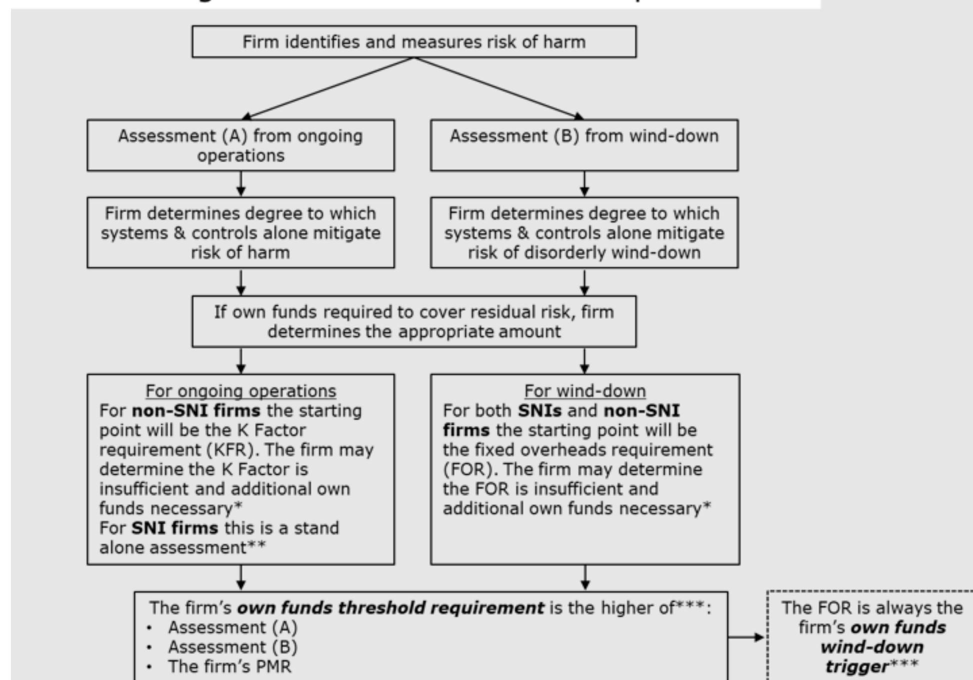
account potential periods of financial stress during the economic cycle; and

(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*:



(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*.

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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).

(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.

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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

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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*:

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*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 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*). 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* 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 these actions, the potential risk of harm to consumers or the markets is likely to increase:

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

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.

7

(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

7

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.

7.10.14 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]

7

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