

## Chapter 7

# Governance and risk management



## 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*.

### **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.

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- (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

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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.

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- (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

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As part of its *ICARA process*, a *firm* must:

- (1) identify the steps and resources that would be required to ensure the orderly wind-down and termination of the *firm's* business in a realistic timescale; and
- (2) evaluate the potential harms arising from winding down the *firm's* business and identify how to mitigate them.

7.5.8

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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

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- (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

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- (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.