

Prudential sourcebook for MiFID Investment Firms

MIFIDPRU TP 4 K-factor metric calculations: transitional

		Application
4.1	R	<p>MIFIDPRU TP 4 applies to a <i>MIFIDPRU investment firm</i> where:</p> <ol style="list-style-type: none"> (1) immediately before 1 January 2022, the <i>firm</i> was carrying on <i>investment services and/or activities</i>; and (2) the <i>investment services and/or activities</i> in (1) result in <i>K-factor metrics</i> that are relevant to the calculation of the following on or after 1 January 2022: <ol style="list-style-type: none"> (i) the <i>firm's K-factor requirement</i>; or (ii) an alternative requirement in MIFIDPRU TP 2 that is calculated by reference to the <i>K-factor requirement</i>.
4.2	R	<p>MIFIDPRU TP 4.11 applies to a <i>UK parent entity</i> where the following conditions are met:</p> <ol style="list-style-type: none"> (1) the <i>UK parent entity</i> is required to apply MIFIDPRU 4 on a <i>consolidated basis</i> in accordance with MIFIDPRU 2.5.7R; and (2) the <i>consolidated situation</i> of the <i>UK parent entity</i> includes one or more of the following: <ol style="list-style-type: none"> (a) a <i>MIFIDPRU investment firm</i> to which MIFIDPRU TP 4.1R applies; or (b) a <i>third country entity</i> to which MIFIDPRU TP 4.1R would apply if it were established in the <i>UK</i>.
		Purpose
4.3	G	<ol style="list-style-type: none"> (1) The standard <i>rules</i> in MIFIDPRU 4 require a <i>MIFIDPRU investment firm</i> to collect data on the <i>K-factor metrics</i> that are relevant to the <i>investment services and/or activities</i> that the <i>firm</i> carries on. Certain <i>K-factor average metric</i> calculations are based on average values and require a minimum level of historical data. (2) MIFIDPRU TP 4 contains transitional rules for the calculation of a <i>firm's K-factor requirement</i> where a <i>firm</i> was carrying on <i>investment services and/or activities</i> immediately before MIFIDPRU began to apply, but does not have the historical data necessary to calculate the relevant <i>K-factor average metric</i>. (3) MIFIDPRU TP 4 is not relevant to the calculation of the following elements of the <i>K-factor requirement</i> because they do not use historical data: <ol style="list-style-type: none"> (1) the <i>K-NPR requirement</i>; (2) the <i>K-TCD requirement</i>; and (3) the <i>K-CON requirement</i>.
		Duration
4.4	G	The duration of the transitional arrangements in MIFIDPRU TP 4 depends on the relevant <i>K-factor average metric</i> . Under MIFIDPRU TP 4.5.R(3), the transitional arrangements cease to apply when a <i>firm</i> has (or should have) collected sufficient historical

information to perform the necessary calculations in accordance with the standard calculation *rules* for the relevant *K-factor average metric* in MIFIDPRU 4.

Missing historical data for K-factor calculations: transitional provisions for individual MIFIDPRU firms

- 4.5 R (1) This *rule* applies to the extent that a *MIFIDPRU investment firm* does not have the necessary historical data to calculate the *K-factor average metric* required for any of the following in accordance with the relevant *rules* in MIFIDPRU 4:
- (a) its *K-AUM requirement*;
 - (b) its *K-CMH requirement*;
 - (c) its *K-ASA requirement*;
 - (d) its *K-COH requirement*;
 - (e) its *K-DTF requirement*; or
 - (f) its *K-CMG requirement*.
- (2) Subject to MIFIDPRU TP 4.13R(2)(a), a *firm* may either:
- (a) use reasonable estimates to fill any missing historical data points in the calculation of the relevant *K-factor average metric*; or
 - (b) as an exception to the standard calculation *rules* in MIFIDPRU 4, use the modified calculation in MIFIDPRU TP 4.11R to calculate the relevant *K-factor average metric*.
- (3) This *rule* ceases to apply in relation to a *K-factor metric* on the earlier of the following:
- (a) the date on which the *firm* has collected sufficient historical information to calculate the *K-factor average metric* in accordance with the *rules* in MIFIDPRU 4; or
 - (b) the date that falls *n months* after the date on which *MIFIDPRU* first began to apply, where *n* is the number of *months'* worth of data points required to calculate that *K-factor average metric* in accordance with the standard calculation *rules* in MIFIDPRU 4.
- 4.6 G (1) MIFIDPRU TP 4.5R(3) specifies the date on which the transitional arrangements for calculating a *K-factor average metric* will cease to apply and the *firm* must therefore use the standard calculation *rules* in MIFIDPRU 4 for that *K-factor average metric*. This date may vary depending on the position of the individual *firm*.
- (2) Under MIFIDPRU TP 4.5R(3)(a), once a *firm* has sufficient historical information to perform the calculation in the standard way, it is no longer permitted to use either reasonable estimates for missing data points or to use the modified calculation in MIFIDPRU 4.11R. For example, on the date on which *MIFIDPRU* begins to apply, Firm A already has historical data on its *AUM* covering the previous 10 *months*. The standard calculation of *average AUM* in MIFIDPRU 4 requires 15 *months* of historical data. Since the *firm* must begin collecting *AUM* data no later than the date that *MIFIDPRU* begins to apply, the *firm* will have sufficient data to perform the standard calculation 5 *months* later. At that point, the transitional arrangements under MIFIDPRU TP 4 will no longer apply to the *firm's* calculation of *average AUM*.
- (3) MIFIDPRU TP 4.5R(3)(b) acts as a "long-stop" date for the transitional arrangements under MIFIDPRU TP 4. A *firm* must begin collecting data on its *K-factor metrics* no later than the date that *MIFIDPRU* begins to apply. Therefore, a *MIFIDPRU investment firm* should have sufficient historical data to perform the standard calculation of a *K-factor metric* once sufficient *months* have elapsed to cover at least the standard calculation period for that *K-factor metric*. For example, the standard calculation for

			<p><i>average CMH</i> requires 9 months of historical data. For the purposes of MIFIDPRU TP 4.5.R(3)(b), the value of <i>n</i> is therefore 9, and the transitional arrangements under MIFIDPRU TP 4 will cease to apply to the calculation of <i>average CMH</i> 9 months after MIFIDPRU first begins to apply.</p>
4.7	R	(1)	A firm must apply its chosen approach under MIFIDPRU TP 4.5R(2) consistently for a specific <i>K-factor average metric</i> .
		(2)	A firm may apply different approaches under MIFIDPRU TP 4.5R(2) for different <i>K-factor average metrics</i> .
4.8	G		MIFIDPRU TP 4.7R prevents a firm from changing its approach to missing historical data points for a particular <i>K-factor average metric</i> . For example, if a firm is missing the necessary historical data points and chooses to apply the modified calculation in MIFIDPRU TP 4.11R to determine <i>average AUM</i> , it cannot subsequently decide to estimate the missing values for <i>average AUM</i> instead. However, a firm may choose, for example, to use reasonable estimates for missing values for <i>average AUM</i> , but to apply the modified calculation in MIFIDPRU TP 4.11R for the purposes of missing values for <i>average COH</i> . In the example, this could reflect the fact that the firm has a reasonable basis on which to estimate <i>AUM</i> , but is unable to produce reasonable estimates for <i>COH</i> .
4.9	R		If the FCA requests it, a firm that uses reasonable estimates in accordance with MIFIDPRU TP 4.5R(2)(a) must explain how it has determined the relevant estimates.
4.10	G		If a firm does not have a reasonable basis on which to estimate missing historical data points for a <i>K-factor average metric</i> , it should apply the modified calculation in MIFIDPRU TP 4.11R.
4.11	R	(1)	A firm that is using the modified calculation for determining a <i>K-factor average metric</i> , other than for the <i>K-CMG requirement</i> , must apply the following requirements:
		(a)	the firm must calculate the arithmetic mean of the daily values (or in the case of <i>AUM</i> , monthly values) for the <i>K-factor metric</i> over the previous <i>n months</i> , excluding the most recent <i>y months</i> ;
		(b)	<i>n</i> is the number of months that have elapsed since MIFIDPRU began to apply (with the month during which MIFIDPRU begins to apply being counted as month 1);
		(c)	<i>y</i> is the greater of:
		(i)	zero; or
		(ii)	<i>n</i> minus <i>x</i> ; and
		(d)	<i>x</i> is a fixed value, being:
		(i)	12 for <i>average AUM</i> ;
		(ii)	6 for <i>average CMH</i> , <i>average ASA</i> or <i>average DTF</i> ; and
		(iii)	3 for <i>average COH</i> .
		(2)	A firm that uses the modified calculation for determining the level of margin for the purposes of the <i>K-CMG requirement</i> must apply the following requirements:
		(a)	the firm must calculate the third highest amount of total margin as calculated under MIFIDPRU 4.13.5R required from the firm on a daily basis over the preceding <i>n months</i> ; and
		(b)	<i>n</i> is the number of months that have elapsed since MIFIDPRU began to apply (with the month during which MIFIDPRU begins to apply being counted as month 1).
4.12	G	(1)	The following are worked examples of the modified calculation in MIFIDPRU TP 4.11R.
		(2)	Firm A has chosen to apply the modified calculation for <i>average AUM</i> . MIFIDPRU has been in force for 6 months. Firm A would calculate its <i>average AUM</i> as follows:

- (a) the value of n is 6, being the length of time that *MIFIDPRU* has been in force;
 - (b) the value of y is zero, as zero is greater than n minus x (i.e. 6 minus 12). This means that Firm A must not exclude any of the most recent *months* of daily figures; and
 - (c) when calculating *average AUM* for present purposes, Firm A must therefore calculate the arithmetic mean of the previous 6 *months* of daily values for *AUM*.
- (3) Firm B applies the modified calculation for *COH*, as it is unable to generate reasonable estimates for missing data points for *COH*. *MIFIDPRU* has been in force for 4 *months*. Firm B would calculate its *COH* as follows:
- (a) the value of n is 4, being the length of time that *MIFIDPRU* has been in force;
 - (b) the value of y is 1, as n minus x (i.e. 4 minus 3) is greater than zero; and
 - (c) when calculating *average COH* for present purposes, Firm B must therefore calculate the arithmetic mean of the previous 4 *months* of daily values for *COH*, excluding the values for the most recent *month*.
- (4) *MIFIDPRU* has been in force for 10 *months*. Although Firm C would like to apply the modified calculation for *average CMH*, under *MIFIDPRU TP 4.5R(3)(b)*, this is not permitted. This is because the standard calculation of *average CMH* under *MIFIDPRU 4* requires only 9 *months* of daily values. Firm C should therefore have collected sufficient data by that time to be able to apply the standard calculation.

Missing historical data for K-factor calculations: transitional provisions for investment firm groups to which consolidation applies

- 4.13 R (1) If the conditions in (2) are met, a *UK parent entity* may apply the transitional arrangements in *MIFIDPRU TP 4.5R* to *MIFIDPRU TP 4.11R*, as modified by *MIFIDPRU TP 4.14R*, when calculating *K-factor average metrics* on a *consolidated basis*.
- (2) The conditions are as follows:
- (a) to the extent that it is relying on the transitional arrangements in *MIFIDPRU TP 4*, each *MIFIDPRU investment firm* in the *investment firm group* must apply the same approach under *MIFIDPRU TP 4.5R(2)* to calculate a specific *K-factor average metric* on an individual basis; and
 - (b) the *UK parent entity* must apply the same approach under *MIFIDPRU TP 4.5R(2)* to calculate a specific *K-factor average metric* on a *consolidated basis* as the *firms* in (a) have applied on an individual basis.
- 4.14 R Where a *UK parent entity* is applying *MIFIDPRU TP 4.5R* to 4.11R in accordance with *MIFIDPRU TP 4.13R*, the following modifications apply:
- (1) a reference to a "*K-factor metric*" or a "*K-factor average metric*" is a reference to that *K-factor metric* or *K-factor average metric* as it applies on a *consolidated basis*;
 - (2) a reference to the "*K-AUM requirement*", "*K-COH requirement*", "*K-ASA requirement*", "*K-CMH requirement*", "*K-DTF requirement*" or "*K-CMG requirement*" is a reference to those requirements as they apply on a *consolidated basis*;
 - (3) a reference to *MIFIDPRU 4* is a reference to that chapter as it applies on a *consolidated basis* in accordance with *MIFIDPRU 2.5*; and
 - (4) a reference to a "*firm*" is a reference to the *UK parent entity*.

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| 4.15 | G | (1) | Under MIFIDPRU 2.5, a <i>third country</i> entity that would be a <i>MIFIDPRU investment firm</i> if it were established in the <i>UK</i> may contribute towards a consolidated <i>K-factor metric</i> . A <i>UK parent entity</i> may rely on the transitional arrangements in MIFIDPRU TP 4 in relation to missing data points relating to such entities that the <i>UK parent entity</i> requires to calculate the consolidated <i>K-factor requirement</i> . |
| | | (2) | However, under MIFIDPRU 2.5.9R, a <i>UK parent entity</i> must ensure that any <i>subsidiaries</i> that are not subject to MIFIDPRU (including <i>third country</i> entities) implement the necessary arrangements to ensure that the <i>UK parent entity</i> can comply with consolidated requirements. As a result, the guidance in MIFIDPRU TP 4.6G(2) is equally applicable to <i>third country</i> entities within the <i>investment firm group</i> , which must ensure that they begin to collect the necessary data once MIFIDPRU begins to apply. |

