Chapter 4

Own funds requirements

4

4.5 Fixed overheads requirement

4.5.1 R

(1) The *fixed overheads requirement* of a *MIFIDPRU investment firm* is an amount equal to one quarter of the *firm's relevant expenditure* during the preceding year.

(2) When calculating its *fixed overheads requirement* in (1), a *firm* must use the figures resulting from the accounting framework applied by the *firm* in accordance with ■ MIFIDPRU 4.5.2R.

(3) This rule is subject to ■ MIFIDPRU 4.5.7R and ■ MIFIDPRU 4.5.9R.

4.5.2 R

(1) For the purposes of the calculation in ■ MIFIDPRU 4.5.1R, a *firm* must use the figures in its most recent:

  (a) audited *annual financial statements*; or

  (b) unaudited *annual financial statements*, where audited financial statements are not available.

(2) If a *firm* has used unaudited *annual financial statements* in accordance with (1)(b) and audited *annual financial statements* subsequently become available, the *firm* must update the calculation in ■ MIFIDPRU 4.5.1R using the audited figures.

(3) Where the financial statements in (1) do not cover a 12-*month* period, the firm must:

  (a) divide the amounts included in those statements by the number of *months* the financial statements cover; and

  (b) multiply the result of the calculation in (a) by 12 to produce an equivalent annual amount.

4.5.3 R

(1) For the purpose of ■ MIFIDPRU 4.5.1R(1), a *firm* must calculate its *relevant expenditure* by:

  (a) calculating the *firm's* total expenditure before distribution of profits; and

  (b) deducting any of the items in (2) from the total expenditure in (1)(a) to the extent that those items have been included in the expenditure.

(2) The items that a *firm* may deduct from its total expenditure are:

  (a) any of the following, if they are fully discretionary:

    (i) staff bonuses and other variable *remuneration*;

(ii) *employees'*, *directors'*, *partners'* and *limited liability partnership* members' shares in profits; and

(iii) other appropriations of profits;

(b) shared commission and fees payable that meet all of the following conditions:

(i) they are directly related to commission and fees receivable;

(ii) the commission and fees receivable are included within total revenue; and

(iii) the payment of the commission and fees payable is contingent on receipt of the commission and fees receivable;

(c) fees paid to *tied agents*;

(d) non-recurring expenses from non-ordinary activities;

(e) unless MIFIDPRU 4.5.4R applies, fees, brokerage and other charges paid to *central counterparties*, exchanges and other *trading venues* and intermediate brokers for the purposes of executing, registering and clearing transactions, provided that the fees, brokerage and charges are directly passed on and charged to customers;

(f) 80% of the value of any fees, brokerage and other charges, excluding any fees or charges to which MIFIDPRU 4.5.4R applies, paid to *central counterparties*, exchanges and other *trading venues* and intermediate brokers for the purposes of executing, registering and clearing transactions in relation to which:

(i) the *firm* is *dealing on own account*; and

(ii) the fees, brokerage or charges have not already been deducted under (e);

(g) interest paid to customers on *client money*, where there is no obligation of any kind to pay the interest;

(h) taxes where they fall due in relation to the annual profits of the *firm*;

(i) losses from trading on own account in *financial instruments*;

(j) payments related to contract-based profit and loss transfer agreements according to which the *firm* is obliged to transfer its annual profit to the *parent undertaking* following the preparation of the *firm's annual financial statements*;

(k) payments into a fund for general banking risk in accordance with article 26(1)(f) of the *UK CRR*, as applied by MIFIDPRU 3.3.1R; and

(l) other expenses, to the extent that their value has already been reflected in a deduction from *own funds* under MIFIDPRU 3.3.6R.

4.5.4 R The deducted amounts in MIFIDPRU 4.5.3R(2)(e) and (f) must not include fees and other charges necessary to maintain membership of, or otherwise meet loss-sharing financial obligations to, central counterparties, exchanges and other trading venues.

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Additional deduction for commodity and emission allowance dealers

4.5.5 R In addition to the deductions in MIFIDPRU 4.5.3R(2), a *commodity and emission allowance dealer* may deduct expenditure on raw materials in connection with the underlying commodity of the commodity derivatives the *firm* trades.

Expenses incurred on behalf of the firm by third parties

4.5.6 R

(1) A *firm* must add any fixed expenses that have been incurred on its behalf by a third party, including a *tied agent*, to the *firm's* total expenditure for the purposes of MIFIDPRU 4.5.3R in accordance with this *rule*.

(2) A *firm* is not required to add fixed expenses incurred on its behalf by a third party to the *firm's* expenditure if the expenses are already included in the figures resulting from MIFIDPRU 4.5.2R.

(3) Where a breakdown of the third party's expenses is available, the *firm* must add to the *firm's* total expenditure the share of the third party's expenses incurred on behalf of the *firm*.

(4) Where a breakdown of the third party's expenses is not available, the *firm* must:

(a) add to the *firm's* total expenditure the share of the third party's expenses incurred on behalf of the *firm* as projected in the *firm's* business plan; or

(b) if the *firm* does not have a business plan that projects the third party's expenses, reasonably estimate the share of those expenses that are attributable to the *firm's* business and add that estimated share of expenses to the *firm's* total expenditure.

Material change to projected relevant expenditure during the year

4.5.7 R

(1) This *rule* applies where there:

(a) is an increase of 30% or more in the *firm's* projected *relevant expenditure* for the current year; or

(b) would be an increase of £2 million or more in the *firm's fixed overheads requirement* based on projected *relevant expenditure* for the current year.

(2) Where this *rule* applies, a *firm* must:

(a) immediately recalculate its *fixed overheads requirement* by applying the methodology in MIFIDPRU 4.5.3R to the projected *relevant expenditure*, taking into account the increase in (1);

(b) immediately substitute the revised *fixed overheads requirement* that results from the calculation in (a) for the *firm's* original *fixed overheads requirement* under MIFIDPRU 4.5.1R(1); and

(c) immediately recalculate its *basic liquid assets requirement* using the revised *fixed overheads requirement* in (b) and substitute the updated amount for its original *basic liquid assets requirement*.

4.5.8 G

(1) Where there is a material increase in the *firm's* projected *relevant expenditure* that triggers the obligation in MIFIDPRU 4.5.7R, a *firm* should also consider the potential impact on its *ICARA process* and the conclusions documented in its last *ICARA document*. In particular, the *firm* should consider any potential impact on:

(a) the *liquid assets* that the *firm* must hold to comply with MIFIDPRU 6, as the requirements in that chapter are calibrated by reference to the *fixed overheads requirement*;

(b) the level of *own funds* and *liquid assets* that the *firm* must hold to comply with its obligations under MIFIDPRU 7; and

(c) the calibration of the *firm's wind-down triggers*.

(2) The review in (1) is particularly important if the *firm's own funds requirement* was determined by the *fixed overheads requirement* immediately before the change occurred.

4.5.9 R

(1) This *rule* applies where there:

(a) is a decrease of 30% or more in the *firm's* projected *relevant expenditure* for the current year; or

(b) would be a decrease of £2 million or more in the *firm's fixed overheads requirement* based on projected *relevant expenditure* for the current year.

(2) Where this *rule* applies, a *firm* may:

(a) recalculate its *fixed overheads requirement* by applying the methodology in MIFIDPRU 4.5.3R to the projected *relevant expenditure*, taking into account the decrease in (1); and

(b) if it has obtained prior permission from the *FCA*, substitute the revised *fixed overheads requirement* that results from the calculation in (a) for the *firm's* original *fixed overheads requirement* under MIFIDPRU 4.5.1R.

(3) To obtain the permission in (2), a *firm* must:

(a) complete the application form in MIFIDPRU 4 Annex 11R and submit it to the *FCA* in accordance with the instructions on that form;

(b) demonstrate all of the following:

(i) that one of the conditions in (1)(a) or (b) is met and the projected reduction in the *firm's relevant expenditure* is a reasonable projection;

(ii) that the firm has adequately considered the impact of the reduction on the *firm's ICARA process* and the conclusions documented in the firm's last *ICARA document*; and

(iii) that there is a reasonable basis to conclude that, following the reduction in the *firm's fixed overheads requirement*, the *firm* will continue to hold sufficient *own funds* and *liquid assets* to comply with its obligations under MIFIDPRU 7.

4.5.10 G

(1) Under MIFIDPRU 4.5.1R, a *MIFIDPRU investment firm* is required to calculate its *fixed overheads requirement* based on its relevant

expenditure as set out in its *annual financial statements* for the previous year.

(2) Under MIFIDPRU 4.5.7R, if there is a material increase in the *firm's* projected *relevant expenditure* for the current year, the *firm* must recalculate its *fixed overheads requirement* on the basis of the projected increased *relevant expenditure*, taking into account the impact of that change.

(3) However, under MIFIDPRU 4.5.9R, if there is a material change that results in a decrease in the *firm's* projected *relevant expenditure* for the current year, the *firm* must obtain permission from the *FCA* before substituting a reduced *fixed overheads requirement* calculated on the basis of the projected decrease.

(4) In many cases, a material change of the type specified in MIFIDPRU 4.5.7R(1) or MIFIDPRU 4.5.9R(1) would result from planned changes to the *firm's* business. Examples of these changes may include:

(a) starting or ceasing a major business line;

(b) acquiring or disposing of a major business; or

(c) undertaking a significant investment, upgrade or restructuring programme.

A *firm* that is planning to implement a material change to its business should calculate the anticipated impact of that change on its *fixed overheads requirement* (and its broader *own funds requirement*) before executing the relevant change. This should include considering the potential impact on its *ICARA process* and its obligations under MIFIDPRU 7.

Firms that have been providing investment services and/or activities for less than one year

4.5.11 R (1) This *rule* applies where a *firm* has been in business for less than one year.

(2) For the purposes of the calculation in MIFIDPRU 4.5.1R, a *firm* must use the *relevant expenditure* included in its projections for the first 12 *months'* trading, as submitted in its application for *authorisation*.