

## Chapter 7

# Governance and risk management

		<div><div></div><div>7.10</div><div>Supervisory review and evaluation process</div></div>
		<div>Application</div> <div></div>
7.10.1	G	<div><div>(1) This section contains <i>guidance</i> on the <i>FCA's</i> approach to the <i>supervisory review and evaluation process (SREP)</i> of the <i>ICARA process</i>.</div><div>(2) Although there are no <i>rules</i> in this section that impose direct obligations on <i>MIFIDPRU investment firms</i> or <i>UK parent entities</i>, these entities may find the <i>guidance</i> in this section helpful in understanding the <i>FCA's</i> general approach to considering whether <i>MIFIDPRU investment firms</i> are complying with the <i>overall financial adequacy rule</i> and the other requirements of the <i>ICARA process</i>.</div><div>(3) The <i>guidance</i> in this section relates only to the <i>FCA's</i> approach to the <i>SREP</i>. It does not apply to any other supervisory action that the <i>FCA</i> may take, except where stated.</div></div>
7.10.2	G	<div><div>Purpose</div><div>The <i>own funds</i> and <i>liquid assets</i> necessary to comply with the <i>overall financial adequacy rule</i> need to be assessed by the <i>firm</i> and, where appropriate, the <i>FCA</i>. This involves:</div><div><div>(1) the <i>ICARA process</i> applied by the <i>firm</i>, or, in the circumstances set out in ■ MIFIDPRU 7.9, by the <i>investment firm group</i>;</div><div>(2) the <i>FCA's</i> monitoring of the information provided by a <i>firm</i> under its ongoing reporting obligations in ■ MIFIDPRU 9; and</div><div>(3) in appropriate cases, a <i>SREP</i>, which is conducted by the <i>FCA</i>.</div></div></div>
7.10.3	G	<div><div>Decision to conduct a SREP</div><div><div>(1) There is no mandatory frequency with which the <i>FCA</i> will conduct a <i>SREP</i> on a particular <i>MIFIDPRU investment firm</i> or <i>investment firm group</i>. Instead, the <i>FCA</i> will prioritise its resources to conduct <i>SREPs</i> by taking into account a range of factors, which include:</div><div><div>(a) the nature, scale and complexity of the business carried on by a <i>firm</i> or <i>investment firm group</i>;</div><div>(b) the <i>FCA's</i> analysis of the risks associated with the <i>firm</i> or <i>investment firm group</i> and its potential to cause harm to <i>consumers</i> or to the financial markets;</div></div></div></div>

- (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

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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

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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

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- (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

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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

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- (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

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- (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



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;



## 7.10.14

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- (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.

- (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*.