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Bye bye ICAAP, IPRU, BIPRU and GENPRU and welcome K-Factors, ICARA and PMR: A simple guide to understanding the Investment Firms Prudential Rules (IFPR).

Come January 2022, The IFPR will come into force and usher in simplified prudential rules for investment firms. IFPR, in comparison to the old prudential rulebooks of GENPRU, BIPRU and IPRU is, in our opinion, a model of simplicity as it is much easier to work out the prudential requirements and regulatory capital of investment firms.

We have produced below a simple summary of the IFPR and the potential sting in the tail for investment firms.

1

Simplified prudential categorization of firms
Under IFPR, firms will fall into either of two prudential categories: Small Non-Interconnected firm (**SNI**) or Non-Small Interconnected Firm (**Non SNI**). This clear categorization does away with the complexity of the old rulebooks which had a multiplicity of categories and made it very difficult to work out a firm's prudential category. With IFPR, Compliance Officers no longer have to grapple with understanding and working out whether a firm is a BIPRU, Limited License, Exempt CAD-Firm or a BIPRU Limited License firm as there are now only 2 categories - i.e., Small Non-Interconnected Firm (**SNI**) or Non-Small and Non-Interconnected Firm (**Non SNI**). Whether a firm is SNI or Non SNI will depend on its permitted activity and the scale of its activities.

2

Simplified regulatory capital requirement
Under the old rules, working out capital requirements was a very complicated and technical exercise. IFPR has made this task less complicated as an investment firm's regulatory capital will comprise of a) its **Permanent Minimum Capital Requirement (PMR)** which depending on its permitted activity will be either
£750K - for firms with the permitted activities of dealing on own account, underwriting /or placing on a firm commitment to operating an OTF; or
£75K - for firms with the permitted activities of reception and transmission of orders, execution of orders on behalf of clients; investment advice, placing without firm commitment without the permission to hold client money e.g Exempt CAD Firms; **and**
£150K for all other investment firms with the permitted activities of dealing on own account, underwriting /or placing on a firm commitment to operating an OTF.

Regulatory capital will also include add-ons such as the **Fixed Overhead Requirement (FOR)** i.e., 25% of the firm's relevant expenditure in the previous year. Non SNI firms will, in addition to the FOR, also need to add on K-Factors (see 4 below) which are a mixture of activity and exposure-based requirements. Most SNIs including Exempt CAD Firms, regulatory capital will be the higher of its PMR - (£75K or £150K) or its FOR (25% of its previous year's capital expenditure).

3

Simplified regulatory reporting and returns.
IFPR introduces a single suite of regulatory returns for all investment firms irrespective of firm type. It does away with the complicated FINREP and COREP returns which we are sure will not be mourned by anyone who has ever experienced having to make FINREP and COREP Returns.

4

The sting in the tail
Undoubtedly, IFPR compared to the old BIPRU, GENPRU, and IPRU rules, is a model of simplicity. However, it is not all smooth sailing as there are some new requirements which firms will have to grapple with. These elements include the following:

1. K Factors -
The K- Factors are additional requirements that firms must take account of when calculating their capital requirement and they are a mixture of activity and exposure-based requirements. Which K-factors will apply to an individual FCA investment firm will depend on the MiFID investment services and activities it undertakes. The K- Factors are the:

- net position risk (K-NPR) - a requirement based on the FCA investment firm's market risk
- clearing margin given (K-CMG) - an alternative to K-NPR to provide for market risk based on the margins given by the FCA investment firm to a clearing member
- daily trading flow (K-DTF) - a requirement based on the value of the FCA investment firm's daily trading flow
- trading counterparty default (K-TCD) - a requirement based on the risk of a trading counterparty failing to meet their obligations to the FCA investment firm
- client order handled (K-COH) and this includes reception and transmission of orders.

2. Basic Liquid Asset Requirement
All firms including Exempt CAD firms will now have to hold an amount of liquid asset that is at least equal to 1/3 of its Fixed Overhead Requirement (FOR) and 1/6 of the total amount of any guarantees provided to clients.

3. ICARA (Internal Capital Adequacy and Risk Assessment process)
The ICARA replaces the ICAAP and is now mandatory for all investment firms including Exempt CAD Firms. For Exempt CAD firms this will be a new requirement as under the old rules, they were exempt from providing an ICAAP. The ICARA process will cover the identification, monitoring and mitigation of harms, business model planning and forecasting, recovery and wind down planning and assessing the adequacy of financial resources.

4. OFAR (Overall Financial Adequacy Rule)
OFAR will require investment firms to hold adequate own funds and liquid assets to a) ensure it can remain viable throughout the economic cycle and b) allow its business to wind

down in an orderly manner. The FCA intends to implement the OFAR through an own fund threshold requirement and liquid assets requirement and firms will determine these through the ICARA process

5. Increase in regulatory capital of Exempt CAD firms

The regulatory capital of Exempt CAD Firms will significantly increase from £50K to £75K or more through the combination of the 50% increase from £50K to £75K, the Fixed Overhead Requirement, Basic Liquid Asset requirement, and the cost of producing the ICARA. This is somewhat tempered by the 5-year transitional period given to all firms to comply with the new capital requirement

6. Classification as SNI for some Exempt CAD Firms

Exempt CAD firms with a gross income of more than £30m per annum could be classified as a Non SNI firm resulting in even higher regulatory capital requirements.

If you require more information or advice on assessing how IFPR affects your firm, implementing the new rules and/or producing your ICARA kindly contact us at **info@openspacesltd.com**