THE INVESTMENT ASSOCIATION

Paul Rich and Hillary Neale
Strategic and Cross-cutting Policy Division
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

The Investment Association
Camomile Court, 23 Camomile Street,
London, EC3A 7LL

+44 20 7831 0898
nicholas.edge@theia.org
theia.org
@InvAssoc @The Investment Association

25 September 2020

Dear Mr Rich and Ms Neale,

RE: FCA DP20/2: A new UK prudential regime for MiFID investment firms

The Investment Association (IA) is pleased to provide input to your consultation on updating the UK's prudential regime.

We welcome the FCA's approach to a tailored prudential regime for UK MiFID investment firms that achieves the same outcomes as those in the Investment Firms Regulation and Directive. Most of our membership will be subject to the rules set out in the FCA's Discussion Paper. In our response, we provide suggestions for some additional detail or clarification in specific sections that would be helpful, as well as more general observations.

We look forward to seeing further developments from the FCA once they have considered the responses to DP 20/02.

Yours sincerely,

N. Edge

Nicholas Edge
Senior Policy Adviser

Response to discussion paper on A new UK prudential regime for MiFID investment firms

September 2020

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.5trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 43% of this is for overseas customers. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

The IA welcomes the FCA's approach of creating a tailored UK prudential regime for MiFID investment firms (IFPR) that aligns to the outcomes of the Investment Firms Regulation and Directive (IFR/IFD), but implements them in a proportionate and pragmatic way to reflect the nature of the UK market.

The FCA Discussion Paper is a thorough explanation of the rules that it intends to implement by 26 June 2021. There are some core areas that the IA would like to ensure the FCA address as it progresses through the policy process that would enable the UK to create a proportionate-and internationally competitive environment for investment managers to operate in the UK, whilst meeting the FCA's statutory objectives on consumer protection and the integrity of the financial system.

The IA supports the FCA's view that it is not appropriate to apply of rules within the Capital Requirements Regulation and Directive (CRR/CRD) to investment firms, even those within a group that has a credit institution.

The areas that the IA would particularly like the FCA to focus include: enabling flexibility in the level of consolidation; excluding delegated assets under management (AUM) from other jurisdictions with comparable investor protection or from firms under different regimes; and applying a less complex methodology for assessing material changes in the fixed overhead requirement that would ensure proportionality for all sizes of firms.

The IA would also like the FCA to take a pragmatic approach on timing and require firms to apply the rules from the start of the next reporting period after 26 June 2021 or, for remuneration, the next full performance year.

We would also like to draw the FCA's attention to the treatment of dividends in relation to deferred remuneration. The IA do not support the view that dividends or interest must not be paid on deferred remuneration in the form of instruments and have set out a preferable approach in our response below which we think fully meets the policy purpose.

1. What are your views on the instruments or funds used by non-joint stock investment firms that should count as CET1 capital?

The IA welcomes the expansion to the qualifying instruments to enable all business models of investment manager to have their usual capital instruments count as core equity tier 1 (CET1) capital in the IFPR. We suggest that the transposition of the current rules in IFPRU 3.2.18G would be acceptable in achieving this. We would urge the FCA to confirm to firms, who would be applying these rules for the first time, and have concerns around instruments meeting the definitions, which specific items would be treated as instruments under the terms of the requirements and allow a suitable timeframe of 5 years to transition to higher quality instruments if required.

2. What level of detail would you find helpful when calculating the fixed overheads requirement (FOR)?

The IA welcomes less complex FOR rules than currently proposed by the EBA. While the current drafting of the EBA requirements provide clarity on several areas, the specific requirements regarding the deduction of bonuses, a key element of investment firms' remuneration arrangements, is unclear and overly complex.

The current form and content of the GENRPU rules appear a good base to build from when developing a UK specific set of FOR requirements that we would like the EBA to also adopt.

The Discussion Paper does not provide further information on the items which would be permissible deductions for the FOR. For consistency across firms, it would be helpful to have a list of permissible deductions from the FCA. Some examples include:

a) The treatment of taxes payable in respect of profits generated by the activities of the investment firm;
b) The treatment of interest paid to customers on client money;
c) The treatment of costs which are ultimately recharged to clients;
d) The treatment of losses arising from trading in financial instruments, including losses on foreign exchange ('FX') derivatives;
e) The treatment of fair value changes in financial instruments held in banking book; and
f) The treatment of losses arising from translation of foreign currency balances held in a branch.

The EBA rules require fixed expenses incurred on behalf of an investment firm by a third party to be included in total fixed expenses of the investment firm, if not already included in the annual financial statements of the investment firm. However, there is no guidance around treatment of such expenses by the third party while calculating its own fixed overhead requirement whereby the third party is a group entity. In our opinion, including such expenses by both investment firm and group entity will lead to double counting of fixed overhead capital requirement.

From the above, the IA would particularly welcome the additional clarification that the EBA rules provide on the deductibility of tax charges on annual profits and would further suggest that the FCA consider permitting the deduction of charges associated with items deducted from Own Funds (e.g. amortisation charges on intangible assets). The rationale for this is that any increased/accelerated amortisation charge on intangible assets in a wind down situation would have no impact on the Own Funds of the Investment Firm, as the reduction in carrying value would reduce the deduction against Own Funds thereby offsetting any loss caused by the additional profit and loss charge.

We would also suggest that the FCA retains a less complex methodology for assessing the materiality of changes in the FOR. The IA suggests a material change is one where there is a change in fixed overheads of greater than 20%. This would provide for an appropriate change that is proportionate for all sizes of firm.

3. What are your views on how any negative values or liabilities an investment firm manages within a portfolio, for example from derivatives or leverage, should be treated when measuring AUM?

For consistency with current business practices, the IA's view is that AUM should be measured as the net asset value. This would enable firms to use existing client reporting rather than creating a new methodology.

By introducing an 'offset' for instruments that have a negative value, further complexity is introduced which we understand is not the intention of the new regime. The IA also notes that 'absolute value' is not clearly defined in either the IFR or the draft regulatory technical standards issued by the EBA.

It is true the use of leverage can expose clients to additional risk. However, negative value instruments, such as derivatives, can also be used to hedge risks as part of proper discretionary portfolio management, where risks are reduced rather than increased. This means that the risks related to the use of leverage would be better captured in the 'Pillar 2' assessment rather than as a 'one size fits all' approach under the minimum K-factors capital requirements. To note that the FCA proposes a similar approach in client money held (CMH), where although recognising that title transfer collateral arrangements (TTCAs) have a similar risk to client money, these are not captured in the measurement of CMH but instead are to be assessed in 'Pillar 2'.

The IA would like to point out that the FCA Discussion Paper and the EBA Consultation Papers differ in the proposed treatment of negative values or liability positions within portfolios i.e. those arising from derivative positions or leverage. The EBA Consultation Paper states that the calculation of AUM should include the absolute value of such positions, which the IA has responded to with a request that the EBA use a net asset value methodology. The FCA Discussion Paper notes that there are a number of ways in which such positions could be treated but does not explain the FCA's preferred treatment. The IA reiterate that the preferred treatment be the use of net asset values.

We would further support the use of net asset value as a measurement method for both AUM and assets safeguarded and administered (ASA) which would ensure consistency and would align to current reporting.

4. Do you have any comments on delegation from or to another financial entity when calculating K-AUM?

We understand from the IFR Article 4(1)(27) that AUM means the value of assets that an investment firm manages for its clients and, under Article 17(2), where those assets have been formally delegated to another firm they should still be included in the total AUM of the delegating firm. There should not be an increased capital requirement based on a potential double count of AUM from delegation provisions, however there is a lack of clarity on the treatment of cross holdings within the same consolidation group and the use of 'feeder funds' investing in funds managed by the same manager. For example, where a firm has a segregated client contracting with one investment manager invested in pooled funds managed by a different investment manager within the same group, it could be read that both investment firms would calculate the K-factor on the same AUM, however the IA understands this is not the FCA's intention and would welcome explicit direction on how these funds should be counted by each investment manager to help ensure a transparent and consistent approach to K-AUM across the industry.

To further avoid double counting, the IA would welcome clarity over whether this principle continues to apply when the firm that has delegated services in another jurisdiction or subject to another regime (such as Solvency II). The IA's view is that it would be appropriate to exclude AUM delegated from firms in other jurisdictions or covered by other regimes that provide comparable investor protection. For this purpose. the IA would like the FCA to provide a list of other regimes that would be deemed to provide sufficient investor protection and where there is a memorandum of understanding in place with other jurisdictions.

We would welcome guidance on AUM based capital requirements, whereby a UK regulated firm (e.g. an insurance firm), not in scope of IFR, delegate portfolio management to an investment firm, which further delegates the portfolio management to a regulated/ unregulated firm in another jurisdiction. In this example, we would expect that, to avoid duplication, the AUM delegated from an insurance entity be excluded from the investment firm's K-AUM calculation.

For firms calculating funds under management (FUM) under article 9(3) of the Alternative Investment Fund Managers Directive (AIFMD), we understand that they should exclude investments by alternative investment funds (AIFs) in other AIFs they manage for the calculation of own funds. We would recommend consistent application of AUM based calculations across the regulations.

The FCA Discussion Paper (Para. 6.18) notes that the investment firm who is delegating portfolio management retains responsibility for the inclusion of those assets in their K-AUM calculation. The FCA Discussion Paper notes that an exception to this would be instances where the delegating firm is not obliged to perform an AUM-based capital requirements calculation. We suggest an approach whereby assets managed under a delegation from another regulated firm, where that firm does not calculate an AUM-based capital requirement, are only included in the K-AUM calculation on an exceptional basis i.e. where there may be concerns that the capital requirement regime is not deemed to be equivalent e.g. for entities managed in third countries without sufficient investor protection.

It is our understanding from the Discussion Paper that Appointed Representatives would meet the definition of Tied Agents, and the relevant amount of metric (AUM) should be included within the total K-AUM of the Investment Firm using a Tied Agent. Where this 'Tied Agent' is also a MiFID Investment Firm and subject to the same regulation, we would recommend not including the AUM of the Tied Agent as this would represent a double count and require both entities to hold capital for the same amount of AUM.

5. Do you agree with our view on how to measure CMH and ASA?

The IA requests further clarity on whether K-ASA, as detailed in section 6.29 – 6.34 of the Discussion Paper, will extend to firms that currently have the permission to 'arrange' the safeguarding and administration of assets but have no responsibility or permissions to safeguard.

The 'arranging safeguarding and administration of assets' should not be in scope of K-ASA. PERG 2 Regulated activities and the permission regime states, "this permission consists solely of arranging for one or more other persons to carry on both the safeguarding of assets belonging to another and the administration of those assets". By including this type of arrangement within K-ASA it would result in a misalignment of regulatory requirements and the business model, risk profile and management strategy.

For K-CMH, the IA would find it helpful for the FCA to confirm whether the expectation is for firms to submit the client money requirement or the client money resource.

6. Do you agree with our views on how to measure COH, and when it does not apply?

The IA agrees with the measurement at the execution stage by the receiving investment firm to avoid a double count. However, we would appreciate clarification on the exclusion of orders handled that, according to Article 20 (IFR) "arise from the servicing of a client's investment portfolio where the Investment Firm already calculates K-AUM in respect of that client's investments."

The IA recommends further direction on the calculation of consolidated K-factors where the treatment applied at a solo level differs from consolidation as in the above example.

We would like to understand the FCA's position on the measurement of timing and value of orders executed through multiple fills (for example where large orders are executed in blocks of trades over an extended period of time, possibly through the use of algorithms). The IA's view is this should be kept as simple as possible and the price should be deal price, rather than the instruction price, which is what would be reported to the clients and therefore will be readily obtainable.

The IA are content with para. 6.40 that states, "in the case of orders executed by the investment firm we believe the measurement should only be taken once the investment firm has confirmation an order has been executed in the market the price is known". However, the FCA elaborates for reception and transmission of orders (RTO) the measurement should be taken "at the point at which the order is transmitted to another investment firm or credit institution" and also states that firms should use the "price stated in the order" (although often there will not be one) or "the current market price at the time the order is transmitted'" This appears to apply PRIIPS 'slippage' methodology to derive the value of a trade for an RTO order, which is complicated and for which adequate data does not always exist. The IA suggests that, even for RTO, firms should always have the option to use the confirmed price once the trade has been executed as investment managers will receive the execution price information back from brokers on a fill-by-fill basis, so that data will be readily available.

It is not clear whether internal trades (i.e. buys/sells between funds that are not traded in the market) should be excluded or included in the calculation.

The IA request clarification that repurchase and securities lending transactions should be out of scope for the definition of cash trades.

Exchange traded options should not be deemed to be cash trades as the true exposure is linked to the notional value. If a firm bought / sold the wrong exchange traded option then that firm would need to compensate for the difference in mark to market (MtM) between the 2 contracts, not the premium.

Further, FX forwards should be treated as cash trades as buying and selling notional amounts is more akin to a cash transaction than a derivative where notional amounts are used to calculate MtM.

7. Do you agree with our views on the treatment of 'cash trades' for DTF and COH?

The IA agrees with the FCA's views on how to measure cash trades for CoH.

8. Do you agree with our views on how to calculate the notional value for derivatives for DTF and COH?

The IA agrees with the FCA's views on how to measure the notional value for derivatives.

9. Do you have any comments on the use of K-CMG 'on a portfolio basis'?

The IA notes the FCA view that "on a portfolio basis" should apply such that each of an investment firm's trading desks constitute a single portfolio, with some applying K-CMG and some applying K-NPR, as applicable. However, the recent EBA draft RTS to specify the calculation of the amount of the total margin for the calculation of K-CMG seems to be a stricter requirement than if a firm uses K-CGM on certain trading desks, it must use a consistent approach between all desks which are similar in terms of business strategy and trading book positions. We would like some clarity on how these different approaches might work in practice.

10. When calculating K-TCD for foreign exchange derivative contracts, do you agree with our view on what 'domestic currency' can mean?

The IA has no comments on this point.

11. Do you have any comments on the composition of an investment firm group including the concepts of 'control' and 'ancillary service undertaking'.

Local regulators can apply their own supervisory techniques regarding consolidation requirements. Therefore, firms with MiFID investment firms in different jurisdictions, could have to apply several different regimes with different requirements and thresholds. This has the potential to cause significant complications for larger groups. The IA would like clarity on how the FCA will manage this.

The IA recommends providing consistent terminology throughout the text to reinforce the definition of ancillary services undertakings as financial sector entities (FSE's). Clarity for firms defined as FSE's would ensure a harmonised approach to own funds calculations and reinforce that the parent entity of an ancillary services undertaking would not be required to take a material holding deduction for this firm which is consistent with the treatment of regulated subsidiaries with a consolidated group.

12. Do you have any comments on how to calculate consolidated FOR, consolidated PMR, and consolidated KFR?

The IA welcomes the FCA stating that consolidated K-Factor Requirement (KFR) should be based on the consolidated situation and not from the aggregation of individual firm's positions.

From para 7.12 of the Discussion Paper, we understand the consolidated situation as parent entity, investment firms, financial institutions, ancillary services undertakings and tied agents, however there is uncertainty around the treatment of AIFMs/UCITS firms that do not have additional MiFID permissions. For example, Para. 7.32 appears to suggest that for the IFR K-AUM calculation, all assets managed by an AIFM/UCITS manager should be included. The IA would like clarity on whether they should be included within the scope of the consolidated K-factor and the correct treatment of assets managed as part of an AIF or a UCITS arrangement for the purposes of the K-AUM calculation.

From para 7.16 of the Discussion Paper on applying the Consolidated Own Funds Requirements, it is not clear what is meant by 'relevant' types of individual entities. As the text does not stipulate 'all' individual entities, it could be assumed that the scope is limited to the activities of investment firms in scope of the IFR and their relevant K-factors. As well as clarifying scope, the definition of consolidated situation also clarifies what is intended by a prudential consolidation. All relevant types of individual entities within an investment firm group are to be treated as if, together, they formed a single (or 'enlarged') investment firm. So, the requirements of the relevant parts of the IFR will apply to this 'enlarged investment firm'.

Providing clarity on the treatment of AUM based calculations will assist in reducing the complexity around applying the rules for all regulated entities. In particular, the IA seeks clarity that cross-holdings within a group should be excluded from AUM calculations in order to avoid double counting.

Under paragraph 7.50 it is suggested that FCA may require consolidated own funds to be independently verified. The IA would like certainty about what circumstances the FCA expect this to be deemed appropriate and whether the expectation is that this verification be performed by the investment firm's auditor or another third party.

Paragraph 7.51 appears to imply that an investment firm should seek approval from FCA before applying proportional consolidation to a minority interest entity / participation, but the IA does not agree that this should be the case. This reflects the implied position in the EBA draft RTS (Article 7 - RTS on prudential consolidation of an investment firm group) which states: "The group supervisor may permit following a request from the Union parent undertaking, or require on its own initiative, proportional consolidation according to the share of capital held of participations in investment firms, financial institutions, ancillary services undertakings or tied agents…" Our assumption is that the firm in question would be able to apply proportional consolidation and that this would only be retrospectively challenged if the FCA found issue with the approach.

For the consolidation of K-COH, we would welcome further detail on whether trades passed internally within an investment firm group for onward transmission/execution should be only counted once for the purpose of consolidation. There is a risk of confusion with Art 11(3)(a) of the EBA's draft RTS on Consolidation which suggests that the investment firm should aggregate the COH across applicable entities.

13. What are your views on the conditions, both of which must be met, before an investment firm group may be given permission to use the GCT?

The IA welcomes further guidance on some of the characteristics that would make a group structure "sufficiently simple". Additionally, we would welcome further clarity on the expected benefits of the Group Capital Test (GCT) on firms given the considerable reporting requirements for the monitoring of group capital would seem to negate any value.

We understand the GCT is available to groups deemed "sufficiently simple" and we would recommend that the reporting requirement for firms taking advantage of the GCT be of equal simplicity.

14. Do you have any comments on our views on the limits that apply for K-CON and our worked examples for calculating it?

The IA would welcome clarification that the large exposure requirement (LERs) will not apply to affiliate entities i.e. firms will not have to calculate LERs on normal intercompany balances between firms at a solo level as they are in the same consolidation group.

15. Do you have any comments on the list of assets that may count towards meeting an investment firm's minimum liquidity requirement?

The list of assets appears to be fairly comprehensive. The IA's view is the list should be sufficiently flexible to allow changes in market developments to allow inclusion of further assets that would meet the required objectives. We would also encourage the explicit inclusion of Low Volatility Money Market Funds (that are solely invested in HQLA) in the list with a haircut which reflects the risk to firms from using these funds to manage short term liquidity. These are important and reliable sources of liquidity for some investment firms.

It would also be helpful to have confirmation that, where liquidity requirements apply on a solo basis but liquidity is managed on a group basis, solo entities will be allowed – through a waiver similar to those currently granted amending BIPRU 12.2 – to count deposits at a Treasury entity within the group to count towards liquid assets.

16. What are your views on the structure and content of the elements being covered in the proposed new 'Pillar 2' framework.

The IA welcomes the alignment of the elements of the internal capital adequacy and risk assessment (ICARA) process to the K-Factor categories (risks to clients, risks to markets, risks to firm). However, we are concerned that firms may have to do considerable reworking of their existing frameworks which may bring little value in terms of risk reduction. For example, some firms consider operational risk as a category which is then broken down into individual risks, but their current analysis would not separately identify harm to clients, harm to markets and changes in the book value of assets (all of which map to operational risk in the current CRD framework in Figure 11.3).

Paragraph 11.34 sets out the potential requirement for ICARA to be performed on a consolidated basis, but there is a lack of clarity over whether this will actually be the case or whether firms will only have to complete the ICARA on a solo basis. The Discussion Paper suggests that the supervisory review and evaluation process (SREP) will continue to be conducted on a solo basis, but it would make sense for the ICARA process to be aligned i.e. if the ICARA is done on a consolidated basis the SREP would too. The IA would welcome the FCA allowing flexibility in approach to reflect their use of the GCT, such that firms can prepare an ICARA at either a consolidated basis or on a solo basis, but not be required to prepare both on a solo and a consolidated basis.

Fig 11.1 of the Discussion Paper states that firms currently assess their different exposure risks according to detailed capital requirements as set out in CRD/CRR. Under ICARA, firms will need to focus on risks to financial adequacy from changes to: i) book value of assets; ii) value of trading book positions; and iii) losses from potential failure of counterparties. The IA would welcome more information on this with further examples of what the FCA expects.

The illustrative examples in Figure 11.2 do not refer to sustainability risk and the IA would be interested to understand the FCA's position on this.

The IA suggest that the Stress & Scenario Testing (SST) report be incorporated into the ICARA rather than having to produce a separate report, thereby only requiring one submission to the FCA.

The IA would like further explanation of how the FCA intend to define and calculate an 'ordinary course' wind-down requirement as part of a SREP (paragraph 11.66).

17. Do you agree with our proposal regarding additional own funds requirements and specific liquidity requirements? This includes the articulation of requirements and guidance, stacking order and the use of VREQs to set own funds and specific liquidity requirements.

Own funds required for an orderly wind-down

Figure 11.4 (paragraph 11.91) states that "The investment firm then calculates any additional own funds required for an orderly wind-down. This is added to its FOR." The IA would welcome clarity that firms should calculate the own funds required for an orderly wind-down and then deduct the FOR. If this is the case, then we would assume that investment firms should hold the higher of the own funds required for an orderly wind-down and FOR as that is how it was being carried out previously (albeit, they were not stacked).

Additional capital from a different regulator

Para 11.72 of the Discussion Paper states that when weaknesses are identified during a SREP, there may be a requirement to hold additional financial resources. The IA welcomes clarity over how the FCA intends to deal with instances where a third country regulator requires additional capital to be held and that additional capital differs from the FCA assessment. For example, for a consolidating entity with a third-country solo entity within its consolidation that has been given an additional capital requirement, would the FCA account for that requirement in its calculation? A firm should be able to take account of additional capital required in other jurisdictions from within the group.

Apportionment of additional own funds requirements
The Discussion Paper indicates in para 11.74 that for SREPs conducted on a consolidated basis, the FCA may consider whether any additional own funds or guidance should be apportioned between the regulated entities forming part of the group. The IA would like the FCA to provide further details on how it is envisaged apportioning additional own funds requirements to solo entities within a group, for example is this likely to be based on each entity's AUM, their Pillar 1 calculation or their Pillar 2 assessments?

VREQ
We note the FCA's intentions to invite firms to apply for a voluntary requirement (VREQ) as deemed necessary by the FCA, which imposes a formal legal requirement to hold the appropriate level of own funds. We would welcome further guidance on the application of the VREQ as it is not clear what the benefit of VREQ is, from the perspective of the firm, and how the overall proposed approach is expected to satisfy the stated aim in the foreword of lowering the on-going regulatory costs. It would be helpful if the FCA can provide details on the process to be followed by firms once a Pillar 2R amount has been determined and a VREQ required.

Can the FCA provide further information as follows:

a) How will the legal requirement be invoked for a VREQ i.e. will it be a standard provision with UK domestic law or will it be individual contracts with firms?
b) Where consolidation takes place, would a VREQ be required at an individual level or a group level?
c) We note that a breach of a VREQ could form the legal basis for enforcement action although the FCA would consider relevant factors. It would be helpful to understand from the FCA the criteria they will apply in their assessment i.e. how will they assess and impact of each breach? What are the implications if the legal requirements are breached for a short period e.g. for 1 day?

Disclosure
The IA supports the FCA's proposal to not require publication of the VREQ as it will contain confidential information that is highly sensitive. It would be helpful to understand from the FCA the circumstances under which a firm would be requested to publish the result of its ICARA process, including the composition of any own funds requirement set as a result of the SREP. Will firms be required to disclose any breach of their VREQ / additional capital guidance or would any disclosure of breaches be subject to a materiality threshold?

Additional capital guidance
The Discussion Paper states that Pillar 2G will act as a 'buffer' to allow for economic cyclical fluctuations. It would be helpful if the FCA could define an 'economic cycle'? as this term is subject to interpretation. Further clarity is also sought in relation to how the FCA intend to assess the economic cyclical fluctuations and detail the criteria for setting a buffer.

Notification of a 'dip into the Pillar 2G component'
The IA would like further guidance for how this notification should take place and the timing around making the notification.

Articulation of Pillar 2R and Pillar 2G
We would welcome a clearer explanation of the Pillar 2R requirement and Pillar 2G.

Paragraph 11.82 states: "We would intend to use the ability to set an additional (Pillar 2G) buffer where a 'buffer' is needed to allow for economic cyclical fluctuations". And paragraph 11.84 states: "If an investment firm's resources dip into the 'Pillar 2G' component, we envisage that it would need to notify the us and provide a plan for how it intends to replace the depleted resources". Many IA members already have capital risk appetites that require them to hold additional capital for economic cyclical fluctuations or stress events. Up until now, these buffers have been managed internally by firms, but paragraph 11.84 now appears to require firms to notify the FCA and provide a plan, which would be a new requirement. The IA would like clarity that the FCA anticipates firms to continue to set their own capital risk appetites and then hold the higher of their own assessment and the Pillar 2G and notify the FCA only if the Pillar 2G level is breached.

Paragraph 11.89 states that Pillar 2 should comprise Pillar 2R and Pillar 2G. The FCA set Pillar 2R and Pillar 2G (as stated in 11.86 and 11.87) yet Pillar 2 also includes the firm's own assessment of the own funds needed to mitigate harm as explained in Fig 11.4 i.e. the outcome of their ICARA process, plus consider the FOR and wind-down requirement for Pillar 2. While we understand the requirements as set out in Fig 11.4, the 'Pillar 2' description as set out in paragraph 11.89 could be confusing to firms.

Does Pillar 2R equate to the firm's additional Pillar 2 capital (based on its ICARA) plus the add-on described in paragraph 11.86 or does Pillar 2R refer only to the add-on?

The narrative in paragraph 11.92 explaining Fig 11.4 states the higher column consists of the KFR plus additional Pillar 2R for harm not captured by other requirements. It is unclear if this includes the firm's additional Pillar 2 capital as a result of their ICARA (as explained in the key for Fig 11.4) or an FCA determined value i.e. the firm's additional Pillar 2 capital plus the FCA's add-on. It would be helpful if the FCA used a different term to distinguish the firm's own assessment.

The IA would also welcome clarification of how the FCA expects Pillar 2G requirements to be held in terms of the quality of capital that firms will be expected to hold.

Additional liquidity requirement
The IA welcomes the clarity provided by the FCA in respect of the factors which will be referenced when determining that an investment firm must satisfy an additional liquidity requirement. We consider it appropriate that a firm's funding profile requirement will influence the extent of any additional liquidity requirement that the FCA may issue. However, we are unclear on the Liquid asset requirement detailed in Para. 11.96 of the Discussion Paper. Para. 11.96 appears to suggest that an additional liquidity requirement could be applied as a means of requiring firms to hold a particular quality or type of liquid asset. The rationale for this is unclear given that the FCA proposal clarifies which assets are consider eligible for satisfying the minimum liquidity requirement. The result of this may be that firms will be subject to an additional liquidity requirement because of the quality of their liquid assets even where the composition of these liquid assets is in compliance with the IFR rules. If there is a desire to manage the proportion of the liquid asset requirement which is satisfied with specific asset types, it would be more transparent, and therefore preferable, to detail this in the rules rather than via the issuance of an additional liquidity requirement. This would ensure consistency across all FCA solo-regulated investment firms.

Use of FSMA powers
Para 11.100 indicates that the FCA may receive additional powers to impose direct requirements on otherwise unregulated firms. The IA would welcome confirmation of what these additional powers may be i.e. are they formalising the VREQ / own initiatives requirement (OIREQ) process for applying it to consolidating parent entities or do they envisage other powers not yet detailed in the Discussion Paper? Also, can the FCA confirm that only unregulated parent entities would be captured, or does this potentially extend to other non-regulated entities within a group?

18. What are your views on the proposed approach for the transition from existing IFPRU/BIPRU ICGs?

The IA welcomes the provision of guidance on the transition of Individual Capital Guidance (ICG). This provides clarity on the process that firms should work through to calculate the new ICG. We would request some additional information on the intentions of the FCA in relation to ICGs which were given to firms a number of years ago and could therefore be "stale" to the extent that a firm's Pillar 1*ICG is now significantly diverged from the Pillar 2 assessment.

The IA would welcome confirmation of our current understanding, based on the Discussion Paper, that if the new Pillar 1 calculation (i.e. the higher of FOR and the K-factors) is greater than the existing Pillar 1 plus ICG, then the existing ICG would no longer be valid. Firms would continue to assess Pillar 2 capital until the FCA informs firms of their new Pillar 2R and Pillar 2G requirements. If the new Pillar 1 calculation is lower than the existing Pillar 1 plus ICG, then the firm needs to recalculate the percentage multiplier for the new Pillar 1 to match the existing Pillar 1 plus ICG amount and apply for a VREQ.

The IA would also request that the FCA allow firms the ability to transition to higher qualities of instruments over the same 5-year time horizon. This would enable the appropriate rolling off of lower quality instruments and the ability to stagger the placing of more appropriate instruments in the market.

19. What are your views on the level of detail required to meet regulatory reporting requirements?

The IA's view is that the current EBA reporting framework is not proportionate. The number of templates and data points in the EBA framework give rise to an increased potential for erroneous reporting. The IA and its members would welcome a reporting regime that was focused on the collection of data for the FCA to meet both prudential requirements as well as risk assessment for supervisory perspective. This may include the provision of summary prudential information on a quarterly basis and more detailed metrics on a six-monthly/annual basis for supervisory purposes.

We understand from the Discussion Paper that it is the FCA's intention to keep in place the existing reporting on balance sheet and profit and loss / income statements for firms on a solo and consolidated basis which would result in a duplication of many data points in the EBA's reporting framework. Can the FCA confirm how the balance sheet and income statement will be submitted to the FCA going forward? The IA support the development of a proportionate FCA regulatory reporting regime, taking into account the experience obtained from implementing other reporting regimes, as soon as possible having a regard that any change in reporting would entail and the need for transitional arrangements. In particular the IA, would not support the overly onerous, and banking-focused, FINREP returns being applied to investment management firms.

The FCA paper does not specifically list out the returns which will be required and the frequency at which the returns will be required to be submitted. Clarity on which specific returns will be required and how frequently they are required would be appreciated. Furthermore, will the FSA 047/048 returns apply or will the form and templates transition to something similar to the PRA 110 returns, which the IA would not support given the complexity and granularity of the PRA 110 return does not correspond to the risks that investment managers pose? However, there will be a need for an appropriate lead-in time for any new reporting regime. Small and large firms will need to go through a significant operational and technological exercise to ensure they are able to regulatory report (gathering new data points on K-factors, etc).

It would be helpful if the FCA could provide a list of the reports / disclosures that are required on an individual basis and those that are only required on a consolidated basis.

20. What are your views on the scope and application of a new remuneration code?

We welcome the FCA's intention to consult on the application of rules to groups including a credit institution and one or more non-SNI investment firms.

In the meantime, we would like to raise the following points:

- As CRD V allows the disapplication of the CRD V rules for firms subject to sectoral rules, we do not support the application of CRD V rules for IFPR firms within a CRD V group (except where an individual holds material risk taking functions for other (and non-IFPR) entities of the CRD V group which have a material impact on the CRD V group's risk profile). Applying CRD V rules instead of IFPR rules to investment firms of banking groups would mean that these firms would be subject to more stringent rules than standalone investment firms (such as a 4-year deferral instead of a 3-year deferral period), ultimately impacting their ability to attract and retain talent due to not being on the same level playing field.
- We would encourage the FCA to consider the case of an investment group which contains a number of investment management regulated subsidiaries (under MiFID, UCITS and AIFMD), but which also includes a banking entity, which undertakes activities that are either ancillary to the investment management activities of the group and/or small in scale by reference to such activities. In this case it would be disproportionate (and not reflective of the intention of the CRD V and IFD to ensure that firms are subjected to a regime proportionate to the nature of their activities) for the fact of the group including an ancillary banking entity to mean that entire consolidation group would be subjected to the remuneration requirements of CRD V. In our view, notwithstanding that there may be consolidation under the CRD for other purposes, it would be appropriate for groups in this situation to be able to seek a waiver from the FCA and PRA, to the effect that the group would be permitted to apply the CRD V remuneration rules to the banking entity only on a solo basis (and not on a consolidated basis), and to instead apply the more appropriate sectoral rules (IFPR, UCITS, AIFMD) on a group basis.
- The application of the CRD III, and then CRD IV, remuneration rules on a group basis has at times in the past been subject to a degree of uncertainty, stemming from references to application on a "group" basis as compared to more recently updated guidance documents focussing on the application to a consolidation group. It will therefore be important for the scope of the IFPR remuneration rules as they apply to consolidation groups to be clearly defined, to avoid reintroducing historic uncertainties.

Effective date

Based on the EBA's statement that it is assuming that institutions will have to comply with the IFD remuneration rules for remuneration awarded for the 2021 performance year, we have significant concerns with the EBA's proposed position.

We would reiterate the point we made in our response to the EBA's consultation, that the remuneration provisions should apply no earlier than a firm's first full performance-year commencing on or after 26 June 2021. This would be consistent with the approach adopted for other regulatory regimes on remuneration, such as the various iterations of CRD, UCITS V, AIFMD, etc. We think any earlier application would result in significant complexity for firms and for material risk takers at those firms.

It is key to ensure that firms are able to understand the requirements, develop their approach to compliance, communicate to impacted employees and implement any policy changes before the start of the performance year in which these rules come into effect. As such, the timelines that we suggest above are contingent on there being clarity on the new requirements and any associated guidance well in advance of that effective date. If it is not possible to achieve that then a later effective date should be considered, e.g. a firm's first full performance-year commencing say 6 months after the key guidance on identifying MRTs, any proportionality provisions, etc. has been finalised.

We think any earlier application would result in significant complexity for firms and for material risk takers at those firms. Firms might end up having to subject their staff to new remuneration terms mid-way through a performance year, which creates legal enforceability risks in some jurisdictions and also brings material administrative and communications complexity.

21. Do you think it would be appropriate for us to include in a new remuneration code a general proportionality rule similar to that contained in the IFD?

The inclusion of a general proportionality rule is important and the principle of proportionality should be part of a new remuneration code. As with other remuneration codes, firms would benefit from clarity in this regard, with clear rules and guidance as appropriately reflected in the FCA handbook remuneration code and supporting guidance.

The inclusion of a general proportionality rule would also be helpful if it facilitated a "comply or explain" style approach for non-SNI firms and consideration should therefore be given to proportionality being applied more broadly.

In addition, we would expect that any thresholds used in the application of the principles of proportionality (whether at the level of the firm or the individual) should be representative of the 'size, level, activity and complexity' of UK investment firms regulated under IFPR to ensure the strong market competition within a major global financial centre is protected. Therefore, we would welcome consideration and clarity on the following points in relation to the principle of proportionality:

Exemption of Individuals
The IFD permits firms to disapply certain of the remuneration requirements in respect of Material Risk Takers whose variable remuneration is less than EUR 50,000 (and represents 25% or less of the total remuneration).

The effect of the FCA applying a de minimis threshold at the level of EUR 50,000 under the UK IFPR would, in practice, amount to the removal of any concept of individual de minimis. Such an outcome would not be reflective of the intention to create a regime that is proportionate to the nature of investment firms and the market in which they operate. We suggest the de minimis threshold should be set at least in-line with the de-minimis level of GBP 500,000 of total remuneration (DP 13.40), but our recommended position would be for individuals to be excluded whose variable remuneration is less than GBP 500,000 (as opposed to the threshold being based on total remuneration).

In our view the requirement that remuneration must represent 25% or less of total remuneration is equally as unreflective of the remuneration structures in investment firms. Given the intention of the IFPR will be to introduce a regime proportionate to the nature of investment firms and their business even the 33% test currently applied in UK would be insufficient to reflect the fact that remuneration structures in investment firms do not follow the same model as those across the banking sector. The de minimis threshold should therefore be based simply on the level of variable remuneration as above (or, if the FCA determines to apply the additional element based on the proportion of pay which is variable, this proportion must be set at a materially higher proportion than 33%).

Exemption of firms
We support the FCA's proposal that it would be appropriate to apply a threshold of EUR 300 million (or GBP 300 million) for investment firms that meet the criteria set under the IFD (which include tests by reference to the firm's balance sheet and trading book business). We recognise the current flexibility under the IFD for member states to apply

discretion between EUR 100m and EUR 300m, however we support the FCA's suggestion that under the UK regime it will apply a threshold which is of "at least" EUR 300 million and recommend that the FCA should consider a higher threshold.

In any event, we do not support the proposal that a threshold of any less than EUR 300 million should be applied.

Mandatory deferral of 60%
In respect of what level of variable remuneration should constitute a 'particularly high amount' (DP 13.103) (being the level of variable remuneration at which the mandatory deferral of 60% applies), we consider a threshold of GBP 1 million to be more appropriate for UK investment firms than the current CRD level of GBP 500,000.

EUR or GBP
To minimise confusion for firms and impacted staff and to avoid the impact of exchange rate movement year on year, we propose that all thresholds to be in GBP as opposed to EUR.

To the extent that the FCA would intend to transpose monetary thresholds from the IFD (noting our comments above that in some cases we encourage the FCA to consider separate, higher, thresholds that are appropriate to investment firms as well as the UK market) then in our view such thresholds should be transposed by applying the same monetary value but in GBP (for example, converting EUR 300 million into GBP 300 million).

If the FCA determines that not to be possible, then at the very least any GBP amounts resulting from the conversion should be rounded up to the next meaningful level. Having to communicate to staff thresholds such as de minimis thresholds of GBP 44,000, or MRT identification based on a threshold of GBP 658,000, as has been suggested in relation to the implementation of the CRD V rules in the UK is liable to lead to confusion.

22. Do you agree with our interpretation of gender-balanced remuneration committee? Do you think it would be appropriate for us to include it as a requirement in a new remuneration code?

We support the policy objective of increasing gender diversity on remuneration committees on the grounds that firms with diverse leadership make better business decisions and drive innovation. The IA is also supportive of the FCA's focus on diversity and inclusion in all its forms.

From a corporate governance perspective, firms are required to ensure that remuneration committee members in aggregate have the skills and knowledge to exercise competent and independent judgement on remuneration policies and practices and the incentives for managing risk, capital and liquidity. It is essential that firms have the necessary flexibility to build a remuneration committee comprising individuals with an appropriate balance of skills, experience, and cognitive diversity.

We therefore agree with the FCA's approach of promoting a culture of inclusion and ensuring appropriate gender representation rather than prescribing equal representation.

Allowing firms to set their own appropriate targets for representation would mean that firms could align their targets with their firm's own diversity objectives. For example, if a firm's target was to have 35%-40% female representation in senior management roles across the business this target could also be applied to the remuneration committee and would avoid the difficulty of achieving equal representation on a small committee with an odd number of members.

In addition, we would like to note that the efficacy of a remuneration committee depends on a degree of stability and experience within its membership and so we ask the FCA to leave it for firms to determine their own reasonable timeframe to achieve a gender balance, and for the onus to be on firms to justify why that timeframe is appropriate.

In terms of detail, we would like to get clarity from the FCA as to whether the 'gender balance' referred to relates to voting members of the Committee or standing attendees.

We also note, however, that currently not all UK firms have, nor are required to have in place remuneration committees. For firms who are enhanced firms under SM&CR, this would require additional applications to the FCA to appoint the Chair of the Remuneration Committee as an SMF.

Group level remuneration committees
In addition, the IFD explicitly acknowledges (Article 33 paragraph 1) that the remuneration committee may be established at the group level, rather than requiring separate committees for each regulated entity. The IA would welcome confirmation that a structure where an IFPR-regulated firm relies on oversight from a remuneration committee at group / holding company level would continue to be acceptable under the new regime.

Remuneration committee composition
We understand the important role that non-executives can play on remuneration committees, offering expertise and impartial guidance. However, we ask that the FCA recognise the different ownership structures across the investment management industry and the practicalities and challenges of engaging non-executives in remuneration committees for many firms.

The requirement set out in Article 33 of the IFD for remuneration committee members (including the chair) to be non-executive members of the management body - 'The Chair and members shall be members of the management body who do not perform any executive function in the investment firm concerned' - is potentially a very onerous requirement for some of our members, creating a need to have non-executive directors where otherwise no such requirement exists (save under Article 28 in respect of the risk committee membership).

Smaller investment management firms and those which are part of a larger group tend to have a remuneration committee which includes members who are not independent non-executives. They seek to achieve strong governance and oversight by ensuring that the committee membership includes representation from different parts of the business/functions and, where applicable, includes members who are not employed directly by the entity but perform an executive function elsewhere within the group or parent company.

We think that requiring remuneration committees to comprise solely non-executives would be unlikely to improve governance outcomes, would result in additional cost and could in practice become a tick box exercise. We ask that proportionality be applied to the requirement for non-executive remuneration committee membership.

One approach to address this may be to take a similar approach to that at paragraph 49 of the EBA Guidelines on remuneration under CRD IV and state that where there are not a sufficient number of non-executive members, institutions should not be required to appoint such directors but instead could implement other measures within the remuneration policy to limit conflicts of interest in decisions on remuneration issues.

We would also like to note that some investment management firms are private partnerships in which the partners of the firm are exempt from the firm's remuneration process (receiving a return on their capital investment in the firm instead of any salary or bonus). It would be helpful to have clarity on whether partners could be classified as 'non-executive' for remuneration committee purposes.

23. Do you agree it would be appropriate for us to include in a new remuneration code rules and guidance on retention, deferral and ex-post risk adjustment?

The IA thinks that it would be appropriate to provide guidance on these areas provided that the guidance extends a degree of discretion to firms for their application. Allowing firms to adopt retention, deferral and ex-post risk adjustment arrangements that are appropriate for the business cycles and nature of the business would seem to be a logical and sensible approach.

Structures which inherently meet the objectives of the IFD/IFPR
In our view, it is important that the IFPR should recognise that firms operate (either through their legal structure, or as part the elements of "remuneration" arrangements) structures which inherently meet the objectives of the IFD and IFPR – inherently creating alignment to the long term interest and position of the firm or clients – and that such structures should be capable of being treated as meeting the requirements relating to risk alignment, the award process and the pay-out process (in relation to deferral, payment in instruments and retention, and ex-post risk adjustment).

One example is carried interest arrangements, which create a very clear long-term alignment with the interests with investors. Indeed, this is already recognised by the ESMA Guidelines on sound remuneration policies under the AIFMD, at paragraph 159, which indicates that subject to certain conditions a carried interest structure shall be treated as meeting the remuneration requirements referred to above. The FCA should adopt this same principle in respect of carried interest arrangements under the IFPR (although we encourage the FCA to adopt its own more flexible formulation of this principle given the ambiguities in the drafting used by ESMA).

There are, however, other structures which similarly meet the objectives of the IFPR. These include terms applicable to partners in investment firms structured as partnerships, such as terms which require partners to maintain a capital investment in the partnership, or which require partners to apply a proportion of annual partnership in some form of reinvestment. These types of structure (which may vary in their detail between firms) tie the interests of the individual to the long-term performance and capital position of the partnership. Consequently, firms should be able to treat such arrangements as causing certain of the remuneration requirements (in particular the pay-out structure requirements) to be met in respect of the partners (either in full or part, depending on the arrangements) without having to impose separate structures to pay further value in the form of instruments or subject to deferral or ex-post risk adjustment.

Given the wide range of firms which will be subject to the IFPR, in our view the above provisions would be most appropriately addressed through a general purposive provision, rather than seeking to define the specific arrangements to which this approach would apply.

Partnerships
It is very important that the IFPR should reflect the principle (which the FCA and ESMA has previously recognised) that a partner is an owner of the firm, and that, any allocation of profits which is in the nature of an ownership interest, or a return which (other than in a partnership context) would be of a capital nature, should be treated as such, and as being outside the scope of the remuneration requirements. We encourage the FCA to avoid an overly prescriptive approach to defining what may constitute payments made by a partnership that are of an ownership or capital nature, given the very wide range in the structure of partnerships.

Separately, in respect of any payments from partnerships that may have the character of variable remuneration, we refer the FCA to our comments above, that some partnerships may be structured so that the objectives of the IFPR in respect of such payments are inherently met, at least to some extent.

Retention
We welcome the FCA's proposal that firms will have discretion to determine and apply an appropriate retention period to variable pay delivered in the form of instruments using factors such as the length of the deferral period, the length of the business cycle, and how long it could take for the prudential risks underlying the performance to crystallise.

Ex-post risk adjustment
We agree that ex-post risk adjustment provisions are good practice, and support the proposal that the provisions should give firms considerable discretion to develop appropriate policies for the types of risk the firm is exposed to or might pose to others.

We also welcome the FCA's recognition that some firms, particularly those which do not currently have malus or clawback policies, may welcome some further indication of what this involves and so we look forward to the FCA's future consultation on guidance on malus and clawback expectations.

In advance of such guidance being developed, we suggest that the following points might be helpful:

- Malus should apply throughout the vesting period as a universal principle.
- The clawback period should be at the discretion of firms so that they can set a period consistent with the length of their business cycle thus allowing sufficient time to uncover any potential risk or financial issues that may require post payment adjustment. This approach would also allow firms to factor in other elements, such as the nature of the activities undertaken and long-tail risks which some areas of the firm, but not all, may be exposed to.
- We think that mandating a 7-year clawback for all Material Risk Takers would be disproportionate when compared to the applicable deferral period, particularly in functions/business areas where no long-tail risk can materialise.
- Similarly, the 7/10 years clawback period applied for banks is not appropriate for investment firms where the cycle and risks would become evident during a much shorter duration. Investment managers do not take proprietary risks with their balance sheets and so the risks posed by asset managers are generally different to banks. In investment firms, remuneration is based on realised revenues rather than mark-to-market valuations of trading book positions and so the need for a longer clawback period does not apply.

24. Do you agree with the list of existing CRR-based permissions that we have identified as continuing under a new regime?

The IA would like clarity over whether the FCA plan to continue the waivers available to currently categorised Significant IFPRU firms listed under IFPRU 1.2.9 around governance arrangements and its position regarding the waiver for the number of directorships held. The IA's view is that the justification for the waivers remain and should be grandfathered to enable firms to continue under their current conditions.

The IA would welcome confirmation that, according to para 13.69, a structure where a firm relies on governance committees at Holding Company level would continue to be acceptable under the new regime.

25. Do you agree with our intended future treatment of CPMIs?

The IA would appreciate clarity on the minimum liquidity requirements for the MiFID activities of CPMIs. The minimum liquidity requirement is calculated with reference to an investment firm's FOR, however the FOR reflects all activities performed by the CPMI and there may be difficulties assessing the fixed overheads relating solely to the MiFID activities.

26. What are your views on whether a MiFID investment firm should be able to 'opt-in' to a regime based on CRR?

The FCA states at paragraph 18.6 of the Discussion Paper that "we would not intend to replicate in our rule the discretion available in paragraph 5 of Article 1 of the IFR to allow firms we prudentially regulate to 'opt-in' to supervision on the basis of a regime mirroring the CRD / CRR."

The IA supports the ability to 'opt-in' to CRR, for example where an investment firm is part of a banking group and did not wish to manage two separate regulatory regimes.

However, as Class 1 firms are regulated under CRD V it is unclear that there is a strong justification for an additional fee.

27. What would be most appropriate way for SNI investment firms to report on the results of their ICARA process?

The IA support the FCA's intention to design a framework that allows the efficient collection of relevant data for supervisory purposes. Any framework should not place a burden on the SNI firm and should summarise the work performed as part of the ICARA process. The data requested may include the internal assessment of the quantification of the risks faced by the firm, the wind down requirement and results of the stresses applied by the firm. Further information may detail the methodology applied in arriving the requirements and the use of external advisors in the process.

The current FCA Pillar 2 return would be an appropriate place to start in developing the reporting required for SNI to provide to the FCA.

28. Do you agree that the group capital test should be made available as an alternative to prudential consolidation?

While we agree that the GCT should be available to firms, we are unsure of the benefits to firms of applying the GCT as it does not seem to provide substantial exemptions from other sections. If the FCA see this as a valuable option, then some clarity on the impact on firms might be useful in allowing them to make a more measured assessment.

29. Do you agree with our intended approach to remuneration exemptions for smaller non-SNI investment firms and individuals?

Exempting smaller firms from the requirements is a practical approach. However, the limited exemption may cause further confusion and challenges with implementation. For instance, exempting firms from deferral requirements but still expecting all firms to apply either malus or clawback seems counter intuitive - clawback is generally seen as more problematic to implement/utilise and the lack of exemption around this requirement seems unhelpful.

30. Do you agree with our intended approach to replicating the effect of the discretions on instruments used and alternative arrangements for variable remuneration?

The IA welcomes the pragmatic approach and flexibility in the application of using instruments for variable remuneration.

We welcome the FCA's approach that to reflect the diverse legal structures of firms, different types of instruments may be used; and the FCA's intention not to limit the options available to investment firms that cannot make use of more common types of instruments.

Many firms use cash-settled instruments that pay out at the end of the retention period based on the value of the firm's shares, or the value of the relevant funds, by reference to which the instrument is granted. As this is common practice, a confirmation from the FCA that these arrangements would continue to be permissible (and not affected by the recent EBA consultation on its RTS on permissible instruments) would also be helpful.

We would like to draw the FCA's attention to our response to the EBA's consultation on its Draft Regulatory Technical Standards (RTS) on classes of instruments that adequately reflect the credit quality of the investment firm as a going concern and possible alternative arrangements that are appropriate to be used for the purposes of variable remuneration.

In particular, as also referred to in our response to the EBA, we would like to draw the FCA's attention to the treatment of dividends in relation to deferred remuneration.

The EBA's RTS indicates that dividends or interest must not be paid on deferred remuneration in the form of instruments (recital 10). We are concerned that this approach, both for the purposes of the EBA's RTS but also in relation to the awarding of deferred remuneration in the form of instruments more generally, would create a potentially significant misalignment of interest with shareholders, investors or other stakeholders. Moreover, in our view there is a preferable approach, to which we refer below, which we think fully meets the policy purpose.

The policy purpose in disallowing receipt of interest or dividends is to ensure that the full amount of variable remuneration represented by deferred instruments remains deferred for the duration of the applicable deferral period (and so as to avoid portions of that value represented by interest and dividends being distributed at an earlier date, thereby weakening the deferral and risk alignment intention of the IFD). However, this purpose would be fully met by an expectation that, whilst interest and dividends could accrue on deferred instruments, those amounts of interest or dividends should not be distributed to the individual staff member prior to the end of the deferral period applicable to the deferred instruments (indeed, this approach, of allowing dividends to accrue but not be paid out until the end of the deferral period is a very common approach in, for example, listed company executive remuneration arrangements). This would achieve full alignment with shareholders, investors or other stakeholders as to the value of the deferred remuneration over time, whilst still ensuring the full value of the deferred instruments (including the full value of accrued but non-distributed dividends or interest) remain subject to deferral over the required periods. In particular, the value of the accrued dividends or interest could therefore remain subject to risk-adjustment through the operation of malus or clawback prior to the end of the deferral period.

In our view it is also not correct to say that staff members receive additional value by reason of dividends or interest accruing on deferred instruments. In our view this mischaracterises the nature of the interest or dividends that accrues, which does not accrue in the nature of remuneration, and further the value of the instrument as at the date the deferred remuneration is awarded will already have taken into account the nature of the instrument, including the impact on value of the right to (or the lack of a right to) receive dividends or interest. Consequently, the fact the dividends or interest would accrue on deferred instruments would be fully factored into the fair value of those instruments at the date the deferred remuneration is awarded.

31. Do you have any comments on the other competent authority options and discretions discussed in Chapter 18?

The IA would welcome clarification from the FCA on which of the IFR/IFD discretions will be applied under the new regime.

32. Do you agree that any transitional provisions for the PMR should also extend to the ICR?

It is not clear from chapter 19 whether the intention is to limit only the permanent minimum requirement (PMR) and not the own funds requirements for investment firms currently classified as Exempt CAD.

The Discussion Paper seems to suggest that Article 11 of the IFR will still need to be applied to calculate Own funds (being the highest of FOR, PMC & KFR) but during the transitional period the PMC can be limited to twice the initial capital requirement currently applied. There would be little benefit in this transitional provision for firms that would be in scope of calculating K-factors such as K-AUM which is likely to be far higher than twice the initial capital requirement (EUR100k) and therefore the trigger for that firm's own funds requirement.

The IA note that the wording of the IFR article 54(4)(a) "firms may limit their own funds requirements to twice the applicable initial capital requirement" is not reflected in the FCA Discussion Paper in para 19.10 where it states that "these firms may limit their PMR to twice this amount" and would recommend providing clarity that Exempt CAD firms who currently have an own funds requirement of EUR50k being the initial capital required (ICR) can apply the transitional provision to limit their own funds requirement to EUR100k for a period of up to 5 years.

33. Can you identify any other scenarios that are not covered by IFR transitional provisions?

Para 11.27 notes that national competent authorities can request that firms include information about any additional own funds requirements resulting from their ICARA process or SREP in their public disclosures. A transitional arrangement for this would be helpful so that firms have been through an ICARA/SREP cycle and had time to take relevant action before they would be required to disclose the information.

34. Do you have any other comments on the content of a new prudential regime for investment firms as described in this DP?

We note the FCA's desire to create a regime tailored to UK requirements which meets the outcomes of the EU27 rules but does not necessarily implement them verbatim. The IA suggests this is an opportunity for the FCA to provide further guidance to firms now that it is not constrained by the processes of the EU. There are a couple of areas which would seem outside the general perimeter of prudential regulation and where we question the need for specific rules or guidance within the UK prudential regime:

Country-by-country reporting (Art27 IFD)
We recommend Article 27 of IFD is not carried across to the UK regime. Country by country reporting has been implemented in the UK by HMRC and does not naturally sit in regulation focused on prudential and governance matters.

Investment Policy (Art 52 IFR)
If Article 52 is implemented in the UK we recommend it is only at group level, as there will be duplication of reporting if done at a solo level due to delegation, as more than one entity within the group will be considered to indirectly hold shares.

Other K-Factor points
A number of K-Factors apply to firms who deal on their own account. The IA would welcome greater clarity around the definition of dealing on own account. For example, would it include a firm that has a seed investment in a fund, or derivatives taken out to hedge positions (e.g. FX forwards)?

Calculation of FX risk
In the IFR, NPR is defined as the value of transactions recorded in the trading book of an investment firm. However, the risk-to-market (RtM) K-factor in Article 21 refers to the K-factor requirement for the trading book positions of an investment firm dealing on own account, and paragraph 4 of this article adds that positions in foreign exchange and commodities other than trading book positions are to be included. There appears to be an inconsistency here and the intent is unclear.

The IA would welcome the FCA making explicit in the IFPR that the net position risk (NPR) only applies to firms that actively deal on own account, in their own name, including for clients, in respect of a trading book. Only if the firm has an active trading book then would NPR apply to the extent it has net positions, which would then extend to FX and commodities risk to positions that exist outside of the trading book.

Considering that the intent is to capture the risk to markets, a firm that does not hold trading book positions, and only holds positions in foreign exchange and commodities as a result of its normal business activity, which is other than trading book, should not be required to calculate the RtM K-factor.

Waivers
The IA would welcome clarity on how the FCA intend to treat existing waivers. In particular that the FCA intends to grandfather across waivers that currently apply.

Governance
The FCA suggests that members of the Risk Committee must be made up of members of the Management Body who do not perform executive functions. Whilst this works more practically in larger non-SNI firms, in many firms (who are not 'large' non-SNIs) the Chair of the Risk Committee is the CRO who also performs a Director function for the firm. Is the intention of this change to recalibrate the membership of Risk Committees? The CRO is usually the most suitable individual to chair or act as a member of such committees, a CRO has duties and responsibilities under SM&CR which does not require that a CRO cannot perform an executive function. Further detail and clarity around this point would be appreciated as otherwise a number of firms will be required to change their governance structures which will not only have an impact from an SM&CR perspective, but could lead to the most suitable individuals not being permitted to sit on the committee.

The IFD does not allow national competent authorities to waive the risk committee requirement in the same way as under CRD although member states can change the thresholds. The IA would support the FCA to allow this waiver under the IFPR for consolidating risk committees.

Similarly, would firms who fall under the proposed EUR 300 million on-and-off balance sheet threshold be required to make the changes outlined to risk committees already established?

Thresholds for SNI firms
Can the FCA confirm if they intend to use the same threshold levels for SNI firms as set out in IFR? Further, the IA recommends the changes in categorisation of investment firms set out in the IFPR be filtered through the rest of the Handbook (e.g. SMCR) to ensure a consistency in the FCA's approach to proportionality.

Definition of non-discretionary advisory services
The Discussion Paper states the K-AUM calculation should include assets which are managed on an ongoing non-discretionary advisory basis; however, it does not clarify the type of services which should be considered in / out of scope for this purpose. Can the FCA please provide further details on the services that would be deemed in / out of scope? The example provided in 6.14 of the Discussion Paper could be interpreted as K-AUM including assets under advice (AUA). This would result in the same asset values in two firms K-AUM

calculations if one firm is providing Financial Planning services and the other is providing Investment Management services, or double counting for a firm providing both Financial Planning and Investment Management services on the same assets. This would also result in an industry data issue as valuations of assets from firms undertaking Investment Management services to firms providing Financial Planning services are provided in many different formats and are typically provided less frequently than monthly.

Definition of a financial services entity
The IA would welcome further detail on the FCA's definition of the types of activity that would constitutes a financial services entity.

Potential double counting
The definition of AUM includes discretionary portfolio management and assets managed under a non-discretionary advisory service arrangement but it is not clear from the Discussion Paper how to treat assets where the services are provided by different entities. This could result in the double counting of assets in the K-AUM calculation so it would be helpful if the FCA could advise on the correct treatment of assets where both services are provided by different entities within the same group.

Treatment of cross-holdings
The IA would like the FCA to clarify the correct treatment of cross-holdings between two entities within the same group or which have the same ultimate parent company, where both of these entities are required to calculate an AUM-based capital requirement.

Client guarantees
Para 10.3 explains that investment firms that provide guarantees to clients need to hold additional liquid assets based on the total amount of guarantees they provide. The IA would welcome further information on the definition of client guarantees.

Consolidated liquidity requirements
According to the Discussion Paper, consolidated liquidity requirements can be satisfied by liquid asset holdings at a parent level, however it also states "investment firms in the group would already need to hold liquid assets to meet their own liquidity requirements on an individual basis". The IA would welcome confirmation that the minimum liquidity requirements need only be satisfied on a consolidated basis.

ICARA liquidity assessment
Para. 10.16 notes that the FCA would expect firms to consider their liquidity requirements as part of the ICARA process. Can the FCA provide more clarity on their expectations in relation to the liquidity assessment in the ICARA document?

SREP
The IA would welcome greater transparency around the frequency of SREPs as they apply to different categories of firms. Whilst it is appropriate that the FCA takes a risk-based approach to performing SREP visits, it would be useful to explain the criteria the FCA will use to determine how often a firm might expect them to occur.

Voting rights
Firms currently disclose certain voting information under the Shareholder Rights Directive (SRD II). The IA would welcome further explanation about what the additional requirements on voting disclosures will be under the IFPR.

Disclosures
The Discussion Paper states that "Investment firms with public disclosure requirements … are expected to publish them on the same date as they publish annual financial statements." For entities where the accounts are not published (e.g. a consolidating entity), what is the equivalent date for submission? For example, can firms use the date of

submission of the annual accounts to Companies House (or equivalent) as the date by which they need to publish the disclosures required?

Exemptions for significant investments and deferred tax assets
The IA does not agree with the EBA's view on the complexity of the CRR thresholds exemptions for: significant investments; deferred tax assets that rely on future profitability and arise due to temporary timing differences; the 17.65% combined threshold for the two aforementioned items; and non-significant investments. The IA's view is that firms subject to the CRR have been calculating these thresholds for a number of years, they are not overly complex in their application, and they recognise an agreed portion of the value/diversification of risk afforded by the items in question. We are also concerned that the differences to the CRR in this respect create level playing field concerns, in that that they effectively define a stricter definition of capital for investment firms compared with banks.

The IA suggests that the FCA continues to allow firms to utilise the threshold exemptions in CRR articles 46, 48, 60 and 70 in the calculation of capital resources. The IA also suggests, therefore, that the FCA continues to apply article 39, in relation deferred tax assets that do not rely on the future profitability of a firm, and article 41, in relation to deferred tax liabilities regarding defined benefit pension schemes.

35. Are there any specific areas where you believe that the requirements could be made even more appropriate for investment firms?

The IA reiterate that thresholds should be quoted in GBP under the final rules rather than EUR.

We would welcome some further clarity on the disclosure obligations set out in Chapter 15 of the Discussion Paper. For the disclosure of the investment policy, should firms assume that meeting the obligations under SRD II (and set out in COBS 2.2B) will be adequate to be compliant with the FCA disclosure requirements around the investment policy?

It would also be beneficial to understand how the ESG disclosure obligations will interact with the risk disclosures in the Sustainable Finance Disclosure Regulations (as implemented in EU and/or UK). The IA suggests that, as ESG disclosure requirements exist elsewhere in UK rules, that they should not be included under the IFPR.

Material Risk Takers
We would like to draw the FCA's attention to our response to the EBA's consultation on its Draft Regulatory Technical Standards (RTS) on criteria to identify categories of staff whose professional activities have a material impact on an investment firm's risk profile (MRTs).

Fixed to variable pay ratios
We support the FCA's approach that it is for firms to set an appropriate ratio between fixed and variable pay and firms should be given flexibility to determine the ratio(s) that are appropriate for the firm and for individuals with that firm taking into account all relevant factors.

Phased vesting during a deferral period
We assume that phased vesting during a deferral period will continue to be permissible.

Control Function employees
We agree that the remuneration of Control Function staff should not influence their independence, although it is important that firms have flexibility to adopt remuneration structures that are appropriate to their specific circumstances.

Reporting and disclosure requirements

We would like the FCA to note that the reporting requirements contained in IFD are much more onerous on firms than previous regimes and will require extensive preparation. For many UK investment firms this will materially expand the scope of the quantitative remuneration disclosures that are required. We request that non-SNI investment firms be able to disapply the public remuneration reporting requirements on the grounds of proportionality.

In addition, we request that firms which are not able to disapply the reporting requirements on the grounds of proportionality should be permitted to make the more specific items of the disclosure only to the regulator and not publicly.

In relation to the scope of disclosures, it is important that firms including multiple non-SNI firms must only be required to make a single consolidated disclosure (at the level of the group, or, as applicable, the level of the wider CRD consolidation group within which such firms sit), and not have to make duplication remuneration disclosures at the solo firm or sub-consolidated levels.

We welcome the FCA's intention to consult on its approach to collecting remuneration data from non-SNI investment firms, including data on the number of employees remunerated at EUR1 million or more.