THE
INVESTMENT
ASSOCIATION

IA response to consultation paper 20/24

A new UK prudential regime for MiFID investment firms

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 £7.7trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 40% 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 to creating a tailored UK prudential regime for MiFID investment firms and the further clarity on how firms are expected to implement aspects of the regime. We look forward to the next consultations in due course and would like the opportunity to revisit elements of this consultation response as further details are released.

In creating a tailored regime, the IA proposes that the FCA collate all relevant rules into a single sourcebook, rather than cross-referencing to other regimes like the CRR, in order to help firms more easily navigate the rulebook.

The IA would urge that the FCA apply the principle that transitioning from the CRR to the IFPR should not result in eroding the own funds of firms where this is due not to an increase in the assessment of risk, but as a result of a change in definitions.

The timeframe between now and implementation is short and the IA urge the FCA to allow for sufficient transition from firms' current capital positions to the requirements under the new rules. For example, transitioning from both BIPRU and CRR/CRDIV and the removal of thresholds is eroding the capital base of some firms. As such, we recommend the addition of clauses aligned to GENPRU 22.209(1). These would have the impact of reducing the quantum of the erosion of the capital base of firms without adding in a complex calculation. If this is not acceptable to the FCA then we would propose a 3 year transitional period to full application of the new own funds requirements.

Finally, although not captured in the questions, the IA would like to note that at present, firms that hold client money use close of business balances for their reporting to the FCA. For SNIs. the MIFIDPRU handbook refers to intraday values to assess client money held. The IA do not see any benefit in asking firms to change their current approach and capture intra-day values. The levels of client money held intra-day are influenced by the processes of third parties, such as banks, as much as the investment firms themselves, and these third parties have their own capital and liquidity requirements to capture these risks intra-day. In addition, the IA would like the FCA to confirm whether it intends for non-SNI firms to use the same basis for calculating K-CMH.

1. Do you agree that FCA investment firms with permission to deal on own account and/or underwrite or place financial instruments on a firm commitment basis (as indicated by a permission to deal as principal in financial instruments) should not be considered an SNI? If not, please include in your response what you consider to be a suitable quantitative threshold for these activities.

The IA agree that principal-based trading represents increased risk over agency-based business and thus are not suitable for the lower risk reporting under SNI. However, the CP refers to "permission to deal as principal" (para 1.30, 5.14). The IA would like a definition of this, with accompanying examples, to help investment firms understand the activities captured by this term.

The IA propose that "matched principal" activity is arguably of lesser risk and there are arguments that such firms could be considered SNI that should be considered by the FCA.

Whilst for most firms the application of SNI criteria is clear, to assist the IA's members, it would be helpful if the FCA could explain how it intends to tell firms if they are an SNI/non-SNI firm or whether it will be left to firms determine this themselves.

2. Do you agree with the quantitative thresholds, as set out in Figure 1, that we are proposing? If not, please include in your response what you consider to be suitable quantitative thresholds.

In order to assist the FCA in considering suitable quantitative thresholds, it would be useful to understand what the aim of the FCA is in this regard. For example, is the intention to ensure private equity businesses are caught under the rules?

The IA would also suggest that the limits are reviewed every 3 years to deal with changes in the industry as a whole and ensure the thresholds are appropriately calibrated.

3. Do you think that any other criteria should be considered for determining if an FCA investment firm can be an SNI? Please provide examples and thresholds as appropriate.

The IA do not think any other criteria is required at present but propose that this is reviewed further as the UK-specific regime evolves. There should also be consideration given to CASS firm criteria when this occurs.

4. Do you have any specific comments on our proposals for the scope and methods of prudential consolidation? Please provide evidence to

support any changes. Is there anything relevant to consolidation that is not covered in our rule proposals?

Status of CPM/CPMI/insurance firms in prudential consolidation
Paragraph 1.4 confirms that the draft rules apply to Collective Portfolio Management Investment (CPMI) and the paper explains that the FCA intend to set out how the draft rules apply to CPMIs in a subsequent consultation. It would be helpful if the FCA could confirm how CPMIs and AFMs, as well as other non-MiFID firms, are caught by the new regime for consolidation purposes. The IA is of the view that the new regime only applies to MiFID top-up activities for UK companies, but would like the FCA to confirm that entities that do not have MiFID top-ups may be excluded from the scope of IFPR. For example, we seek clarity over whether the FCA will continue the GENPRU 3 treatment of Solvency II insurance subsidiaries within the group.

Connected undertakings
The concept of "connected undertaking" (see para 3.16) is quite broad and may potentially broaden the scope of existing consolidation groups. This may have pros and cons – for example, it may be more complex to have a larger consolidation group, especially if composed of different funds groups, but there may be certain benefits from netting within the consolidation group. Given the wide range of different group structures this concept will impact IA members differently. Considerations include: their corporate structure, voting rights, management, whether a standalone investment manager or part of a wider financial group, whether they already apply prudential consolidation, etc. The wording in the consultation paper seems to suggest that the list of factors that firms should consider when making a determination on collective undertakings is not exhaustive. Therefore, the IA would request further clarification on what material "connected undertakings" are (see paragraph 3.88), with thresholds and ask the FCA to confirm that where the prudential consolidation is different from the accounting consolidation there is not a need to have the prudential consolidation independently verified.

Waiver for use of accounting consolidation
The IA notes that paragraph 3.7 mentions that an FCA Investment Group will comprise a UK parent undertaking and its 'relevant subsidiaries', as defined in 3.11. For larger groups with multiple subsidiaries, which may not all meet the definition of 'relevant subsidiaries', this could create complexity as there could be material differences to the accounting consolidation group. The IA would like the FCA to clarify that it would be allowable to follow the accounting consolidation group in these cases.

The current rules are also not clear whether certain firms are able to apply consolidation and the Group Capital Test. For example, some firms under common ownership, with the parent entity outside the UK/EU, currently have no consolidation groups under current rules; does this mean that prudential consolidation does not apply? Further clarity on what a firm without a UK holding company is able to do for consolidation purposes is welcome.

In using the Group Capital Test, the IA would like further guidance on what the book value of assets is. The IA's view is that it should be cost less impairment.

Paragraph 3.31 indicates that notification to the FCA is required before applying proportional consolidation. It would be helpful if an expected timeline by which the notification is required is added to the finalised handbook.

While we note that there has been potential for different treatments of seed capital holdings across firms subject to the CRR, we have highlighted above the need for confirmation that the FCA does not see Collective Investment in Transferable Securities (UCITS) funds as FSE. Therefore, the IA would like clarification on the appropriate treatment from an own funds resources perspective under the IFPR for instances where a firm holds units in a collective investment undertaking which are subject to accounting consolidation. At present holdings in UCITS could be treated as one of the following:

- Qualifying holding – under article 89 of the CRR
- Exposure to units in a collective investment undertaking (CIU) and subject to credit risk weighting under article 132 of the CRR.

This clarification would include whether UCITS meet the definition of qualifying holdings if a firm holds more than 10% of the capital or voting rights and deemed to be held for the long-term in line with the CRR. This is particularly important for seed funds where firms in the Group Capital Test.

5. Are our proposals for how to calculate the consolidated own fund requirements (including the consolidated fixed overheads requirement, the consolidated permanent minimum requirement and the consolidated K-factor requirement) clear and sufficient? If not, do you have any specific suggestions for how to improve this?

K-AUM and K-CMH

Para 2.5.29 (2) of the draft MIFIDPRU sourcebook notes that, for the purpose of the consolidated K-AUM calculation, only amounts relating to MIFIDPRU investment firms should be consolidated. Annex B of CP 20/24 defines a 'MFIDIPRU investment firm' in such a way as to exclude any activity which is not a MiFID activity. In CP20/24, the narrative relating to the K-AUM factor does not explicitly refer to "MiFID business". However, for the K-CMH factor, para 2.5.30 (2) of the draft MIFIDPRU sourcebook makes explicit reference to "MiFID business" when detailing the scope of the consolidated K-CMH requirements. The IA would welcome confirmation on whether the services and/or activities to be included in the K-AUM and K-CMH calculations are consistent. If not, further details of the differences in scope between the two calculations would be helpful.

CPMI firms in the consolidated situation

Para 3.38 of the consultation paper notes that, "When calculating the contribution of a CPMI firm to the consolidated situation, the UK parent would be required to include only amounts that are attributable to the investment services and/or activities that CPMI firm undertakes". Para 3.42 (Consolidated FOR) of the consultation paper advises that the FCA would expect a UK parent to use audited consolidated annual financial statements as the basis for its fixed overheads. However, the guidance for calculating the consolidated FOR does not include any allowance for deductions relating to fixed overheads incurred in a CPMI. The fixed overheads of a CPMI would, generally, be comprised of overheads incurred in relation to both the AIFM/UCITS activities of the CPMI and the overheads incurred in relation to the investment services and/or activities of the CPMI. Clarity on the permissibility of a deduction reflecting the nature of fixed overheads in a CPMI would be welcome. In addition, an appropriate methodology for determining such a deduction would also be helpful i.e. an appropriate methodology for the apportionment of fixed overheads between the AIFM/UCITS activities and the investment services and/or activities of a CPMI.

Clarity on the treatment of fixed overheads relating to CPMs (or third-country equivalents i.e. AIFMs and UCITS managers) where such entities are included in audited consolidated annual financial statements would also be welcome.

Materiality

Para 2.5.26 of the draft MIFIDPRU sourcebook notes "where the FCA considers that there has been a material change in the activities of the investment firm group, the FCA may … require a UK parent entity to use an appropriate adjusted figure as the consolidated fixed overheads requirement". However, neither the draft MIFIDPRU sourcebook text or the consultation paper text details the methodology which would be adopted in making such a decision. Further information on this methodology to be used would be appreciated, for example can the FCA provide the thresholds which the FCA would apply in determining that a revised consolidated FOR should be adopted? We would also welcome clarity on the process to be followed if a revised consolidated FOR is deemed necessary.

Consolidated liquidity requirements - guarantees

Para 2.5.48 (1) of the draft MIFIDPRU sourcebook notes that the consolidated liquidity requirement will require a consolidation group to hold liquid assets equal to or greater than one third of the consolidated FOR plus "1.6% of the client guarantees provided to clients by entities included within the consolidated situation". The IA would welcome clarity on the following matters:

- The definition of "client guarantees" to be applied for the purpose of the IFPR liquidity requirements, and
- Whether there is any restriction to the scope of services and/or activities which should be included when calculating the client guarantee component of the consolidated liquidity requirement i.e. should this be limited to client guarantees provided in the course of the MiFID business performed by the entities in the consolidated group?

Interaction with EBA requirements

Para 2.5.48 (2) of the draft MIFIDPRU sourcebook notes that an investment firm group must satisfy its consolidated liquidity requirement by holding liquid assets in a UK entity, even if the consolidated liquidity requirement is in part driven by third country entities which contribute to the consolidated FOR.

Para 2.5.19 (2(a)) of the draft MIFIDPRU sourcebook notes that an exemption to the consolidated liquidity requirement may be available where "all MIFIDPRU investment firms in the investment firm group are subject to the rules in MIFIDPRU 6… on an individual basis". We would welcome confirmation of whether the FCA envisages the application of this rule on an equivalence basis for MIFIDPRU investment firms which are included within an investment firm group, but which are third country entities. This would be particularly relevant for entities in EEA member states which will be subject to the IFR.

In the instance that an investment firm group is subject to consolidation in more than one jurisdiction (for example, where a group is subject to consolidation in the UK and in an EEA member state) the requirement to hold consolidated liquid assets in the UK may result in the group satisfying a consolidated liquidity requirement twice in respect of the same underlying liquidity requirement. The availability of the exemption outlined in para 2.5.19

(2) on an equivalence basis may provide investment firm groups with an opportunity to avoid such a situation, whilst still complying with the underlying IFPR/IFR liquidity requirement on an individual basis.

K-NPR – offsetting of positions within group
In regard to K-NPR, we suggest that it should be possible for UK parent companies to be able to automatically offset positions in one entity with those of another entity in the consolidation group, without having to notify or obtain permission from the FCA. Paragraph 3.64 also states that once it does apply, it would apply to non-trading book positions where they give rise to foreign exchange risk or commodity risk. However, it would be helpful to clarify that it will not apply at all to firms that do not have any entities that can trade on their own account within the group as alluded to in the FCA webinar on this regime in 2020.

Use of unaudited consolidated financial statements
Paragraph 3.42 indicates that unaudited consolidated financial statements can be used when audited statements are not available. It would be helpful to clarify the circumstances under which this would be acceptable for both the own funds and fixed overhead requirement calculations. In a scenario where there is no statutory requirement under company law for consolidated statements of the investment firm group, can unaudited financial statements be used, or should non-statutory audited financial statements be prepared for the investment firm group?

6. Do you agree with our approach towards the use of the group capital test (as an alternative to prudential consolidation), including our proposal for a transitional provision to allow its use as part of our initial implementation of the IFPR?

The IA agrees with the approach.

7. Do you agree with the proposals for the definitions and types of, and deductions from, regulatory capital that investment firms should use to calculate their own funds? Do you think that any additional simplification is needed? If yes, please provide suggestions.

Deductions from own funds
The IA would like the FCA to reassess the decision to not transpose several articles from the UK CRR to the IFPR. These articles, referred to throughout section 3 of the CP, provide firms with thresholds and offsets in the calculation of the deductions required from own funds. This decision to disapply these articles has met the objective of simplifying the calculation of own funds, but with the consequence of eroding the own funds of firms transitioning from the CRR to the IFPR. We would request that the FCA reconsider the omission of the articles in the UK CRR which provide firms with thresholds and offsets when calculating the deductions required from own funds. The impact of which is likely to require firms to introduce more capital, not as a result of an increase in the assessment of risk, but purely as a result of a change in the definition of own funds. IA members firms are

comfortable with the potential for additional complexity as it leads to the maintenance of the current capital base of firms.

We disagree that software assets should be deducted in full in all cases, and we encourage the FCA to adopt the approach being taken in EU CRR2.

The UK CRR contains numerous items that need to be deducted from the different tiers of own funds. This includes certain deductions which, under the UK CRR, have the potential for partial deduction according to a detailed calculation. It is proposed that defined benefit pension fund assets on the balance sheet of the institution are deducted in full under the IFPR. This has been proposed on the basis that the amount of defined benefit assets held on investment firm's balance sheet is immaterial, so the FCA expect that for FCA investment firms, deduction rather than risk weighting will have little or no impact on firms' costs. This is not immaterial for a number of firms, which will see capital resources decrease materially from the inclusion of the DB pension asset's deferred tax also included in the deductions. Retaining the CRR exemptions will ensure an equally onerous approach. It is stated that IFPR firms should have a more proportionate approach to capital compared to banks, however the current approach proposed results in the opposite outcome.

We would recommend that the FCA adopt rules aligned to GENPRU 2.2.209. This requires deduction of a holding when either

i) the investment firm holds more than 10% of the issued share capital of the financial sector entity. In this case the entire value of the investment is deducted or

ii) the investment firm holds less than 10% of the shares of the financial sector entity, but the value of the holding exceeds 10% of the investment firm's capital. In this case the investment firm deducts the excess amount over the 10% of the firm's capital.

The IA do not support the FCA proposal for deferred tax assets that rely on future profitability should be deducted in full under the IFPR. We are 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. If adopting the UK CRR requirements is not acceptable then we would propose that the value of deferred tax assets that rely on future profitability in excess of 10% of the firm's own funds should be deducted from capital.

If the proposals relating to the deductions are not acceptable then we would request the FCA provide a 3-year transitional period to allow firms to build up capital in a measured fashion.

Section 3.3.13 provides firms with an exemption from the deduction of holdings in subsidiaries where certain conditions apply. One of these conditions is that "the risk evaluation, measurement and control procedures of the parent undertaking include the financial sector entity." In the situation where an investment firm is both a subsidiary and a parent entity (i.e. it is an intermediate parent firm and a parent, child, grandchild relationship exists) clarification is required as to whether the ultimate parent or parent is required to include the lowest level subsidiary in the risk evaluation, measurement and control procedures for the condition to be met. In many instances the risk management framework will be applied at the UK group level, incorporating all entities, not at the intermediate parent level. We would also welcome some consideration as to how this condition would interact with any decision to require all firms to conduct the ICARA at an individual firm level, which we have previously stated should be at the discretion of the firm to decide whether this is done at group or solo level.

Financial Sector Entities

As the IFPR expects to adopt large elements of the UK CRR, we would like the FCA to confirm that the stated position of the EBA in Q&A 2015_2383 will also be transposed. The EBA stated that "Undertakings for Collective Investment in Transferable Securities (UCITS), as defined in Article 1(2) of Directive 2009/65/EC, and equivalents funds in third countries … are not considered as "financial sector entities" based on point (27) of Article 4(1) CRR as long as they do not pursue one or more of the activities listed in points 2 to 12 and point 15 of Annex I to Directive 2013/36/EU as their principal activities." This confirmation is likely to ensure a consistent interpretation and application of the requirements relating to investment in financial sector entities. This treatment is expected to have a material impact on the own funds of several firms.

The IA propose the FCA follow the approach in CRR for transitioning Tier 3 capital over a period up to 5 years in order to avoid a costly need for short-term recapitalisation.

8. Do you agree with our proposals for trigger events for the conversion or write-down of AT1 instruments, including setting the minimum the same as under the UK CRR but expressed in a different way to reflect the structure of capital under the IFPR? If not, please let us know why and what trigger events you think there should be instead?

The IA support the proposals for this expression in the same terms as the rest of the IFPR.

9. Do you agree with our proposed transitional provisions for existing permissions in respect of own funds instruments (under UK CRR)? Do you think that any additional transitional provisions are necessary and if so, please identify what they should be and why?

The IA welcomes the consistency that the new rules provide firms in the treatment of own funds instruments. We agree that providing additional information on the procedures required to include interim profits during the transitional period will help firms to plan. Additionally, the clarification of the characteristics of partnership capital that meet the conditions provides that sub-set of firms with the assurance they sought.

We welcome the FCA providing additional information as to how the requirements of section 3.3.3 and 3.3.4 will be applied. We would seek clarity of the requirement for firms not previously subject to the UK CRR to seek permission for own funds instruments that have been issued under the now superseded regime. Several member firms will issue instruments annually and we would seek a pragmatic solution to ensure that there is not an undue burden placed on firms or the FCA in the first year of the new regime. Going forward, we would also seek clarity on what period the FCA feels is “sufficient” when firms are notifying them of the subsequent issuance of own funds instruments.

The IA would like to reiterate from its response to the FCA Discussion Paper, that the IA would like clarity 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 should remain and be grandfathered to enable firms to continue under their current conditions.

10. Are our proposals for the PMR sufficiently clear, including how it interacts with the ICR? If not, please explain what else could help.

We feel that the guidance provided on the relationship and interaction between the PMR and ICR are sufficiently clear and do not have any further recommendations.

11. Do you agree with our approach to K-NPR, which carries forward the current approaches to calculating market risk used in the UK CRR, including relevant rules and guidance from our current prudential sourcebooks?

IA member firms do not, as a rule, have trading permissions, and as such, we have not answered the detailed questions on the K-factors. That said, we welcome the statement within paragraph 4.11.4 relating to the calculation of K-NPR. This provides the clarity required that there is no requirement to calculate K-NPR for firms which do not have trading permissions but who have foreign currency exposures in their non-trading book.

Paragraph 5.25 states “the approach to K -NPR is essentially to carry forward the current market risk requirements under the UK CRR. The FCA therefore propose to carry forward the rules & guidance on market risk from the IFPRU sourcebook.” Firms currently covered by IFPRU calculate a credit risk requirement on the risk retention held in particular instruments e.g. CLOs. The wording in MIFIDPRU 4.11.4 regarding K-NPR could be tweaked to clarify that K-NPR relates to firms that deal on their own account *or act as a sponsor or originator*.

The IA propose that there should be a single sourcebook for firms under the IFPR, rather than referring back to CRR or other sourcebooks to assist in firms more easily navigating the applicable rules.

12. Are the requirements relating to the application and calculation of K-CMG sufficient, or do you have any specific suggestions for improvement?

The IA has no comments on the application or calculation of K-CMG.

13. Do you have any specific comments on our detailed proposals for calculating the K-TCD, including the approach to potential future exposure?

The IA has no comments on the proposals for calculating the K-TCD.

14. Are our proposals for how to calculate K-DTF sufficiently clear? And should there be the possibility of an adjustment to calculating the coefficients for K-DTF in periods of extreme market stress and volatility? What specific suggestions do you have, and how could any adjustment operate effectively within the proposed framework for calculating K-DTF?

The IA has no comments on the proposals for calculating the K-DTF.

15. Do you agree with our proposals for the various transitional provisions relating to own funds requirements and that they cover all relevant situations? If not, what specific suggestions do you have?

The IA supports the proportionate approach to allowing firms that face a significant increase in their own funds requirement to defer the impact of the change in the requirements.

Para 6.31 of the consultation paper notes “If an FCA investment firm does not have a TP for its FOR, there is no credit available”. Can the FCA please clarify whether this limitation is referring to:

- category of firms for which an FOR TP is not available; or
- firms for which an FOR TP is available but where it is not applicable on an individual basis because, for example, the KFR TP amount is higher than the FOR TP amount and therefore takes precedence.

In clause 6.27, the FCA notes that it will allow firms to apply a “credit” to their consolidated own funds requirement. The consultation paper states that “this credit is based on the difference between the full MIFIDPRU requirement for each FCA investment firm that is part of the consolidated situation and its transitional requirement on an individual basis”. There appears to be no facility to apply a credit where an uplift in the consolidated own funds requirement is caused by other subsidiaries (i.e. non FCA investment firms) that form part of the consolidation group. As an example, there appears to be no transitional arrangement to enable a firm to manage a significant increase in the FOR relating to the change in the calculation methodology and its impact on the element of the consolidated FOR that is driven by third country subsidiaries.

16. Are our suggestions for the transitional provisions for the initial collection and use of K-factor metrics practical? Do you have any specific suggestions for improvement?

Given the delay in publishing more final definitions for the K-factor calculation, the issuance of these transitional provisions is essential. They provide sensible options for firms, either by using explainable estimates of historical data, or by using only data commencing from the month before the effective date of the IFPR.

Using generally accepted measures for AUM (e.g. NAV) should mean that all firms will be in the position to utilise historical data at minimal effort. The use of Gross Asset Value or Gross Plus (the terms used when negatives values are converted to positive and added to Gross Asset Value) would mean that firms would need to avail themselves of the transitional provisions or undertake significant re-work of historical data. The delayed publication of the KFR calculation definitions will mean that some firms are unable to benefit from the smoothing and lagging of metrics that is expected to be in the IFPR.

It is still the position of the IA that NAV should be used in the calculation of K-AUM and K-ASA.

17. If we did not introduce our proposed transitional provisions on advanced data collection of the K-factor metrics, what alternative solution would you propose?

The linkage between TP5 and TP4 appears to mean that the two transitional provisions are inter-reliant. The proposal to mandate the collection of advanced data does not feel unreasonable, so long as the final definitions are provided in time to allow firms to design, test and implement the data collection process.

The IA would like to understand whether it is the case that the firm would assess its capital adequacy against this single month's data, if the KFR was the biting requirement? If this was the case, then the use of a single month's data does not provide the firm with the benefits of the smoothing and lagging that the final calculation is expected to provide. This position would continue, with the benefit of smoothing as time passed, for the first 15 months of the new regime.

The IA would like to revisit this issue when the next consultation is published with more detail on K-Factor metrics.

18. Do you have any comments on the proposal for monitoring and control of concentration risk? Please provide suggestions for any specific clarifications that you feel may be helpful.

The IA would like to understand what the FCA's intentions are for this reporting as it is not clear whether the intention is to capture aggregate exposure to a group. The IA has concerns over disclosing LEIs, for example, on confidentiality grounds and would prefer to be able to use internal coding, as discussed in our response to question 23.

In MIFIDPRU 5.2, the FCA lists sources of concentration risk that all firms should monitor and control above and beyond exposures in the trading book. The requirement is to have sound administrative and accounting procedures and robust internal control mechanisms. If we are to report in MIF004 on these sources of concentration (non-trading book assets, off-balance sheet items, location of client money, location of custody assets, location of its own cash deposits, the sources of its earnings) will there be any form of quantitative concentration thresholds that must be adhered to? Also, exposures from non-trading book assets and off-balance sheet items are familiar to firms under the CRR regime, but the FCA are now introducing a concept of concentration for client money, custodied assets and own cash deposits, which will be unfamiliar to many IA members, particularly smaller firms.

The IA would like the FCA to confirm that location refers to "with whom" the items are lodged as this is already covered by the understood concept of large exposure so do not warrant separate attention, rather than introducing geographical concentration.

MIFIDPRU 5.2.2 asks firms to consider concentration in respect of earnings, which we would recommend are better viewed under the ICARA than under a Pillar 1 process.

Under articles 5.1.14 and 5.1.15(1) the FCA refer only to regional governments and local authorities that can be treated as exposures to a central government:

- Does this mean that PSE's that can be considered exposures to a central government cannot be treated as such under these rules as is the case under CRR article 116(4)?
- Also, under 5.15.15(2) the rules only stipulate how you can find out what regional governments and local authorities are treated as exposures to the UK Government. It makes no reference as to how this should be done for other jurisdictions or indeed whether other jurisdictions are covered by 5.1.14 and 5.1.15.

19. Are the proposed concentration risk requirements for investment firms that deal on own account sufficiently clear? For example, how to determine the soft limit for exposures to a group of clients involving a mixture of banks and investment firms and corporates? If not, what improvements would you suggest?

For the monitoring and control of concentration risk outside of the trading book, some additional areas of clarification that would be helpful are:

- Definition of client – MIFIDPRU 5.1.11 defines client as a counterparty of a firm. How should this apply in the Earnings Concentration of an investment manager? Earnings will largely be collected from the funds that the firm manages as agent and the funds themselves would be considered the counterparty. Is this in line with what would be expected under this metric?

- Treatment of intercompany exposures for earnings concentration – For entities within Investment Firm Groups, a large counterparty (i.e. client per definition in MIFIDPRU) will likely be intercompany recharges.

For consolidation groups, does concentration reporting of client money held apply only to CMH within MiFiD entities. Or, for example, would client money held within CPM firms that are within the group also be required to be captured?

The IA request confirmation in paragraph 5.4.1R (1) that exposures to the underlying positions of derivatives and credit derivatives are brought into the K-CON calculation and that there will be no additional rules adopted to reflect such exposures in accordance with those being brought into CRR2 as part of Article 390(5) and the yet unadopted rules in the EBA draft RTS (EBA/CP/2020/14). Similarly, the FCA should recognise exposures to the underlying issuers of collateral used to reduce counterparty credit risk exposures in line with that adopted under CRR2 article 401(4).

The IA do not agree that immediate notification is required as set out in paragraph 5.6.2 in relation to a large exposure that exceeds the concentration risk soft limit, which is a departure from the requirement for banks and other CRR investment firms where immediate notification is required only for non-trading book exposures that breach the 25% limit.

The worked examples of the K-CON own funds requirement calculation in 5.7.6 and 5.7.7 are useful. We request for a more comprehensive example calculation with a mix of exposures and confirmation that firms are free to allocate exposures to the first 25% as appropriate.

20. Would you suggest any specific changes to our proposals for commodity and emission allowance dealers?

The IA has no comments on these proposals.

21. Do you agree that all FCA investment firms should have the same basic regulatory reporting forms? If not, what changes to the regulatory reporting form do you suggest, and to which types of investment firm should they apply?

The IA agrees with the FCA's view that all FCA firms should have the same basic regulatory reporting forms, which should create better alignment across the industry. We welcome the FCA's introduction of simplified, less onerous reporting.

One area that might be useful to consider is for the returns to require more information on FOR, to include main deduction categories and the value of the deductions under each.

22. Do you agree with the frequency of the reporting? If not, please state what the frequency should be and explain why.

The IA agrees that the new IFPR reporting forms should be submitted quarterly. FSA029 and FSA030 reporting should remain bi-annual for SNI Investment Firms to ensure that the approach taken to reporting remains proportionate. This will reduce the data collection and processing time for small firms but will still ensure that the FCA have regular information to assess the financial adequacy of the entities in question.

23. Do you think that the instructions for completing the regulatory forms are clear? If not, please specify where additional detail is required and what level of additional detail would be helpful.

The IA welcomes the relatively straightforward layout and proportionate scope of the proposed regulatory forms. The IA would suggest further guidance could be improved to include:

- Information on the FCA expectations in the first year of the regime.
- There be more information provided on the transition powers used.
- Source of additional capital requirement in year 1.
- The IA is awaiting further details on the calculation of Risk To Client K-factors before responding further in relation to MIF003 Monitoring Metrics, but it should be amended to have "K-AUM" at data point 3 (repeat for each KFR in MIF003).
- Further clarity is requested for MIF004 Non-K-CON concentration risk reporting in respect of the definitions of 'exposures', 'client securities' and 'cash'. In particular, whether on and off-balance sheet exposures are included.
- For MIF002 Liquidity – Whether firms show the MMF manager as the counterparty and full MMF holding or show the underlying bank as the counterparty and underlying exposure to that bank. An investment firm could have exposure to a counterparty directly and through a MMF investment. Would you sum the exposures and mark Y in column C if a proportion of the exposure is from an MMF?
- Confirm that MIF006 GCT Reporting is only needed for firms that do not prepare a full prudential consolidation.

Finally, as mentioned earlier in our response, the IA is concerned about the identification of client LEIs in earnings concentration reporting. As an alternative, the following options could be considered:

- Application of a minimum threshold of 20% for reporting of earnings.
- Reporting of earnings by geography and/or industrial sector, rather than clients.
- If client earnings must be reported, the ability to report using an internal code instead of a client LEI.

The minimum threshold of 20% reduces de minimis reporting and focuses on areas of the highest potential concentration risk. Reporting of earnings by geography and/or industrial sector may be more useful to the FCA as an indication of any concentration risk for the MiFID investment firms as a whole, for example, to a particular geography or industrial sector.

The IA propose that the FCA make explicit that investment management firms' main banking relationships will be an accepted concentration risk for investment firms.