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The UK’s FCA Reports on a Multi-firm Review of Investment Firms Internal Capital Adequacy Assessment Processes

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The UK’s Financial Conduct Authority (“FCA“) has published its final report on the implementation of the Investment Firms Prudential Regime (“IFPR”) “*IFPR implementation observations: quantifying threshold requirements and managing financial resources – concluding report.*”

The report is the conclusion of a review of the implementation of IFPR for 3,500 MiFID investment firms that are prudentially regulated by the FCA, and while it concludes that firms have generally engaged well with IFPR requirements, there are areas where improvement is needed:

1. Liquid Asset Assessments

The FCA has observed that firms are not assessing liquid asset requirements to cover periods of liquidity stress. As part of the internal capital adequacy and risk assessment (“ICARA”) process, MiFID investment firms must process, assess and monitor the adequacy of their liquid assets and capital and liquidity planning to make sure that they can withstand severe but plausible stresses while minimising harm. The FCA is concerned that the firm's plans for liquidity coverage during such times of stress are “*insufficiently time-granular*” to identify mismatches between cash requirements and cash flows, particularly when winding down. Firms are also failing to distinguish between own funds and liquid assets needs, further jeopardising orderly wind-downs.

2. Early Warning Indicators, Triggers, and Interventions

Being able to spot early warnings and triggers allows firms to identify when they should intervene. The FCA observed that firms are generally identifying two main internal intervention points at times of stress: (1) the activation of the recovery plan; and (2) the activation of the wind-down plan, and is concerned that firms are not actually identifying the right time to intervene and the right amount of

resources needed above and beyond threshold requirements. The FCA wants to see more effective use of stress testing to better understand appropriate intervention points and resources buffers.

3. Wind-down Plans

Here, the FCA calls for greater consideration of the role of group governance and group risk appetite statements when formulating wind-down plans for individual group entities. This is important in order to be able to assess group-wide impacts, which may include the wind-down of other group entities, as well as the dependencies that exist intra-group which will be affected.

4. Operational Risk Capital Assessments

The FCA has identified poor practices in assessing operational risk capital, including the inappropriate use of group models and poor governance and oversight over modelling. These poor practices lead to an incomplete assessment of risk, with consequent failures of resourcing when those risks crystallise.

Next Steps

While none of the FCA's observations involve policy change, the FCA's expectation is that firms will review their own practices to make sure they are meeting rules and requirements already in place. The final report also includes a comprehensive list of good and poor practices the FCA review found, and firms can cross-check these against their own.