Unpacking the IFPR transitional provisions

The FCA' s first and second consultation papers (CPs) on the new UK prudential regime for MiFID investment firms provide clarity on the prudential sourcebook for MiFID investment firms known as MIFIDPRU transitional provisions (TPs) which will provide for a phased application of the full own funds requirements (OFR).

For non-small and non-interconnected (Non-SNI) firms, CPs confirm that the OFR of a non-SNI MIFIDPRU investment firm will be the highest of its:

1. permanent minimum capital requirement (PMR);
2. fixed overheads requirement (FOR); or
3. K-Factor Requirement (KFR).

For small and non-interconnected (SNI) firms, the own funds requirement will be the higher of its:

1. PMR; and
2. FOR.

For the PMR, the CPs repeat the guidance in the FCA's June 2020 discussion paper that the initial capital requirement (i.e. the amount of capital that a firm must hold at the point of authorisation) must not be less than its PMR. The amount of PMR will also be more than the analogous amounts which investment firms are currently required to hold. TP2 contains the TPs for OFR and, taken together with PMR, will have the effect set out in the following table.

Investment firm service/activity	**Current amount of capital resources**	**TP year one**	**TP year two**	**TP year three**	**TP year four**	**TP year five**	**End of year five onwards = PMR**
Currently IFPRU 730K firms ▪ Dealing on own account ▪ Underwriting and/or placing on a firm commitment basis ▪ Operating an OTF without a limitation that prevents both matched principal trading	€730,000	£730,000	£735,000	£740,000	£745,000	£750,000	£750,000
Firms currently relying on matched principal exemption	€50,000 for currently BIPRU firms €125,000 for currently IFPRU 125K firms	£250,000	£190,000	£330,000	£470,000	£610,000	£750,000

Investment firm service/activity	Current amount of capital resources	TP year one	TP year two	TP year three	TP year four	TP year five	End of year five onwards = PMR
Currently BIPRU firms ▪ Reception and transmission of orders ▪ Execution of orders on behalf of clients ▪ Portfolio management ▪ Investment advice ▪ Placing without a firm commitment basis ▪ The firm does not have permission to hold client money or securities in the course of MiFID activities	€50,000	£50,000	£55,000	£60,000	£65,000	£70,000	£75,000
Currently Exempt CAD firms ▪ Reception and transmission of orders ▪ Investment advice ▪ The firm **does not have permission** to hold client money or securities in the course of MiFID activities	€50,000 or €25,000 + PI insurance	£50,000	£55,000	£60,000	£65,000	£70,000	
▪ All other activities, e.g. operating an MTF ▪ For activities above, e.g. portfolio management, the firm **does have permission** to hold client money or securities in the course of MiFID activities (currently IFPRU 125K firms)	€125,000	£125,000	£130,000	£135,000	£140,000	£145,000	£150,000

Notes: there are additional rules for “local firms” and exempt commodities firms.

Other points on the TP2 for the FOR and KFR calculations worth noting

- TP2 effectively caps the FOR or KFR at twice the current own funds requirement for an IFPRU or BIPRU firm. Firms will have to recalculate the alternative requirement regularly, with the FCA proposing that this be done quarterly.
- TP2 allows an investment firm, that was not a MiFID investment firm in the UK immediately before the IFPR takes effect, to cap its KFR at twice its FOR.
- For a currently Exempt CAD firm (assuming (a) a FOR or KFR > PMR and (b) that it is a non-SNI firm) TP 2 will have the following effect on the calculation of its FOR or KFR.

TP year one	TP year two	TP year three	TP year four	TP year five	End of year five onwards
£50,000 (i.e. transitional PMR for TP year 1)	10% of FOR or KFR (whichever is higher and > PMR)	25% of FOR or KFR (whichever is higher and > PMR)	45% of FOR or KFR (whichever is higher and > PMR)	70% of FOR or KFR (whichever is higher and > PMR)	100% of FOR or KFR (whichever is higher and > PMR)

Main points on the TP4, which governs K-factor metric calculations

- For calculating the KFR metrics, TP4 will require historical observations of data points for some K-factors that stretch back for considerable periods of time before 1 January 2022.
- TP4 will allow a firm to use reasonable estimates to fill any missing historical data but will require firms to use the same method until the form has sufficient data.
- TP4 will require a firm to first calculate the relevant average value for the K-factor using the monthly value for assets under management K-factor or the daily value for the remaining K-factors, applying a formula by reference to when the IFPR came into effect.

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