Under the IFR, the regulators are effectively signalling the end of the 'local firm' requirement awarded under CRDIV. Local firms will be treated the same as principal dealers for prudential purposes under the IFD/IFR

- Local firms are currently subject to a significantly lower EUR50K initial capital requirement awarded through CRDIV based on clearing guarantees received whilst dealing on their own account. Under the IFR, the regulators are effectively signalling the end of the 'local firm' requirement awarded under CRDIV
- The new initial capital requirement (ICR) will be EUR750K for all firms dealing on own account including local firms
- Local firms that currently do not hold own funds (share capital, retained earnings/losses, etc) that amount to EUR750K might want to engage in immediate capital planning (transitional provisions are available up to five years, see below)

Transitional provisions for ICR available for local firms

- Given the significant increase in ICR to EUR750K under the IFD, the transitional provisions below will be available to local firms
    - 26 June 2021 to 25 June 2022 to EUR 250k
    - 26 June 2022 to 25 June 2023 to EUR 350k
    - 26 June 2023 to 25 June 2024 to EUR 450k
    - 26 June 2024 to 25 June 2025 to EUR 550k
    - 26 June 2025 to 25 June 2026 to EUR 650k
    - 26 June 2026 and beyond EUR750K

Fixed Overhead Requirement (FOR) to be met by all investment firms

- A fixed overhead requirement (FOR) must be quantified and held by local firms. The FOR is calculated by taking a quarter of annual fixed overhead costs

New liquidity requirements to be met by local firms

- Under the IFR the mandatory liquidity requirement will apply to local firms. The requirement is to hold an amount of liquid assets equivalent to at least one third of the FOR

K-factor variable capital requirements will apply to local firms- salient points below

- K-DTF (daily trading flow): For DTF what is included under a 'cash trade' is not defined within the IFR. The FCA believes it should include transactions where purchase and settlement of the instrument takes place on the same trading day, or in line with a market standard settlement or delivery date (or earlier). This will include transactions covering transferable securities, money-market instruments, units in a collective investment scheme or exchange traded options
- K-CMG (clearing members guarantee): Investment firms may only use K-CMG when the competent authority permits its use

Local firms will be required to document an ICARA (internal capital adequacy and risk assessment)

- Local firms are currently not required to document an internal capital adequacy assessment process (ICAAP) like most BIPRU and IFPRU firms do. However, under the IFR, local firms will be treated no different to other investment firms and will be required to document an internal capital adequacy and risk assessment (ICARA) to capture capital adequacy, liquidity assessment, and stress testing

Implementing Pillar 1 and Pillar 2 (P2R and P2G) will require work from local firms who were previously not subject to these requirements

- The new pillar 1 consists of an initial capital requirement (ICR), fixed overhead requirement (FOR), K-factor requirements, and liquidity requirement. This full set of prudential requirements will apply to local firms under the IFR
- Local firms will also be subject to stringent Pillar 2 requirements and SREPs (Supervisory Review and Evaluation Processes). The pillar 2 approach will consist of a legal minimum requirement under P2R replacing the current Individual Capital Guidance (ICG) and where appropriate also an additional buffer to sit on top of the minimum requirements under P2G

Local firms will be in scope of the recover and resolution directive (RRD)

- Local firms are currently not in scope of the recover and resolution directive (RRD). However, after a shift to a EUR750K ICR category under the IFD, local firms will come within scope of the RRD and will have to document their RRD procedures similar to IFPRU730K principal dealers currently in scope of the RRD

Wind down to be linked to reverse stress testing and included as part of an ICARA

- The FCA expects wind-down plans to be linked to the outcomes of reverse stress testing. It also needs to consider both the qualitative and quantitative (e.g. own funds and liquid assets) aspects and any applicable provisions of the Recovery and Resolution Directive. For example, the operational tasks that need to be completed, including communications with customers, and the liquid resources such as redress that need to be available to cover costs, and 'what if' scenarios
- The FCA would likely consider whether to issue individual guidance (separate from, and additional to, any 'Pillar 2R') on further own funds to cover wind-down in stressed economic conditions

Mandatory risk committee requirement

- Local firms whose value of on-and off-balance sheet assets average is more than EUR100 million over the 4-year period immediately before the given financial year will be required to establish a risk committee

Remuneration code to apply to local firms

- A new remuneration code is likely to apply to local firms under the new EUR750K ICR classification

Please note that this is not an exhaustive list of requirements applicable to local firms. Other requirements may apply depending on your business model. Please also read our full summary of the IFD/IFR under heading 'New prudential requirements for investment firms' on our website https://www.pillar4consultants.co.uk/insights. Speak to us for a free initial consultation.

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