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Final FCA report on implementation observations for the IFPR

On 27 November 2023 the FCA published the final report on generalised input identified as good and bad practice from the subset of ICARA submissions assessed. This is especially helpful for investment firms that have not received any particular feedback on their ICARAs.

The goal of the multi-firm review is to help enterprises improve their operations and comprehend and comply with the standards.

The report emphasises that the majority of the evaluated organisations performed satisfactorily and demonstrated their ability to adjust to the new rules. There was room for improvement, though, particularly in the areas of internal intervention points, operational risk capital assessments, wind-down assessments, liquidity assessments, group ICARA processes, and regulatory data submissions.

Specifically, the FCA observed that:

Liquid Asset Assessments

According to the FCA, companies are failing to determine how much liquid asset is needed to cover times of liquidity stress. MiFID investment businesses must process, evaluate, and track the sufficiency of liquid assets and capital and liquidity planning as part of the ICARA process to ensure that they can resist significant but realistic stressors while minimising harm. The FCA is worried that the company's preparations for covering its liquidity during stressful periods are "insufficiently time-granular," making it difficult to spot discrepancies between cash flows and requirements, especially as the company is shutting down. Additionally, businesses are not making the distinction between needs for liquid assets and own finances, which puts orderly wind-downs at greater risk.

Inadequate internal early warning systems prevent businesses from acting quickly enough

The FCA has found serious flaws in several companies' internal monitoring metrics development. It has been noted in the past that several companies, without using any additional firm-specific indicators, have adopted the MIFIDPRU notification indicators as their own internal monitoring metrics. On the other hand, it was noted that several companies established internal monitoring metrics without providing a well-documented justification for the metric's calibration.

The FCA has offered some fundamental illustrations of appropriate procedures when establishing internal early warning indicators.

- Making sure that when establishing early warning indications, a comprehensive approach to stress testing, recovery planning, and wind-down planning is taken into account
- Adjusting internal buffers under stress depending on the biggest shift in surplus capital and liquidity resources
- Defining the precise steps for escalation and internal intervention points

In the case of companies whose resources are insufficient to facilitate a smooth wind-down, the FCA brought attention to the possibility that, in the event that internal indicators are not appropriately calibrated, a slight strain could swiftly push the company toward winding down. A company might then discover that it has insufficient resources to wind down under a serious but realistic crisis, which would result in an unorganised wind-down.

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Regulations continue to scrutinize wind-down planning

The FCA has pointed out flaws that compromise the legitimacy and functionality of wind-down plans for numerous companies. It has also been observed that a lack of proper group risk consideration has frequently been the focus of the FCA's SREP feedback regarding wind-down panning.

Businesses should pay close attention to the following instances of best practices that the FCA has shared:

- War games or simulations are used to test wind-down strategies
- A stressed background is taken into account when determining the initial financial resource level
- Operational plans are detailed enough to enable accurate cost and cash flow analysis during wind-down, including the identification of items that are special to wind-down
- Non-financial factors like client concentration and reputational risk have been taken into account as winding-down triggers

Insufficient evaluations of operational risk capital

There has been a noticeable shift in emphasis recently regarding the SREP and how businesses evaluate their operational risk capital. The FCA has brought up a number of particular issues and shortcomings with both modelled and non-modelled approaches, such as:

- A firm's exposure to all risks was not taken into account in the capital assessment
- It was unclear how to use the quantification methods (for both modeled and non-modelled approaches), and important underlying assumptions (such correlation and diversification) were not sufficiently explained
- The improper application of group models (e.g., the absence of proof that utilising an insurance or banking model for an investment company business is suitable)
- Poor model risk management and rarely independent model validation, particularly when a complicated modelling technique is being applied

In addition, the FCA has identified several additional areas of good and poor practices summarised below:

Section	Good Practice	Poor Practice
Group ICARA Process	• Clear assessment of risks for each entity • Thorough assessment of activities and costs in group wind-down plans	• Failure to adjust group level numbers for intragroup offsets • Lack of clear link between resource allocation and specific wind-down actions • Completing ICARA on a consolidated basis without FCA agreement
ICARA Process	• Joined-up assessments with consistency in threshold requirements analysis	• Lack of linkage and integration of ICARA assessments

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	• Holistic assessment of harms beyond K-factors	• Inadequate consideration of harms, confined to K-factors • Reduction of capital without proper justification
Early Warning Indicators, triggers and interventions	• Risk appetite based on financial resource behaviour under stress • Use of stress testing insights for resource buffer definition	• Thresholds and triggers not linked to the firm's risk understanding • Lack of own assessment in monitored metrics • Insufficient assessment of risk, trigger framework, and stress scenarios
Assessment of Liquid Asset Requirements	• Assessment under normal and stress conditions with forward looking views • Granular analysis of intra-day, inter-day, weekly, and monthly cash-flows	• Lack of consideration for financial stress periods • Insufficiently relevant liquidity stresses and time intervals for analysis • Inadequate review and adjustment of stress assessments
Operational risk capital assessments	• Clear linkage between enterprise risk assessment, RCSA, and scenario analysis • Individual entity focus, excluding consolidation effects	• Inadequate consideration of risks sustained by the individual firm • Use of group operational risk models without examination • Lack of independent validation for individual firm use
Wind-Down Planning Process	• Consideration of stress backdrop for required resources • Detailed wind-down plans covering firm-specific activities and costs	• Outdated wind-down plans with unrealistic assumptions • Inadequate consideration of stress conditions and group dependencies • Failure to test wind-down plans
Useability of the ICARA document and process	• Clear presentation of threshold requirements, framework, and detailed discussions	• Lack of clear summary and discussion of significant reductions • Inconsistency and lack of relevance in ICARA document

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	• Record of scenarios, assumptions, analysis, and decisions	
Data Integrity	• Consistency in regulatory submissions, ICARA, annual reports, and internal information	• Inconsistencies in MIF007 compared to ICARA and other reports • Failure to follow guides for regulatory report completion

Next Steps

Although the FCA's findings do not require alterations to policies, the expectation is for firms to internally assess their practices to ensure adherence to existing rules and requirements. The final report outlines a comprehensive set of both positive and negative practices identified by the FCA during its review, providing firms with a benchmark to evaluate and enhance their own operations.

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