INVESTMENT FIRMS PRUDENTIAL REGIME

As of 1st January 2022, the Investment Firm Prudential Regime (IFPR) has replaced the previous Capital Requirements Directive/Regulations (CRD). The framework largely follows the EU Investment Firm Directive & Regulation and despite slight changes, the key drivers of the regulation are aligned:

- Streamline and simplify the prudential requirements for MiFID investment firms.
- Find more appropriate ways to measure the activities of investment firms that have different models – such as a credit institution – rather than a 'one size fits all' approach

WHAT DOES THIS MEAN FOR THE FINANCIAL INSTITUTIONS SECTOR?

While MiFID II used service-based indicators, IFPR changes this to a quantitative based system via the introduction and use of 'K-factors'. K-factors are divided into three groups: Risk to Client, Risk to Market and Risk to Firm, aiming to cover the risk the Investment Firm poses to customers, market access and the firm itself. Alongside these K-factors are different classifications which will determine the level of regulation required at each firm. Class 1 firms will be those with assets of €5bn or higher while smaller Investment Firms will be classified as either:

- Class 2 / non-SNI: Any firms that exceed one of the Class 3 thresholds
- Class 3 / SNI: Firms that do not have permission to deal on their own proprietary capital and satisfy all the below:
    - average assets under management (AUM) < £1.2 billion;
        - cash trades < £100 million per day;
        - derivative trades < £1 billion per day;
    - average assets safeguarded and administered = zero;
    - average client money held = zero;
    - average daily trading flow = zero;
    - on- and off-balance sheet total < £100 million;
    - average total annual gross revenue from investment services and/or activities < £30 million;
    - not a clearing member or an indirect clearing member firm; and
    - not appointed to act as a depositary.

Clearly in the immediate term a greater level of risk monitoring and reporting is required as firms need to read and understand the thresholds of each classification, put themselves in the correct classification and subsequently abide by the regulation applicable to that class. There is then continual monitoring needed to ensure this classification is unchanged. Those firms on the border of such classifications may find themselves with important management decisions in respect of altering or maintaining their current positions. For example, a novation agreement from an advisory position to full discretionary management would warrant a change in classification.

ABOUT PROTEAN RISK

Protean continue to advise several clients in this sector as a specialist, boutique insurance broker for UK businesses. While the IFPR brings with it a long period of transition, adapting appropriately to and evidencing the required changes will form a key part of insurance renewals going forward. Communicating with insurers to effectively outline the measures taken and those in progress will ensure a smoother and more beneficial result for your insurance programme.

We tailor our market presentation for each client to give a clear, detailed picture of the business to insurers and challenge holistic regulatory concerns with a thorough understanding of the client's risk profile. Now more than ever, it is essential to engage with an expert broker that adopts a bespoke approach and seeks to work with the insurance market to dissipate concerns they may have in relation to the wider sector.

WHAT DOES THIS MEAN FOR YOUR INSURANCE?

Under CRD, exempt CAD firms were able to use the purchase of Professional Indemnity to reduce their capital requirement. This is now changed with at least a £75,000 permanent minimum requirement applicable. While we appreciate the significance of such an adjustment, we encourage clients to maintain their Professional Indemnity. These policies provide protection to the company in the event of third-party liability, including investigation expenses following a regulatory body inquiry. In the face of changing regulation, Professional Indemnity is a key risk management tool. For exempt CAD firms in particular, the regulation will introduce completely new requirements (and therefore risk) such as Internal Capital and Risk Assessment and clearly documented remuneration policies.

More generally, it is an opportune time for investment firms to evaluate their Directors' & Officers' Liability and Professional Indemnity policies in key areas such as Regulatory Investigation Expenses. Challenging insurance market conditions have led to several insurers sub-limiting this coverage to low proportions of the limit of liability. It is therefore essential that clients explore whether increased coverage is available elsewhere or if their limit of liability should be adjusted accordingly to increase the amount available to them.

GET IN TOUCH

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