

Technical Briefing: FCA CP13/6 ('CP') UK CRD IV Implementation

CP Published: 31 July 2013
 CP Closes: 30 Sept 2013
 Policy Statement: Q3/4 2013
 Effective from: 1 January 2014

Transitionals to 2019

CRD IV Package is the Directive (CRD IV) and the Delegated Act Regulations ('CRR')

Main proposals – Chapter 1

1. €50k BIPRU Investment Firms (that meet the definition in CRD IV) will be classified as BIPRU Firms from 1 January 2014 (a new designation);
 - a) subject to a slightly revised GENPRU/BIPRU which is established in line with the UK's domestic CRD, CRD2 and CRD3 Implementing Legislation.
 - b) **NB** some 1,000 current BIPRU Investment Firms likely to fall into this definition.
2. All other BIPRU Investment Firms, and some Exempt CAD Firms which have permission to Safeguard and Administer Client Assets and/or Money, will be subject to CRD IV Package from 1 January 2014 with a new sourcebook IFPRU;
 - a) all BIPRU €125k and €730k Base Capital Investment Firms;
 - b) some BIPRU €50k Investment Firms which are permitted to undertake Activities which take them into the CRD definition of Investment Firm;
 - c) some Exempt CAD Firms which are permitted to safeguard client assets; and
 - d) Limited Licence, Limited Activity and Full Scope Investment Firms

NB Simplified Credit Risk will remain available only for firms that are classified as BIPRU Firms from 1 January 2014.

3. CRD IV repeals all previous EU Prudential Directives (e.g. BCD, CRD, CRD 2, CRD 3 and CAD).

CP13/6 - 1.18

Directive deals with

- Prudential supervision (ICAAP)
- Capital buffers
- Corporate governance (SYSC)
- Remuneration
- Sanctions

Regulation deals with

- Pillar 1
- Large exposures
- Liquidity
- Leverage
- Pillar 3 (disclosure)

- 1.21 FCA in implementing the CRD IV proposes to do the legal minimum and to be pragmatic and proportionate.

- a) Forward looking to the possible dedicated Investment Firms Capital Directive which would leave only Credit Institutions subject to CRD. View from EU Commission due by end of 2015.
 - b) FCA is looking to use time during 2014/2015 consulting on most appropriate regime for Investment Firms in order to influence EU Commission's work.
- 1.22 Discretions and Derogations are allowed via CRR (i.e. UK may interpret how CRR applies in certain situations and the UK will be left to decide precise details).
- a) HMT to publish its own CP.

CRD IV, the Directive's Application to Investment Firms – Chapter 2

- 2.2 The definition of a CRD Investment Firm is now a sub-set of the MiFID definition of Investment Firm. Hence MiFID encompasses a wider population of than Investment Firms which will be within scope of CRDIV Package. Some Exempt CAD firms will be subject to CRDIV.
- 2.10 A new FCA sourcebook, IFPRU, will be created covering the following categories all classified collectively as IFPRU Firms:
- Full Scope IFPRU Investment Firms;
 - IFPRU Limited Activity Firms;
 - IFPRU Limited Licence Firms;
 - Exempt IFPRU Commodities Firms;
- plus:
- BIPRU Firms – subject to revised GENPRU/BIPRU; and
 - Exempt CAD Firms (not then subject to IFPRU) will remain subject, as appropriate, to IPRU(INV) 9 or 13.
- NB** The FCA Schedule Derogations will apply to each of these types of firm, but it is not yet clear if UK will take up all of these.

2.14 FinRep & CoRep (IFPRU Firms only)

- FinRep replaces FSA001 & FSA002 but only in regard to Consolidated Reporting and is based on IFRS Accounting Standards (it is not clear if this mean that Consolidation Groups have to adopt IFRS or that this only apply to those which do). FSA001 and FSA002 will continue at an unconsolidated level for all firms. FinRep is not applicable until Reporting Dates on or after 31 July 2014).
- 2.16 CoRep from 1 Jan 2014, Capital Data Items, e.g. FSA003 replaced etc. except FSA019 as ICAAP/Pillar 2 not covered by CoRep, just Pillar 1.
- 2.19 CoRep and FinRep do not apply to BIPRU Firms and Exempt IFPRU Commodities Firms.

FCA's approach to implementing CRD IV (the Directive) – Chapter 3

3.1 This covers:

- Pillar 2 and Capital Buffers (new definition);
- Recovery and Resolution Plans;
- Stress Testing;
- Remuneration;
- Disclosure of corporate information; and
- Other technical amendments from Directive.

3.3 Pillar 2 (ICAAP little changed including current SREP)

- 3.5 Relevant sections of GENPRU and BIPRU are to be copied across to IFPRU. There may be a change by the 2015 EU Commission's Investment Firm review outcome.
- 3.6 Existing Individual Capital Guidance notifications where provided will continue to apply post 1 January 2014 until further notice.

Capital Buffers

3.7 Capital Buffers (not to be confused with existing Capital Planning Buffer (CPB) issued to Firms – current Limited Licence Investment Firms are not subject to CPB).

3.8 Buffers (across all firms/industries) – do not apply to IFPRU Limited Licence Investment Firm. Types of Capital Buffer under CRD IV:

- a) Capital Conservation Buffer (CCB)
- b) Counter Cyclical Buffer (CyB)

Some exemptions may also apply, to disapply these two buffers:

- CCB is not optional and is phased in progressively over the period 2014, 2015, 2016, 2017, 2018 & 2019 via a Transitional Provision (3.10) and may add a further 33% to an IFPRU Firm's current Pillar 1 Minimum Capital Requirement.
 - The maximum CyB is phased in over similar time periods but only applies to the maximum this buffer can represent and which is itself optional and set by the Bank of England (3.13). In the event that the BoE sets the maximum CyB, this can add a further 33% to an IFPRU Firm's current Pillar 1 Minimum Capital Requirement.
- c) Globally Systemically Important Institution Buffer (3.14) – set by EU and defined and set at Firm specific level.
 - d) Other Systemically Important Institution Buffer (Domestic version) – set by Bank of England – firm specific.

NB c) and d) are unlikely to apply to FCA firms.

- e) Systemic Risk Buffer (might apply to IFPRU Full Scope Investment Firms but those regulated by the PRA) and is applied to all firms in a particular market sector which is subject to systemic risk.

Recovery & Resolution Plans

- 3.27/28 CRD IV Art. 74.4 states Competent Authorities need only apply this where institutions present systemic risks to financial markets.

Current thresholds applied by FCA likely to be those proposed previously in regard to Recovery and Resolution Plans. FCA not yet consulting on this point.

Stress Testing

- 3.29 Directive Article 100 – EBA to issue guidelines and Implementing Technical Standards in regard to the Supervisory Review and Evaluation Process as a requirement of Directive Article 97.

IFPRU Firms should all be subject to the Reverse Stress Test which currently has a threshold of AUM >£10 billion; or Revenue >£250m; or assets/liabilities of >£2billion.

- 3.30 Significant IFPRU Firms (the basis of this is discussed later) require comprehensive Stress Tests (similar to those required currently under GENPRU 1.2.24 and Reverse Stress Test of SYSC 20.2). IFPRU Firms which are not classified as Significant IFPRU Firms will only be required to undertake the Reverse Stress Test.

- 3.31 Stress Testing also includes Art.74.4 Recovery & Resolution Plans where these are required.

Remuneration

- 3.31 IFPRU Firms will be subject to essentially the same Remuneration Code (SYSC 19A) and the proportionality as currently applies under CRD 3. However, CRDIV introduces additional requirements:

- 3.36 – limits on bonuses;

– national discretion on bonus caps; and

– proportionality application on bonus caps.

- 3.37 EBA (not ESMA) is the European Supervisory Authority coordinating CRD IV and is yet to issue Remuneration Guidelines (to update those of CESR) and Implementing Technical Standards (ITS). ITS due by 31 March 2014 (as first awards subject to these new standards are those earned in 2014 and awarded early in 2015).

- 3.39 **Hard limits on Variable Remuneration as a ratio of Fixed Remuneration**

1:1 is the standard or 1:2 if shareholder approval is obtained.

- 3.41 FCA is not consulting on remuneration changes as a result of CRD IV. The FCA to going to issue a second CRD IV implementation Consultation Paper (CRD IV CP2) and this will include further remuneration code consultation.

Country by country disclosure of corporate information

- 3.42/3 The FCA is not at this stage consulting on this.

FCA's approach to the CRR's Implementation – Chapter 4

The FCA has few powers to alter or apply its own rules in place of CRR which replaces those areas currently in the FCA Handbook (mainly BIPRU). However the UK (FCA) is afforded some discretions on the actual application of the binding CRR Rule Book (published on the EU website).

4.4 Liquidity Standards and Reporting

- 4.6 The FCA believes the existing rules at BIPRU 12 are broadly appropriate and therefore, the UK will implement CRD IV's liquidity requirements through BIPRU 12 until the discretion on Binding Minimum Liquidity Standards has to apply in 2015. IFPRU 7 will initially refer IFPRU Firms to BIPRU 12 in this regard.
- 4.7 However, the FCA may not afford complex IFPRU Firms this discretion and on a firm-by-firm (case-by-case) basis, the FCA may choose to apply full CRD IV liquidity requirements. The FCA estimates that 20 out of the 60 IFPRU Full Scope Investment Firms that are not Exempt Full Scope Investment Firms (because their net balance sheet is <£50 million) will likely be subject to full CRD IV liquidity requirements and not subject to the discretion.

Hence:

- 40 of these IFPRU Firms will remain subject solely to GABRIEL Data Items FSA042 etc.; and
 - 20 of these IFPRU Firms will be subject to CoRep liquidity reporting and GABRIEL FSA042 etc.
- 4.10 CoRep liquidity reporting will also apply on a Consolidated Group basis to groups that contain at least one Full Scope IFPRU Investment Firm which meets the Significant IFPRU Firm definition (see Chapter 5).
- 4.14 This shows the Liquidity Reporting Application table for CoRep and GABRIEL liquidity reporting.
- 4.19 Capital
- CRD IV/CRR introduced significant changes to the definition of eligible capital.
 - CRD IV removes Tier 3 capital.
 - CRD IV increases the loss absorbing capacity thresholds for capital instruments to be eligible within the regulatory capital regime (gearing).
- 4.23 The way in which minimum capital is required to be held in accordance with CRD IV's provisions is subject to a transitional period up to 2017.
- 4.26 The CRD IV definition of Common Equity Tier 1 Eligible Capital and Tier 1 does not define expressly what is currently Eligible Partnership Capital or Eligible LLP Member Capital.

4.32 Large Exposures

– will continue to apply as under current CRD 3 rules i.e. not to Limited Licence or Limited Activity Firms;

– Existing Waivers:

- Intra group exposures – will continue;
- Reserves held at overseas central bank – will be abolished;

- National guarantees – will be abolished.

4.36 Large Exposures will only apply to Full Scope IFPRU Investment Firms.

4.37 – no change to Institutional Exemption of €150 million on 100% capital.

- Large Exposure Limit to remain at 25% of Regulatory Capital.

New Leverage Ratio

4.39/40 The FCA is afforded a Reporting Discretion that it will adopt which will enable the reporting of a firm's Leverage Ratio to be on a quarterly 'point in time' basis not on a 'three month average' basis.

EU financial reporting

FinRep

4.39/40 The FCA retains the discretion to widen the group of IFPRU investment firms to which FinRep will apply. The FCA may choose to do that but no decision has yet been made.

Simplified Credit Risk

4.48 Will not be available to IFPRU Firms but will remain available to BIPRU Firms.

The Definition of a Significant IFPRU Firms - Chapter 5

5.2 Chapter 5 will apply the following requirements:

Directive

- Art. 76 Risk Committee
- Art. 88 Nominations Committee
- Art. 91 Separate CEO and Chairperson and limitation on the number directorships held
- Art.95 Remuneration Committee
- Art.100 Pillar 2 Stress Testing beyond just Reverse Stress Test
- Art.129/130 the Capital Consolidation Buffer and Counter Cyclical Buffer's application

Regulation

- Art. 6 scope of liquidity reporting on an unconsolidated basis
- Art. 11 Scope of liquidity reporting on a consolidated basis
- Art.450 Remuneration disclosure basis

5.11 The Five Thresholds which trigger the existence of a Significant IFPRU Firm:

– Total Assets	£530 million; or
– Total Liabilities	£380 million; or
– Annual Fees/Commissions	£120 million; or
– Client Money	£425 million; or
– Client Assets	£7.8 billion.

Investment firms which will no longer be within CRD scope from 1 Jan 2014 - Chapter 6

- Not all MiFID Investment Firms which are currently subject to CRD will remain subject to CRD from 1 January 2014.
- These are, typically, €50k Base Capital BIPRU Investment Firms (but not all as some may currently be permitted to undertake Regulated Activities which would bring them back within scope of CRD IV).
- However, the vast majority of €50k BIPRU Investment Firms, by pure definition, will not be subject to CRD IV from 1 January 2014.

As long as the MiFID Investment Firm is only permitted to Deal in Investments as Agent, provide Investment Advice, undertake Managing Investments and Arranging (bringing about) Deals in Investments and is specifically not permitted to Safekeeping or Administer Client Assets or Money, it is highly likely to fall out of scope of CRD IV from 1 January 2014.

6.10 These newly out of CRD scope MiFID Investment Firms will then be classified as BIPRU Firms (the newly proposed FCA Prudential classification of a Firm).

BIPRU Firms will remain subject to a modified GENPRU/BIPRU which will then be subject only to the domestic UK CRD 3 Implementing Legislation not CRD 3 itself (which will cease to exist from 1 January 2014).

Existing rules will continue to apply including the current Remuneration Code (now SYSC 19C for BIPRU Firms, SYSC 19A for IFPRU firms).

6.11 New GENPRU 1,2,3, BIPRU 1,2,3,4,5,7,8,9,11,13 and 14 will all apply to BIPRU Firms.

SYSC will continue as applicable to BIPRU Firms which remain Common Platform Firms.

BIPRU 12 (Liquidity) will apply to BIPRU Firms (likely to be as non-ILAS firms).

6.14 Approximately 1,000 of the circa 2,500 Investment Firms authorised and regulated by the FCA, are estimated to fall into the BIPRU Firm category.

6.16 CRD IV requires the EU Commission to review the appropriateness of CRD's applications to Investment Firms by the end of 2015. The industry needs to engage with this consultation to ensure the likely dedicated "Investment Firms Capital Directive and Regulations" are fit for purpose.

Therefore, the FCA proposes, where possible, to maintain the status quo pending the outcome of the review and possible implementation of the Investment Firms Capital Directive and Regulations. As Paul Rich of the FCA stated the FCA wishes to avoid 'marching Investment Firms to the top of the hill only to march them half way back down again' in 2015/2016.

6.17/18 Exempt CAD

Some current Exempt CAD Firms are permitted to hold client assets (e.g. some Private Equity Firms). These Exempt CAD Firms will lose certain exemptions under current CRD/CAD from 1 January 2014 and will become subject to CRD IV, and hence will become IFPRU Firms.

For those Exempt CAD Firms operating under the AIFMD Art.61.1 Transitional, which expires on 22 July 2014, unless they seek authorised AIFM status prior to 1 January 2014, they will become IFPRU Firms until such time as they do formally become authorised as AIFM and will then most likely be subject to IPRU (INV) 11.