

## Exempt CAD firms: How to prepare for the **new UK prudential regime**

Newgate Compliance Managing Director, [Matthew Hazell](#), outlines the steps investment firms classified as ‘Exempt CAD’ need to take in order to prepare for the new UK prudential regime. This article forms part of our IFPR readiness series.

The Financial Conduct Authority (FCA) is introducing a new UK Investment Firm Prudential Regime (IFPR) for firms authorised under the Markets in Financial Instruments Directive (MiFID) which will come into force on 1 January 2022. **The proposals will have a significant impact on the requirements Exempt CAD firms will have to meet from that date.**

### Determine your firm’s classification

The first step is to determine which prudential category your firm falls into. Firms will no longer be classified as Exempt CAD under the new regime but will instead fall under one of the following two types of investment firms under IFPR:

- ‘Small and non-inter connected’ (SNI); or
- firms that are not SNIs (Non-SNI).

See which category your firm falls into by reviewing the thresholds from our [previous note](#).

### Exempt CAD Firms: Understand the impact to your firm

The table below indicates a short summary of Exempt CAD firms’ current prudential requirements and how they might change following the implementation of IFPR.

Issue	Current Requirement	New Requirement under IFPR
<b>Own Funds – Composition of Capital</b>	Existing gearing levels in place in relation to tier one instruments.	Common Equity Tier 1 capital $\geq$ 56% of own funds requirement; Common Equity Tier 1 + Additional Tier 1 Capital $\geq$ 75% of own funds requirement; Common Equity Tier 1 + Additional Tier 1+Tier 2 $\geq$ 100% of own funds requirement. No tier 3 capital permissible
<b>Minimum Capital</b>	€50k (sterling equivalent) or a combination of £5k capital and eligible Professional Indemnity Insurance Policy.	Greater of (1) €75k; or (2) Fixed Overhead Requirement (FOR) of $\frac{1}{4}$ of fixed annual expenses.  For non-SNIs, it is the greater of: (1) £75k; or (2) FOR of $\frac{1}{4}$ of fixed annual expenses; or (3) new K-factor requirements (KFR), a mix of activity and exposure-based requirements.
<b>Group capital requirements</b>	None.	The relevant own funds, own funds requirements, concentration risk, liquidity, disclosure and reporting will have to be applied on a solo and consolidated basis. If a group is sufficiently simple and does not pose a significant threat to clients or the markets, the parent could apply to use a group capital test instead of the consolidated own funds requirement.
<b>Concentration Risk</b>	Nothing specific	Basic requirement to monitor and control ‘concentration risk’. Additional regulatory reporting for Non-SNI firms.
<b>Liquid Asset Requirement</b>	Pay liabilities as they fall due.	Maintain liquid assets equal to $\frac{1}{3}$ of FOR to be held in core liquid assets.
<b>Risk Management, Governance and Review Process</b>	General organisational and control requirements.	Firms will be required to adhere to the ICARA Process which will form the centre piece of a firm’s risk management framework and assesses financial resource adequacy to ensure it corresponds with the risk, harm and complexity of your business model. Requires firms to set their ‘own funds threshold requirement’ and ‘liquid asset threshold requirement’ which dictates their overall financial adequacy.  Involves risk of harm assessment, stress testing, recovery and wind down plans. Results of ICARA need to be reported to the FCA via a new return annually. Assessments may be reviewed periodically by the FCA.

<b>Reporting</b>	Current RegData schedule.	Change to RegData reporting with quarterly capital, liquidity, SNI threshold monitoring, balance sheet and income statement. Annual ICARA and remuneration reports. Non-SNI firms will have additional concentration risk and remuneration reports.
<b>Remuneration</b>	Requirements driven by MiFID for sales staff.	All firms subject to 'basic remuneration requirements' for all staff in relation to MiFID business.  For Non-SNI firms, there are additional 'standard remuneration requirements' for Material Risk Takers. Additionally, 'Extended remuneration requirements' apply to significant non-SNI firms on deferral of bonuses, use of non-cash instruments and retention periods.
<b>Public disclosure</b>	None.	Some disclosure required if own funds consist of anything other than common equity tier 1 capital regarding risk management objectives, own funds and own funds requirement.  For Non-SNIs, firms must disclose risk management objectives, own funds and own funds requirement, remuneration, and governance arrangements (similar to current Pillar 3 obligations). Larger non-SNIs will also need to disclose ESG risks and investment policy.

## Frequently Asked Questions

**Q: I currently use a combination of capital and PII to meet my firm's requirement. Will I still be able to do this?** No, it is unlikely that would be permitted under the new regime.

**Q: Do I have to increase capital to the higher of £75k, the FOR or KFR from 1 January 2022?** No, you will be able to gradually increase capital with the full requirements applying at the end of the fifth year.

**Q: Is there a way my firm can avoid the above requirements?** You should review your scope of permission and whether your activities actually fall within the scope of MiFID and if not, consider a Variation of Permission to become an Article 3 exempt firm.

### Next steps

Firms should start familiarising themselves with the proposed IFPR changes and starting planning on how to meet the new requirements. As the IFPR poses the most significant change for Exempt CAD firms, firms should start planning imminently to be well prepared for the changes taking effect from 1 January 2022.

### How can Newgate help?

Newgate have developed a readiness assessment to undertake a gap analysis of a firm's systems and controls against the requirements identifying any remediation actions to be undertaken.

We have developed an enhanced compliance framework on our proprietary compliance system "GATEway" that encompasses updated policies, assessment documents and the compliance monitoring plan to ensure these changes are considered and complied with on an ongoing basis.

Please do not hesitate to get in touch to discuss how we can help.



[Matthew Hazell](#)  
Managing Director