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6 REGULATORY CAPITAL AND LIQUIDITY

6.1 Introduction

This section of the Manual sets out the Firm's arrangements to maintain adequate capital resources at all times. This reflects the Firm's prudential supervision as a MiFID investment firm covered by the Investment Firms Prudential Regime (IFPR) from January 2022 and as a small and non-interconnected (SNI) firm. On that basis, the Firm comes under the rules in the MIFIDPRU Prudential Supervision sourcebook. Maintaining adequate capital resources also forms part of the Firm's ongoing Conditions of Authorisation.

6.2 Overall Financial Adequacy Rule (OFAR)

MiFID investment firms can be categorised either as a small and interconnected (SNI) firm or a non-SNI firm. The determination of that is whether the firm is below the threshold of a number of different metrics relating to its regulated activities and business. These are called K-Factors with the most significant for the Firm being K-AUM (assets under management). The Firm does not exceed any of the relevant K-Factors and therefore remains categorised as a SNI firm. The Firm continues to monitor relevant K-factors to ensure it does not exceed any thresholds otherwise it must notify the FCA of a change to a non-SNI firm (which is a more onerous regime).

The Firm must at all times hold own funds (as defined at [MIFIDPRU 3](#)) and liquid assets (as defined at [MIFIDPRU 6](#)) which are adequate, both as to their amount and quality, to ensure that the Firm is able to remain financially viable throughout the economic cycle, with the ability to address any material potential harm to the business or clients that may arise from its ongoing activities, and to enable the Firm's business to be wound down in an orderly manner, minimising harm to consumers or to other market participants. This is known as the overall financial adequacy rule (OFAR).

Essentially, the Firm must have capital resources to meet its liabilities as they fall due, and additionally have processes, strategies and systems to assess and maintain adequate (financial, capital, internal capital) resources to withstand the risks it is exposed to, and to meet all regulatory obligations.

Firms must also take account of any individual capital guidance (ICG) provided by the FCA, or any other relevant directions provided by the FCA, as part of any Supervisory Review and Evaluation Process (SREP), as set out in MIFIDPRU 7.10, when deciding the level of capital that is to be maintained.

6.3 Responsibility for Maintaining Adequate Capital Resources

The Compliance Officer in conjunction with the partners is responsible for monitoring capital resources and capital requirements. The partners are responsible for ensuring that there are sufficient capital resources.

6.4 Ongoing Capital Resources Requirement

As a SNI firm, the rules in MIFIDPRU state that ongoing capital must be comprised of an own funds requirement (OFR) and a liquid assets requirement.

For the Firm, the minimum own funds requirement is the higher of the Firm's permanent minimal capital requirement (PMR) under MIFIDPRU 4.4 and its fixed overheads requirement (FOR) under MIFIDPRU 4.5. For firms such as Midmar, PMR is normally £75k. However as an existing firm at the time of IFPR implementation, the Firm could benefit from incremental transitional rules over 5 years on PMR as follows:

2022 - £50k, 2023 - £55k, 2024 - £60k, 2025 - £65k, 2026 - £70k, 2027 - £75k.

A firm's FOR is an amount equal to one quarter of the firm's relevant annual expenditure during the preceding financial year and based on its most recent audited accounts, subject to any permitted deductions. The accounting framework applied must accord with the criteria set out in MIFIDPRU 4.5.2R and set out at 6.5 below. A principal firm's FOR does not include expenditure of its ARs.

6.5 Annual Operating Expenditure

The Firm's relevant expenditure is defined as follows:

'The sum of the amounts described as total expenditure in the 4 quarterly financial returns up to (and including) that have been prepared at the firm's most recent accounting reference date, less the following items (if they are included within such expenditure)'.

- Staff bonuses, except to the extent that they are guaranteed, and other variable remuneration.
- Employees' and partners' shares in profits, except to the extent that they are guaranteed.
- Other appropriations of profits.
- Non-recurring expenses from non-ordinary activities.
- Shared commission and fees payable, which are directly related to commission, and fees receivable, which are included within total revenue.
- Interest charges in respect of borrowings made to finance the acquisition of the Firm's readily realisable investments.
- Interest paid to customers on client money (not applicable to Midmar).
- Interest paid to counterparties.
- Fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing, registering or clearing transactions.
- Taxes where they fall due in relation to the annual profits of the firm.
- Other expenses to the extent that their value has already been reflected in a deduction from own funds under MIFIDPRU 3.3.6R (Common equity tier (CET) 1 deductions).

FOR should be based on the last audited accounts. However, if the FOR increases by 30% or more during the financial year, this must become the new FOR requirements under the ICARA with immediate effect. If the FOR reduces by the same, own funds can be reduced but only with prior FCA consent.

6.6 Liquid Assets Requirement

The basic liquid assets requirement (BLAR) for a firm equates to an amount of core liquid assets (defined in MIFIDPRU 6.3) which is equal to the sum of:

- One third of the amount of its FOR; and
- 1.6% of the total amount of any guarantees provided to clients.

The Firm normally holds its liquid assets requirement in cash. The Firm's must also meet its liquid assets threshold requirement (LATR), which is the higher of the following two assessments:

- BLAR + additional ongoing requirements (assessment A), and
- BLAR + additional requirements for orderly wind-down (assessment B).

For some firms, the outcomes of assessment A and B are the same. Based on the latest ICARA process (see below), the Firm has concluded that the outcome of assessment A is greater than B.

Accounts receivable can also be used to meet required liquid assets, however this is limited to 1/3rd of accounts receivable being eligible as liquid assets.

6.7 ICARA

The Compliance Officer in conjunction with the partners is responsible for making sure that the OFAR is met. The Firm will utilise the internal capital adequacy and risk assessment (ICARA) process to identify whether it complies with the OFAR. This process is laid out in [MIFIDPRU 7](#).

The ICARA is central to a firm's risk management process to identify and monitor the potential harms to consumers, to the market in which it operates and to the firm itself, and to reduce all potential material harms that may result from the ongoing operation of its business or from winding down.

Under FCA requirements, it covers:

- Identification, monitoring and mitigation of risks and harms (in line with MIFIDPRU7 Annex 1).
- Business model planning and forecasting.
- Recovery and wind-down planning – assessing the adequacy of financial resources.

This will normally include a firm-wide Risk Register. The outcome may include holding additional own funds and liquid assets, where necessary. A principal firm's assessment of risk should also consider risks from the activities of its ARs. The ICARA should also include the outcomes of relevant stress tests.

The ICARA process is intended to identify whether a firm should hold additional capital on a risk assessed basis over and above its FOR. It is up to the Firm to decide whether additional capital should be maintained. However, the FCA has the right to challenge this under its SREP and set Individual Capital Guidance (ICG) either on own funds and/or liquidity should it so require.

The ICARA process should be reviewed at least once every 12 months but also following any material change including an increase in costs (trigger of 30%+ increase). More complex firms might need to consider half yearly reviews.

The ICARA process should also consider a firm's wind-down processes and costs, which should be set out and maintained in a detailed Wind-down Plan that sets out potential scenarios and procedures that should be followed. The Wind-down Plan should also follow guidance in the FCA's [Wind-down Planning Guide \(WDPG\)](#).

6.8 External Disclosures and FCA Notification Requirements

There are a number of external disclosures that firms in scope of IFPR and MIFIDPRU should make and these are detailed at [MIFIDPRU 8](#). However, the majority of detailed disclosures are only relevant to non-SNI firms and only [MIFIDPRU 8.6](#) (Remuneration) is relevant to all MiFID investment firms. Accordingly the Firm is required to publish an annual Remuneration Disclosure on the Firm's website no later than the date of publication of its annual audited accounts at Companies House (which must be within 9 months of financial year end).

Otherwise, there are relevant FCA notifications under MIFIDPRU including rules that require firms to notify the FCA where their level of own funds and/or liquid assets fall below these intervention points.

The Firm needs to consider any notification impacts if own funds fall to within 110% of its OFAR or any ICG provided by the firm. This is called the early-warning indicator. Therefore, it is always recommended to hold more than the notification threshold to avoid notification risk.

6.9 ARs and Capital Adequacy

ARs are not themselves subject to specific capital adequacy rules. However, the Firm as principal is required to ensure the financial soundness of its ARs in line with [SUP 12 Annex 1](#). The Firm does this as part of onboarding a new AR but also on an ongoing basis through monthly reporting, receipt of at least quarterly management accounts from its ARs, and again as part of formal annual monitoring exercises and internal reviews.

6.10 Financial Reporting

Principle 4 requires firms to maintain adequate financial resources. By submitting regular data, firms enable the FCA to monitor their compliance with Principle 4 and their prudential requirements in the FCA Handbook.

6.10.1 Electronic Reports

The Firm's required financial returns, as an IFPR SNI firm, are showed at [MIFIDPRU 9](#).

The Firm's reporting schedule is listed on the FCA reporting system known as RegData. This normally requires the submission of quarterly financial statements based on the Firm's accounting reference date which is 31 March. In addition, annual audited financial statements must be sent to the FCA within 80 business days of its financial year end.

6.10.2 Submission of Data Items

When submitting the completed data item, except where there is no standard format, the Firm must use the format of the data item set out in [MIFIDPRU 9 Annex 1](#). Guidance notes for completion of the data items are contained in [MIFIDPRU 9 Annex 2](#).

Sterling is the normal reporting currency; however, the systems permit reporting in the currency of the annual accounts.

Any non-standard format items must be sent to:

Central Reporting
The Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Or via email to: Regulatory.reports@fca.org.uk

Copies of each submission should also be retained on the Firm's own records.