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Some UK investment firms need better risk management, including over liquidity, regulator says

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UK investment firms have broadly made good progress in taking account of prudential rules aimed at heightening their risk management, but there are a number of areas for improvement, their financial regulator has reported. Among problem points, some didn't carefully assess their cashflows and liquidity, putting them at risk of failure, the Financial Conduct Authority said.

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Among problem points, some didn't carefully assess their cashflows and liquidity, putting them at risk of failure, the Financial Conduct Authority said today in a final report on the implementation of its Internal Capital Adequacy and Risk Assessment process, known as Icara.

The Icara process was introduced under the new Investment Firms Prudential Regime, which began at the start of 2022, and requires firms to identify the risk of harm in their operations and assess appropriate resources to mitigate harm, whether as a going concern or when winding down.

The regime applies to investment firms — such as fund managers, asset managers, investment platforms, firms that deal on their own account, depositaries, and securities brokers — that are engaged in activities under the UK Markets in Financial Instruments Directive, or Mifid, which was inherited from the EU after the UK's withdrawal.

The FCA today published its final review into firms' progress in implementing the Icara process and their reporting requirements under the prudential regime.

"Firms have made progress in understanding the requirements of the new regime," the FCA said. "We saw a deliberate shift toward considering and seeking to mitigate the harm the firm can pose, particularly to consumers and markets."

But the regulator said it had also found "some areas for improvement."

"Several firms applied insufficient consideration of cashflows and liquidity stresses, which led to an inadequate assessment of liquid asset requirements. These firms were at risk of running out of cash in stressed conditions, which could have resulted in firm failure," it said.

Most firms lacked internal checkpoints and safeguards that would allow action to be triggered quickly and prevent harm, especially in case of potential failure, it said. Assessments for winding down operations of companies didn't sufficiently consider the impact of being part of a larger group.

"In some firms," the FCA said, "there were significant failings in the application of capital models for operational risk. This gives little assurance that these firms have adequate resources to mitigate harm."

The FCA had published initial observations in February on the adoption of the new regime and the implementation of Icara processes in companies. Today's update summarized good and poor practices, the FCA said, and "firms should consider these and how they can strengthen their processes."

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