Fundhouse Bespoke[1] Limited: Capital Requirements (Regulatory)

As of 30 November 2020

[1] The legal entity that is the provider of model portfolio services to advisers

Important Context

We are classified as a "BIPRU" firm. BIPRU firms have some leniency with respect to minimum capital requirements and the FCA has released a paper that suggests this may change in Summer 2021, but for now the rules remain as they are. BIPRU firms are firms which are authorised to execute client orders and/or provide portfolio management services (and may also provide investment advice and/or receive and transmit orders) but do not hold client money or securities. Since January 2014, the FCA has exercised its discretion to exclude these firms from the more onerous CRR/CRD regime and they have been subject instead to the less complex requirements in the recast CAD; they have therefore been treated differently from so called 'IFPRU firms'. In exercising such discretion, the FCA acknowledged that the CRR/CRD was essentially the EU implementation of Basel III for banks and its application to investment firms conducting less risky activities was a temporary measure pending the outcome of the Commission's review of the prudential regime for investment firms. The new IFPR regime will increase the capital requirements of some investment firms that are currently categorised as BIPRU firms by the FCA. This may include Fundhouse Bespoke. We are investigating this and will report to the committee in due course, but if this change occurs, it will only happen late next year.

BIPRU firms currently "benefit" from a base capital requirement of EUR 50,000 (around £45k) and have a relatively simple variable capital requirement (usually one quarter of annual fixed overheads or, if higher, the sum of the credit risk and market risk calculation). As most BIPRU firms operate on an exclusively agency model (i.e. don't take market or credit risk themselves), the fixed overheads requirement is usually the variable capital requirement.

What capital is needed by Fundhouse Bespoke?

- A BIPRU firm must maintain at all times capital resources equal to or in excess of the base capital resources requirement. In our case this is EUR 50,000. The purpose of the base capital resources requirement for a BIPRU firm is to act as a minimum capital requirement or floor.
- A BIPRU firm must maintain at all times capital resources equal to or in excess of the variable capital requirement for a BIPRU firm.

Therefore, our capital requirement is:

- The base capital resourced requirement (€50k), or
- The variable capital requirement calculated by taking the higher of either the sum of the Credit risk capital requirement and Market risk capital requirement or
- the Fixed overhead requirement

Fundhouse Capital Requirements – November 2020

As at the end of November, Fundhouse Bespoke had £67,000 in cash (Tier 1 capital), of which £29,700 was needed for regulatory capital, suggesting an excess of £37300.

As mentioned, Fundhouse Bespoke Limited is small and is not viewed as complex following the guidance in the FCA handbook (BIPRU 2.2). It is a 50k Bipru firm. Such firms, according to the FCA must maintain at all times capital resources equal to or in excess of the base capital resources requirement of €50,000. At the moment our base capital is approximately €74,000 (£67k x1.1 fx rate). But we must also ensure that our capital covers the variable capital requirement, calculated by taking the higher of either the sum of the Credit risk capital requirement and Market risk capital requirement or the Fixed overhead requirement. Because we are a business that acts as an agent for our clients and has no "trading book", our balance sheet is not subject to credit and market risk (by investing in securities). But, to be very conservative, we have calculated a degree of market and credit risk, with respect to our normal operations and this follows next.

WHAT IS OUR MARKET AND CREDIT RISK?

Estimated conservatively at **£4,500**.

There is no obvious market risk because all of our business cash and receivables are held in Sterling (GBP). What about credit risk? Arguably there is credit risk by holding cash on our balance sheet (the bank could go bankrupt) and our accounts receivables may not pay. But, because the bank balance is guaranteed to £85,000, we believe the risk is zero (All UK-regulated current or savings accounts and cash ISAs in banks, building societies and credit unions are covered by the Financial Services Compensation Scheme (FSCS). Therefore, if the bank fails, we recover up to £85,000). But we may have some credit risk from our clients not paying us. What could this be? As at the end of November 2020, we invoiced approximately £4,500. Let's assume 100% of this was not paid, to be safe – that would add £4,500 to our credit risk.

CALCULATING FIXED OVERHEAD REQUIREMENT

Estimated conservatively at **£29,700**.

The FCA says: A BIPRU firm must calculate a fixed overheads requirement, an amount that is equal to one quarter of the firm's relevant fixed expenditure calculated in accordance with GENPRU. We have calculated the amount as being the sum of all costs to run Fundhouse Bespoke Limited, but reducing the amount by the following:

- Staff bonuses, except to the extent that they are guaranteed;
- Employees' and directors' shares in profits, except to the extent that they are guaranteed;
- Foreign exchange losses.

Note, we would also exclude the following, but we see very little likelihood of these costs being incurred by is within the normal course of business:

- 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;
- 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;

What are our fixed overheads? We are charged around £36,000 per year by Fundhouse in SA to support our models (operationally). A quarter of this is £9,000. Then, we also have insurance, which costs £900 a month, so add another £2700 per quarter. This creates a total cost of £11700 per quarter.

However, they do also make the following statement: If a firm has a material proportion of its expenditure incurred on its behalf by third parties and such expenditure is not fully recharged to that firm then the firm must adjust its relevant fixed expenditure calculation by adding back in the whole of the difference between the amount of the expenditure and the amount recharged. This would suggest that Fundhouse Limited, which incurs costs that are used to help fund Fundhouse Bespoke, should be fully recharged. Examples would be the cost of manager research, proportionate staff costs etc. Fundhouse Limited runs at a cost base of around £60,000 per month. We would apportion around 10% of this cost to Fundhouse Bespoke. This would add a further £18,000 to our fixed overhead. So, our fixed overhead is estimated as follows:

Cost	Per Quarter
Ops Costs (SA)	9000
Insurance	2700
FH shared costs	18000
Fixed Overhead	**29700**

Because the fixed overhead is larger than our credit and market risk, this results in our variable costs being linked to fixed overhead.

WHAT IS OUR NET CAPITAL BUFFER? (end November 2020):

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Actual Capital (cash = Tier 1)	67000
Less:	
Fixed Overhead	29700
Net Excess Capital	**37300**