THRESHOLD CONDITIONS (COND)

3. Threshold Conditions (COND)

The threshold conditions set out five conditions that the FCA require a firm to meet to become authorised to undertake any regulated activity. These conditions are as follows:

Location of Offices	For a regulated UK firm carrying on insurance mediation activities only, then its registered office, or head office if it does not have registered office, must be in the UK. If the firm is not a body corporate but has its head office in the UK, then it must also carry on its business in the UK.
Effective Supervision	The FCA must be satisfied that it can effectively supervise a firm, taking into account the nature and complexity of the regulated activities it carries on, the complexity of the products it provides and the structure of the firm. It also takes into account whether the firm is a member of a group and other firms to which it has close links.
Appropriate Resources	The FCA must be satisfied that the firm has appropriate resources in relation to the regulated activities it carries on. Consideration is given to the nature and scale of the business and whether the firm is a member of a group. They also must be satisfied that a firm has adequate financial and non-financial resources. Non-financial resources would include the skills and experience of management..
Suitability	The FCA must be satisfied that the firm is “fit and proper” to be authorised. In assessing this, the FCA considers the competence and ability of management, as well as its commitment to carrying on the business with integrity and in compliance with the requirements of the FCA.
Business Modelling	The firm’s business model or strategy must be suitable for the regulatory activities it carries on. It must allow for the business to be conducted and to continue to be conducted in a prudent manner that is in the interests of consumers and in compliance with regulation.

3.1 Effective Supervision

In assessing a firm's application the FCA need to be notified of controllers and parent undertakings of firms. Controllers are those individuals or firms who exercise at least 20% of control of a firm. In reviewing the application, the FCA will consider a firm's connection with any person, including its controllers and parent undertakings. Where the regulated firm is dependent upon support, either financially or from resource provided, further information may be required to be presented as part of the application and supervision process.

A firm must notify the FCA if it has become or ceased to become closely linked with any person. The notification must be made by completing the Close Links Notification Form which may be found on the FCA website. Unless the firm has elected to report on a monthly basis, the firm must submit the notification as soon as is reasonably practicable and no later than one month after it becomes aware that it has become or ceased to become closely linked with any person.

In addition to such notifications, the firm must submit a report to the FCA annually, again by completing the Close Links Notification form. The firm must also submit a group organisation chart.

3.2 Appropriate Resources

The FCA will be looking at the Prudential requirements, e.g. whether the firm has enough capital to meet its liabilities as they fall due. It will also look at non-financial resources such as staff and other effective means to manage risk.

The FCA requires firms on a regular basis to undertake an assessment of Appropriate Resources to ensure that they are satisfied that they have adequate resources as expected by the FCA. This should cover both financial and non-financial resources.

The assessment should not be a "one off" assessment at the request of the FCA but should be an intrinsic part of the management's decision making process when running the business.

Financial Resources

In assessing the adequacy of financial resources a firm should consider the following (this is not an exhaustive list):-

- Cash flow – the impact of unallocated cash and legacy balances and funding from client monies of from the firm's own resources;
- Impact upon cash and liquidity on the regulated entity in relation to any cash sweeps e.g., where the firm is part of a group;
- Credit control – the adequacy of credit control processes including the timely collection of premiums, monitoring of aged debt, application of suitable bad debt provision, timely payment of premiums to the market (particularly where a premium warranty or condition might apply);
- Treasury management – the value and performance of any investments made by the business including where relevant how foreign exchange exposure is monitored and mitigated;
- Acquisitions – firms need to consider the impact of any acquisitions on their adequacy of financial resources and ensure this is considered in the due diligence process;
- Changes to funding requirements that may be needed in order to manage:-
    - Liquidity;
    - Banking covenants;
    - Crystallisation of group obligations; and
    - Liabilities owed to third parties.
- Weaknesses in controls over client money and other client assets;
- Weaknesses in the firm's risk assessments of the size and probability of potential causes of significant stress to business models;
- The quality of other relevant systems and controls such as risk transfer arrangements including terms of business agreements;
- The quality and adequacy of the firm's professional indemnity insurance in relation to its exposures;
- Various aspects of the firm's financial statements and in particular the quality of assets, working capital requirements and the robustness of cash flow forecasts;
- Where a firm is part of a group, the recoverability of intercompany balances or, where several firms are under common control, amounts due from connected persons; and
- The types of liabilities to which firms are exposed including;
    - Pensions obligations which require funding and could impact on the going concern of the firm;
    - Contingent liabilities, such as E&O claim which could result in material creditor balances arising;
    - Mortgage debentures which create a fixed and floating charge over all the assets of a regulated firm.

Performing the Financial Assessment

In performing the assessment firms may wish to consider the following approach:-

- Producing profit and loss and cash flow forecasts as part of general business planning. Forecast financial positions should also be analysed including compliance with regulatory capital rules. When producing forecasts firms should take into consideration the points outlined above.
- Identifying risks from the risk register, creating scenarios and assessing each scenario for potential financial impact. Any potential impact should assess not only any potential loss of income but also any reductions in costs.
- Stress testing financial forecasts by assessing the impact of the scenario on the profit and loss, cash flow and overall solvency. Firms should also consider modelling “worst case” scenarios.

Remember Adequate Resources should be included as part of regular financial management information to the Boards of regulated firms.

Non-Financial Resources

The non-financial areas that should be assessed for current and future adequacy include:

Staff

This is probably the most critical area for assessment. The FCA expects firms to have adequate quantity and quality of staff available to deliver the current business and sufficient managers to supervise and manage those staff. E.g. are there enough sales staff to deal with the sales of insurances, are they sufficiently competent to undertake the role and how many managers do you have to supervise those staff?

Consideration should also be given for how effectively responsibilities are being discharged. Any future changes such as natural growth, acquisition or disposal should be considered.

In determining quality of the staff firms should consider the quality of recruitment, induction training and competency requirements,

Back-office Functions

This will include IT, human resource, financial, compliance and risk management functions. If the firm has an internal audit function this should also be considered.

Premises

Consider whether the firms' premises are capable of meeting both your current and future needs.

3.3 Business Modelling

The Business Model Threshold Condition demonstrates the importance the FCA places on a firm having an appropriate, viable and sustainable business model. The model should reflect the nature, scale and complexity of the business the firm intends to carry out. A firm's business model and any changes to it after a firm has been authorised is considered fundamental to the viability of the business as a whole and the fair treatment of consumers.

1. Firms will need to consider how they satisfy and going forward, how they will continue to satisfy, matters including but not limited to:

    a. The assumptions underlying the firm's business model and the supporting justification;
    b. the rationale for the business the firm proposes to undertake or continues to undertake, its competitive advantage, viability and the longer-term profitability of the business;
    c. the needs of and the risks to consumers;
    d. the expectations of any stakeholders such as shareholders or regulators;
    e. the products and services being offered and the product strategy;
    f. the governance and controls of the firm (and of any member of its group if appropriate);
    g. the strategy for growth and any risks arising from it;
    h. strategies for diversification; and
    i. the impact of the external business environment.

2. The firm should also consider how it intends to implement its business model, taking into account any procurement and outsourcing arrangements and recruitment.

3. Firms should seek to identify situations which may negatively impact on the firm's business model. This includes assessing the vulnerability of the business model to specific events and the risks and consequences that might arise. Firms should have credible and realistic plans in place to minimise the risks it identifies to the business model and a contingency plan for addressing risks and the resulting consequences should they materialise.

4. Any adjustments to the business model should be approved at the appropriate level with consideration also given to the potential risks of the changes as well as the needs of consumers.