payments and crypto network

Preparing an Application for Authorisation

A series of guides addressing common issues in relation to preparing an application for authorisation.

Guide 8: Financial forecast

Background

Electronic Money Institutions ("EMI") and Payment Institutions ("PI") are required to submit a financial forecast, covering a period of three financial years, with their application for authorisation. The financial forecast will need to demonstrate that the firm is able to employ *"appropriate and proportionate systems, resources and procedures that allow the applicant firm to operate soundly"*.

The financial forecast will need to be prepared at a reasonable level of detail, and presented as a Profit & Loss Statement, Balance Sheet and Cash Flow, with accompanying descriptions of the assumptions upon which the forecast has been made.

A summary of the financial forecast should be included in the Regulatory Business Plan, a key submission document, and the forecast model also included as a supporting document in the application submission. Developing a Regulatory Business Plan is the subject of the ***Applications for Authorisation Guide 11 – Developing a Regulatory Business Plan.***

The FCA will review the financial forecast as part of the assessment of the application for authorisation and will seek to ensure that the forecast, and its assumptions, are consistent with the other descriptions provided in the application (e.g. staffing levels, outsourcing arrangements, service developments, etc.). Consistency between the written content and the numbers is important!

The two main concerns of the FCA, when reviewing the financial forecast, will be:

1. Whether the business meets its capital requirements (these are described in ***Applications for Authorisation Guide 9 – Capital requirements***); and
2. Whether there will be sufficient cash to remain a 'going concern' (an accounting term referring to the ability to meet liabilities as they fall due).

Stress tested financial forecasts will also need to be submitted in the application.

This guide should help you develop a suitable financial forecast for inclusion as part of your application for authorisation (and should certainly be read in conjunction with the other 'Applications for Authorisations' guides that we have prepared.

Duration of the financial forecast

The financial forecast that is required to be included in the application for authorisation will need to cover a period of three financial years from the expected date of authorisation. You first need to identify or establish the applicant firm's year-end accounting reference date (ARD), i.e. the date to which the financial statements are made. If the applicant entity is part of a group the ARD would probably best be kept consistent throughout the group.

It would be reasonable to expect the FCA's assessment of an application for authorisation to take in the region of 6 months (following the date of submission). As such, a view will need to be taken on which financial years should be included. For example, if an application is going to be submitted in March and your year-end date is 31 December, the first financial year for the forecast could reasonably be the current financial year. If submitting in September however, the first financial year should be the following year (since September to December is a bit too short a period).

Scope of the financial forecast

The forecast should be prepared for the applicant entity and be consistent with the written content provided in the Regulatory Business Plan. For example, the forecast will need to be consistent with the written descriptions of the scope of services to be provided, service development plans, marketing activities, number of staff / employees, recruitment profile, outsourcing arrangements, provision of any unregulated services, etc.

If the applicant is part of a group the forecast may need to include some inter-company charges / revenues in relation to the outsourcing arrangements with the group or the reimbursement of the applicant's costs from the group. Inter-company costs are often recharged using a 'Cost Plus' model (this can help the applicant firm maintain capital to meet regulatory requirements).

The application will need to include a financial forecast, and detailed assumptions, for a 'Base Case' as well as under stress scenarios (see section below). Ideally two stress scenarios would be included, basically 'flexing' the assumptions made under the Base Case.

In assessing the financial forecast the FCA will have two main concerns: (i) whether the capital requirements (both initial and ongoing) will be met, and (ii) whether the applicant firm will maintain sufficient cash resources to remain a 'going concern'. These two concerns should be considered when developing the forecast model and explained in the accompanying narrative.

Preparing a forecast model

A forecast model will need to be prepared using a tool such as Excel that facilitates the entry of assumptions to drive the production of the forecast Profit & Loss, Balance Sheet and Cash Flow statements. The model for the Base Case can then be replicated to produce the stress scenario models. These will then need to be submitted to the FCA as part of the application.

The forecast model should be agreed by the Board and used to prepare the written narratives regarding the forecast financials that are included in the Regulatory Business Plan. The model will need to cover the three financial years, as determined above, and as a prudent measure (in case of delayed assessment by the FCA) include an additional year for good measure. The model should be prepared on a monthly basis, i.e. assumptions and the financial statements that are generated will be shown on a monthly basis. Capital calculations should be included in the model (see the separate guide referenced above); both the forecast capital requirements (for e-money and any unrelated payment services) and forecast capital held (Share Capital, Share Premium and Reserves) will need to be considered.

The workings and assumptions included in the model will need to be consistent with the assumptions described in the Regulatory Business Plan. Given that the model will be submitted as part of the application for authorisation you will need to be comfortable that questions raised by the FCA can be answered.

Stress testing the forecast

The Base Case financial forecast will need to be stress tested, ideally to produce two additional stressed scenarios for description in the Regulatory Business Plan with the separate models being submitted as part of the application.

The stress scenarios should make some negative assumptions compared to the Base Case, for example, increased competition in the FinTech market resulting in reduced customer numbers and lower fees / charges as well as increased staffing costs (due to increased competition for recruitment). Additional scenarios could be based on recession, business failures / losses, etc.

What do we need to describe in an application for authorisation?

The financial forecast models for the Base Case and stressed scenarios will need to be submitted as part of the application for authorisation and be described in the Regulatory Business Plan.

The Regulatory Business Plan could show separate summary and detailed tables presenting the Profit & Loss, Balance Sheet and Cash Flow with written details on the assumptions relevant to each. The tables in the body of the Regulatory Business Plan could show annual figures and then monthly figures included in an appendix. There is no set format to present the information – it just needs to be reasonably comprehensive and clear to the reader (including the FCA Case Officer tasked with assessing your application).