

General Prudential sourcebook

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Chapter 1

Application

1.1 Application

- 1.1.1** **G** There is no overall application statement for *GENPRU*. Each chapter or section has its own application statement.
- 1.1.2** **G** Broadly speaking however, *GENPRU* applies (except as provided in ■ GENPRU 1.1.2-AAG) to:
- (1) [deleted]
 - (2) [deleted]
 - (3) [deleted]
 - (4) a *BIPRU firm*; and
 - (5) groups containing such *firms*.
- 1.1.2-AA** **G** ■ GENPRU 3 (Cross sector groups) applies to:
- (1) an *IFPRU investment firm*;
 - (2) an *insurer* that is a "UK Solvency II firm" as defined in the PRA Rulebook: Glossary; and
 - (3) a *group* containing both the *firms* in (1) and (2).
- 1.1.2-A** **G**
- 1.1.2-B** **G** *GENPRU* applies to a *collective portfolio management investment firm* that is a *BIPRU firm* in parallel with ■ IPRU-INV -link- 11 (see ■ IPRU-INV -link-11.6).
- 1.1.2A** **G** A firm should refer to ■ GEN 2.2.13A R (cross-references in the Handbook) and ■ GEN 2.2.23 R to ■ GEN 2.2.25 G (cutover: application of provisions made by both the *FCA* and the *PRA*) when applying the rules and guidance in *GENPRU*.
- 1.1.2B** **G** As the *FCA* does not have the power to impose prudential rules and guidance on *PRA-authorised persons*, references to *PRA-authorised persons*

or *PRA rules* that are included in *FCA GENPRU* provisions will not be relevant in the *FCA's* application of that provision, unless otherwise stated.

Scope

1.1.3

R

GENPRU applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.



1.2 Adequacy of financial resources

Application

1.2.1 **R** This section applies to a *BIPRU firm*.

(3) [deleted]

1.2.1A **R** [deleted]

- 1.2.2 R [deleted]
- 1.2.2A R [deleted]
- 1.2.3 R [deleted]
- 1.2.3A G
- 1.2.4 R [deleted]
- 1.2.5 R [deleted]
- 1.2.7 G The *guidance* in this section is drafted with respect to a *firm* to which this section and the other provisions of *GENPRU* and *BIPRU* (except ■ *BIPRU* 12) referred to in this section apply in full.
- 1.2.8 G [deleted]
- 1.2.9 G [deleted]
- 1.2.11 G The adequacy of a *firm's* financial resources needs to be assessed in relation to all the activities of the *firm* and the risks to which they give rise and so this section applies to a *firm* in relation to the whole of its business.
- 1.2.11A G In the case of a *collective portfolio management investment firm*, ■ *GENPRU* 1.2.11 G means that this section also applies to its activities in relation to the management of *AIFs* and/or *UCITS*.
- Purpose**
- 1.2.12 G Adequate financial resources and adequate systems and controls are necessary for the effective management of prudential risks. This section therefore has requirements relating to both of these topics.
- 1.2.13 G This section amplifies *Principle 4*, under which a *firm* must maintain adequate financial resources. It is concerned with the adequacy of the financial resources that a *firm* needs to hold in order to be able to meet its liabilities as they fall due. These resources include both capital and liquidity resources.
- 1.2.14 G In the case of a *BIPRU firm* this section implements the third paragraph of article 95(2) of the *EU CRR* applying Article 34 of the *Capital Adequacy Directive* so far as that Article applies Article 123 of the *Banking Consolidation Directive*.

1.2.15 **G** This section also has *rules* requiring a *firm* to identify and assess risks to its being able to meet its liabilities as they fall due, how it intends to deal with those risks, and the amount and nature of financial resources that the *firm* considers necessary. ■ GENPRU 1.2.60 R provides that a *firm* should document that assessment. The *FCA* will review that assessment as part of its own assessment of the adequacy of a *firm's* capital under its *supervisory review and evaluation process (SREP)*. When forming a view of any *individual capital guidance* to be given to the *firm*, the *appropriate regulator* will also review the regulator's risk assessment and any other issues arising from day-to-day supervision.

1.2.16 **G** This section also has *rules* requiring a *firm* to carry out appropriate stress tests and scenario analyses for the risks it has previously identified and to establish the amount of financial resources needed in each of the circumstances and events considered in carrying out the stress tests and scenario analyses. In the case of a *BIPRU firm*, the *FCA* will consider as part of its *SREP* whether the *BIPRU firm* should hold a *capital planning buffer* and, in such a case, the amount and quality of that buffer. The *capital planning buffer* is an amount separate, though related to, the *individual capital guidance*, insofar as its purpose is to ensure that a *BIPRU firm* is able to continue to meet the *overall financial adequacy rule* throughout the relevant capital planning period in the face of adverse circumstances, after allowing for realistic management actions. Therefore, when forming its view on a *BIPRU firm's capital planning buffer*, the *FCA* will take into account the assessment made in relation to the *firm's ICG*.

1.2.17 **G** The basic requirements in this section are drafted to apply to a *firm* on a solo basis. This section then goes on to describe when its requirements do and do not apply on a solo basis and on a consolidated basis (see ■ GENPRU 1.2.45 R to ■ GENPRU 1.2.47 R and ■ GENPRU 1.2.57 R to ■ GENPRU 1.2.58 R). It also sets out some details about how the solo requirements are adjusted when they are applied on a consolidated basis (see ■ GENPRU 1.2.48 R to ■ GENPRU 1.2.56 G and ■ GENPRU 1.2.29 G).

Outline of other related provisions

1.2.18 **G** ■ GENPRU 2.1 sets out the minimum *capital resources requirements* for a *firm*. ■ GENPRU 2.2 sets out how *capital resources* are defined and measured for the purpose of meeting the requirements of ■ GENPRU 2.1.

1.2.19 **G**

- (1) ■ BIPRU 2.2 (Internal capital adequacy standards) sets out detailed *guidance* on how a *firm* should carry out the assessment referred to in ■ GENPRU 1.2.15 G. The more thorough, objective, and prudent a *firm's* assessment is, and can be demonstrated as being, the more reliance the *FCA* will be able to place on the results of that assessment.
- (2) ■ BIPRU 2.2 also has information on how the *FCA* will review and respond to the assessments referred to in ■ GENPRU 1.2.15G and ■ GENPRU 1.2.16 G. In particular they deal with the giving of *individual capital guidance* to a *firm*, which is *guidance* about the amount and quality of capital resources that the *FCA* thinks a

firm should hold at all times under the *overall financial adequacy rule* as it applies on a solo level and a consolidated level. ■ BIPRU 2.2. also deals with the giving of a *capital planning buffer* to a *BIPRU firm* on a solo level and a consolidated level.

- 1.2.20 G SYSC sets out general *rules* and *guidance* on the establishment and maintenance of systems and controls.

- 1.2.21 G [deleted]

- 1.2.21A G
 - (1) ■ BIPRU 12 sets out material on systems and controls that apply specifically to *liquidity risk* in relation to a *BIPRU firm*.
 - (2) ■ GENPRU 2.2 (Adequacy of financial resources) requires certain *BIPRU firms* to deduct illiquid assets when calculating their *capital resources*.

- 1.2.22 G ■ BIPRU 2.3 contains *rules* and *guidance* on interest rate risk in the *non-trading book*. That material elaborates on the general obligation in the *overall Pillar 2 rule*.

- 1.2.23 G For a *BIPRU firm* using a *VaR model* ■ BIPRU 7.10.72 R (Risk management standards: Stress testing) sets out certain stress tests that the *firm* should carry out.

- 1.2.24 G

- 1.2.25 G For a *BIPRU firm* using the *IRB approach* ■ BIPRU 4.3.39 R to ■ BIPRU 4.3.40 R set out a recession credit rating migration stress test that the *firm* should carry out. Further *rules* and *guidance* on such stress tests are set out in ■ BIPRU 2.2 (Internal capital adequacy standards).

- 1.2.26 R **Requirement to have adequate financial resources**
 A *firm* must at all times maintain overall financial resources, including *capital resources* and *liquidity resources*, which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.

- 1.2.26A G ■ BIPRU 12 contains *rules* and *guidance* in relation to the adequacy of a *BIPRU firm's* liquidity resources. Consistent with ■ GENPRU 1.2.2A R, in assessing the adequacy of its liquidity resources, a *BIPRU firm* should do so by reference to the *overall liquidity adequacy rule*, rather than the *overall financial adequacy rule*.

- 1.2.27 G The liabilities referred to in the *overall financial adequacy rule* include a *firm's* contingent and prospective liabilities. They exclude liabilities that might arise from transactions that a *firm* has not entered into and which it could avoid, for example, by taking realistic management actions such as

ceasing to transact new business after a suitable period of time has elapsed. They include liabilities or costs that arise both in scenarios where the *firm* is a going concern and those where the *firm* ceases to be a going concern. They also include claims that could be made against a *firm*, which ought to be paid in accordance with fair treatment of *customers*, even if such claims could not be legally enforced.

1.2.28 **G** A *firm* should therefore make its assessment of adequate financial resources on realistic valuation bases for assets and liabilities taking into account the actual amounts and timing of cash flows under realistic adverse projections.

1.2.29 **G** Risks may be addressed through holding capital to absorb losses that unexpectedly materialise. The ability to pay liabilities as they fall due also requires liquidity. Therefore, in assessing the adequacy of a *firm's* financial resources, both capital and liquidity needs should be considered. A *firm* should also consider the quality of its financial resources such as the loss-absorbency of different types of capital and the time required to liquidate different types of asset.

Systems, strategies, processes and reviews

1.2.30 **R** A *firm* must have in place sound, effective and complete processes, strategies and systems:

- (1) to assess and maintain on an ongoing basis the amounts, types and distribution of financial resources, *capital resources* and internal capital that it considers adequate to cover:
 - (a) the nature and level of the risks to which it is or might be exposed;
 - (b) the risk in the *overall financial adequacy rule*; and
 - (c) the risk that the *firm* might not be able to meet its *CRR* in the future; and

- (2) that enable it to identify and manage the major sources of risks referred to in (1), including the major sources of risk in each of the following categories where they are relevant to the *firm* given the nature and scale of its business:
- (a) credit risk;
 - (b) *market risk*;
 - (c) *liquidity risk*;
 - (d) *operational risk*;
 - (e) insurance risk;
 - (f) concentration risk;
 - (g) residual risk;
 - (h) *securitisation risk*;
 - (i) business risk;
 - (j) interest rate risk (including, in the case of a *BIPRU firm*, interest rate risk in the *non-trading book*);
 - (k) pension obligation risk; and
 - (l) group risk.

1.2.31

R

- (1) This *rule* defines some of the terms used in the *overall Pillar 2 rule*.
- (2) Residual risk means the risk that *credit risk mitigation* techniques used by the *firm* prove less effective than expected.
- (3) *Securitisation risk* includes the risk that the *capital resources* held by a *firm* in respect of assets which it has *securitised* are inadequate having regard to the economic substance of the transaction, including the degree of risk transfer achieved.
- (4) Business risk means any risk to a *firm* arising from changes in its business, including the risk that the *firm* may not be able to carry out its business plan and its desired strategy. It also includes risks arising from a *firm's remuneration policy* (see also the *Remuneration Code* which applies to *BIPRU firms* and the detailed application of which is set out in ■ SYSC 19A.1).
- (5) Pension obligation risk is the risk to a *firm* caused by its contractual or other liabilities to or with respect to a pension scheme (whether established for its employees or those of a related *company* or otherwise). It also means the risk that the *firm* will make payments or other contribution to or with respect to a pension scheme because of a moral obligation or because the *firm* considers that it needs to do so for some other reason.

1.2.32

G

- (1) This paragraph gives *guidance* on some of the terms used in the *overall Pillar 2 rule*.
- (2) Insurance risk refers to the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities.

- (3) Interest rate risk in the *non-trading book* is explained in ■ BIPRU 2.3 (Interest rate risk in the non-trading book).
 - (4) In a narrow sense, business risk is the risk to a *firm* that it suffers losses because its income falls or is volatile relative to its fixed cost base. However, in a broader sense, it is exposure to a wide range of macro-economic, geopolitical, industry, regulatory and other external risks that might deflect a *firm* from its desired strategy and business plan. ■ GENPRU 1.2.73 G provides further *guidance* on business risk.
 - (5) Further material on pension obligation risk can be found in ■ GENPRU 1.2.79 G – ■ GENPRU 1.2.86 G.
 - (6) Group risk is the risk that the financial position of a *firm* may be adversely affected by its relationships (financial or non-financial) with other entities in the same *group* or by risks which may affect the financial position of the whole *group*, for example reputational contagion. Further *guidance* on group risk can be found in ■ GENPRU 1.2.87 G to ■ GENPRU 1.2.91 G.
- 1.2.33 **R** (1) This *rule* amplifies some of the obligations in the *overall Pillar 2 rule*.
- (3) As part of its obligations in respect of *market risk*, a *BIPRU firm* must consider whether the value adjustments and provisions taken for *positions* and portfolios in the *trading book* enable the *firm* to sell or hedge out its *positions* within a short period without incurring material losses under normal market conditions.
- (4) The processes, strategies and systems required by the *overall Pillar 2 rule* must take into account stress tests and scenario analyses that the *firm* is required to carry out under any other provision of the *Handbook*.
- 1.2.34 **G** In the *overall Pillar 2 rule*, internal capital refers to the financial resources of a *firm* which it treats as being held against the risks listed in the *overall Pillar 2 rule*. The obligation in that *rule* to assess the distribution of such capital refers, in relation to a *firm* making an assessment on a solo basis, for example, to the need to take account of circumstances where part of a *firm's* financial resources are held by a *branch* of that *firm* which are subject to restrictions on its ability to transfer that capital. An assessment of internal capital distribution might also take account of such of a *firm's* financial resources as may be ring-fenced in the event of its insolvency.
- 1.2.35 **R** The processes, strategies and systems required by the *overall Pillar 2 rule* must be comprehensive and proportionate to the nature, scale and complexity of the *firm's* activities.
- 1.2.36 **R** As part of its obligations under ■ GENPRU 1.2.30R (1) (Main requirement relating to risk processes, strategies and systems), a *firm* must identify separately the amount of *tier one capital*, *tier two capital*, *tier three capital*, other capital eligible to form part of its *capital resources* and each category of capital (if any) that is not eligible to form part of its *capital resources* which it considers adequate for the purposes described in ■ GENPRU 1.2.30R (1).

1.2.37 **R** The processes and systems required by the *overall Pillar 2 rule* must:

- (1) include an assessment of how the *firm* intends to deal with each of the major sources of risk identified in accordance with ■ GENPRU 1.2.30R (2);
- (2) take into account the impact of diversification effects and how such effects are factored into the *firm's* systems for measuring and managing risks; and
- (3) include an assessment of the *firm-wide* impact of the risks identified in accordance with ■ GENPRU 1.2.30R (2), to which end a *firm* must aggregate the risks across its various business lines and units, making appropriate allowance for the correlation between risks.

1.2.38 **G** Certain risks such as systems and controls weaknesses may not be adequately addressed by, for example, holding additional capital and a more appropriate response would be to rectify the weakness. In such circumstances, the amount of financial resources required to address these risks might be zero. However, a *firm* should consider whether holding additional capital might be an appropriate response until the identified weaknesses are rectified. A *firm*, should, in accordance with ■ GENPRU 1.2.60 R (Documentation of risk assessments), document the approaches taken to manage these risks.

1.2.39 **R** A *firm* must:

- (1) carry out regularly the assessments required by the *overall Pillar 2 rule*; and
- (2) carry out regularly assessments of the processes, strategies and systems required by the *overall Pillar 2 rule* to ensure that they remain compliant with ■ GENPRU 1.2.35 R.

1.2.40 **G** A *firm* should carry out assessments of the sort described in the *overall Pillar 2 rule* and ■ GENPRU 1.2.39 R at least annually, or more frequently if changes in the business, strategy, nature or scale of its activities or operational environment suggest that the current level of financial resources is no longer adequate. The appropriateness of the internal process, and the degree of involvement of senior management in the process, will be taken into account by the FCA when reviewing a *firm's* assessment as part of the FCA's own assessment of the adequacy of a *firm's* financial resources. The processes and systems should ensure that the assessment of the adequacy of a *firm's* financial resources is reported to its senior management as often as is necessary.

Stress and scenario tests

1.2.42 **R**

- (1) As part of its obligation under the *overall Pillar 2 rule*, a *firm* must, for the major sources of risk identified in accordance with ■ GENPRU 1.2.30R (2), carry out stress tests and scenario analyses that are appropriate to the nature, scale and complexity of those major sources of risk and to the nature, scale and complexity of the *firm's* business.

- (a) [deleted]
- (b) [deleted]
 - (i) [deleted]
 - (ii) [deleted]
 - (iii) [deleted]
 - (iv) [deleted]

(2) In carrying out the stress tests and scenario analyses in (1), a *firm* must identify an appropriate range of adverse circumstances of varying nature, severity and duration relevant to its business and risk profile and consider the exposure of the *firm* to those circumstances, including:

- (a) circumstances and events occurring over a protracted period of time;
- (b) sudden and severe events, such as market shocks or other similar events; and
- (c) some combination of the circumstances and events described in (a) and (b), which may include a sudden and severe market event followed by an economic recession.

(3) In carrying out the stress tests and scenario analyses in (1), the *firm* must estimate the financial resources that it would need in order to continue to meet the *overall financial adequacy rule* and the *CRR* in the adverse circumstances being considered.

(4) In carrying out the stress tests and scenario analyses in (1), the *firm* must assess how risks aggregate across business lines or units, any material non-linear or contingent risks and how risk correlations may increase in stressed conditions.

(5) As part of its obligation under the *overall Pillar 2 rule*, a *BIPRU firm* must also incorporate and take into account any stress tests and scenario analyses that it is required to carry out under *BIPRU*. In particular, a *BIPRU firm* with an *IRB permission* must incorporate and take into account the stress test required to be carried out under ■ BIPRU 4.3.40 R (2).

1.2.42A

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In order to comply with the *general stress and scenario testing rule*, a *firm* should undertake a broad range of stress tests which reflect a variety of perspectives, including sensitivity analysis, scenario analysis and stress testing on an individual portfolio as well as a *firm-wide* level.

1.2.42B

G

A *BIPRU firm* with an *IRB permission* which has any material credit exposures excluded from its *IRB* models should also include these exposures in its stress and scenario testing to meet its obligations under the *general stress and scenario testing rule*. A *BIPRU firm* without an *IRB permission*, should conduct analyses to assess risks to the credit quality of its counterparties, including any protection sellers, considering both on and off-balance sheet exposures.

1.2.42D **G** In carrying out the stress tests and scenario analyses required by **■ GENPRU 1.2.42R (1)**, a *firm* should also consider any impact of the adverse circumstances on its *capital resources*. In particular, a *firm* should consider the *capital resources gearing rules* where its *tier one capital* is eroded by the event.

1.2.42E **G** A *firm* should assign adequate resources, including IT systems, to stress testing and scenario analysis, taking into account the stress testing techniques employed, so as to be able to accommodate different and changing stress tests at an appropriate level of granularity.

1.2.42F **G** **■ GENPRU 1.2.63 G** to **■ GENPRU 1.2.78 G** provide additional *guidance* on stress testing and scenario analyses. In particular, **■ GENPRU 1.2.73A G** provides specific *guidance* on capital planning.

1.2.43 **G** Stress tests and scenario analyses should be carried out at least annually. A *firm* should, however, consider whether the nature of the major sources of risks identified by it in accordance with **■ GENPRU 1.2.30R (2)** (Main requirement relating to risk processes, strategies and systems) and their possible impact on its financial resources suggest that such tests and analyses should be carried out more frequently. For instance, a sudden change in the economic outlook may prompt a *firm* to revise the parameters of some of its stress tests and scenario analyses. Similarly, if a *firm* has recently become exposed to a particular sectoral concentration, it may wish to add some stress tests and scenario analyses in order to reflect that concentration.

**Application of this section on a solo and consolidated basis:
General**

1.2.44 **G**

- (1) **■ GENPRU 1.2.45 R** – **■ GENPRU 1.2.56 G** explain when the *ICAAP rules* apply on a solo basis and when they apply on a consolidated basis. This material also explains how the *ICAAP rules* are adjusted to apply on a consolidated basis.
- (2) **■ GENPRU 1.2.57 R** – **■ GENPRU 1.2.59 R** provide that the *overall financial adequacy rule* always applies on a solo basis. They also explain when and how it applies on a consolidated basis.

**Application of this section on a solo and consolidated basis:
Processes and tests**

1.2.46 **R** The *ICAAP rules* do not apply on a solo basis to a *BIPRU firm* to which the *ICAAP rules*:

- (1) apply on a consolidated basis under **■ BIPRU 8.2.1 R** (Basic consolidation rule for a UK consolidation group); or
- (2) apply on a sub-consolidated basis under **■ BIPRU 8.3.1 R** (Basic consolidation rule for a non-EEA).

1.2.47 **R** The *ICAAP rules* apply on a solo basis:

- (1) [deleted]

1.2.47A **R**

(2) to a *BIPRU firm* to which those *rules* do not apply on a consolidated or sub-consolidated basis as referred to in ■ GENPRU 1.2.46 R (including a *BIPRU investment firm* with an *investment firm consolidation waiver*).

(3) [deleted]

1.2.48 **R**

The requirements of the *ICAAP rules* as they apply on a consolidated basis must be carried out on the basis of the consolidated position of:

(1) [deleted]

(2) (if ■ BIPRU 8.2.1 R (Basic consolidation rule for a *UK consolidation group*) applies) the *UK consolidation group* of which the *firm* is a member; and

(3) (if ■ BIPRU 8.3.1 R (Basic consolidation rule for a non-EEA sub-group) applies) the non-EEA sub-group of which the *firm* is a member.

1.2.49 **R**

(1) In accordance with the general principles in ■ GENPRU 1.2.48 R and ■ BIPRU 8 (Group risk – consolidation), for the purpose of the *ICAAP rules* as they apply on a consolidated basis:

(a) the *firm* must ensure that the relevant group as defined in (2) have the processes, strategies and systems required by the *overall Pillar 2 rule*;

(b) the risks to which the *overall Pillar 2 rule* and the *general stress and scenario testing rule* refer are those risks as they apply to each member of the relevant group;

(c) the reference in the *overall Pillar 2 rule* to amounts and types of financial resources, *capital resources* and internal capital (referred to in this *rule* as resources) must be read as being to the amounts and types that the *firm* considers should be held by the members of the relevant group as defined in (2);

(d) other references to resources must be read as being to resources of the members of the relevant group as defined in (2);

(e) references to the *CRR* are to the consolidated capital requirements applicable to the relevant group under ■ BIPRU 8 (Group risk - consolidation) ;

(f) the reference in the *overall Pillar 2 rule* to the distribution of resources must be read as including a reference to the distribution between members of the relevant group as defined in (2); and

(g) the reference in the *overall Pillar 2 rule* to the *overall financial adequacy rule* must be read as being to that *rule* as adjusted

under ■ GENPRU 1.2.59 R (Application of the *overall financial adequacy rule* on a consolidated basis).

- (2) For the purpose of this *rule* the relevant group is the group referred to in ■ GENPRU 1.2.48 R and the members of that group are those *undertakings* that are included in the scope of consolidation with respect to the *UK consolidation group* or, as the case may be, *non-EEA sub-group* in question.

1.2.50 **G** ■ GENPRU 1.2.49 R means that non-financial members of the *firm's* group are excluded from the *group* assessment. Notwithstanding the scope of ■ GENPRU 1.2.49 R, a *firm* should nevertheless take account of risks arising from the activities of those excluded members in its overall assessment of risk.

1.2.51 **R**

(1) This *rule* relates to the assessment of the amounts, types and distribution of financial resources, *capital resources* and internal capital (referred to in this *rule* as "*resources*") under the *overall Pillar 2 rule* as applied on a consolidated basis and to the assessment of diversification effects as referred to in ■ GENPRU 1.2.37R (2) as applied on a consolidated basis.

(2) A *firm* must be able to explain how it has aggregated the risks referred to in the *overall Pillar 2 rule* and the resources required by each member of the relevant group as referred to in ■ GENPRU 1.2.49R (2) and how it has taken into account any diversification benefits with respect to the group in question.

(3) In particular, to the extent that the transferability of resources affects the assessment in (2), a *firm* must be able to explain how it has satisfied itself that resources are transferable between members of the group in question in the stressed cases and the scenarios referred to in the *general stress and scenario testing rule*.

1.2.52 **R**

(1) A *firm* must allocate the total amount of financial resources, *capital resources* and internal capital identified as necessary under the *overall Pillar 2 rule* (as applied on a consolidated basis) between different parts of the relevant group (as defined in ■ GENPRU 1.2.49 R). ■ GENPRU 1.2.36 R (Identifying different tiers of capital) does not apply to this allocation.

(2) The *firm* must carry out the allocation in (1) in a way that adequately reflects the nature, level and distribution of the risks to which the group is subject and the effect of any diversification benefits.

1.2.53 **R** A *firm* must also allocate the total amount of financial resources, *capital resources* and internal capital (referred to in this *rule* as "*resources*") identified as necessary under the *overall Pillar 2 rule* as applied on a consolidated basis between each *firm* which is a member of the relevant group (as defined in ■ GENPRU 1.2.49 R) on the following basis:

- (1) the amount allocated to each *firm* must be decided on the basis of the principles in ■ GENPRU 1.2.52R (2); and

(2) if the process in (1) were carried out for each group member, the total so allocated would equal the total amount of resources identified as necessary under the *overall Pillar 2 rule* as applied on a consolidated basis.

1.2.54 **G** A *firm* to which the *ICAAP rules* apply on a consolidated basis need not prepare a consolidated basis assessment if such an assessment has been prepared by another member of its *group*. Where that is the case, a *firm* may adopt such an assessment as its own. A *firm* nevertheless remains responsible for the assessment.

1.2.55 **G** The purpose of **■ GENPRU 1.2.51 R – ■ GENPRU 1.2.53 R** is to enable the *FCA* to assess the extent, if any, to which a *firm's* assessment, calculated on a consolidated basis, is lower than it would be if each separate legal entity were to assess the amount of capital it would require to mitigate its risks (to the same level of confidence) were it not part of a group subject to consolidated supervision under **■ BIPRU 8 (Group risk - consolidation)** . The reason the *FCA* wishes to make this assessment is so that individual capital *guidance* which it gives is fair and comparable as between different *firms* and groups. Group diversification benefits which a *firm* might assert exist can be a material consideration in a capital adequacy assessment. Understanding the methods used to aggregate the different risks (for example, the correlation assumptions) is crucial to a proper evaluation of such benefits.

1.2.56 **G** Whereas a single legal entity can generally use its capital to absorb losses wherever they arise, there are often practical and legal restrictions on the ability of a group to do so. For instance:

- (1) capital which is held by overseas regulated *firms* may not be capable of being remitted to a *firm* in the *UK* which has suffered a loss;
- (2) a *firm* which is insolvent or likely to become so may be obliged to look to the interests of its creditors first before transferring capital to other group *companies*; and
- (3) a parent *company* may have to balance the interests of its shareholders against the protection of the creditors of a *subsidiary undertaking* which is or might become insolvent and may, rationally, conclude that a *subsidiary undertaking* should be allowed to fail rather than provide capital to support it.

**Application of this section on a solo and consolidated basis:
Adequacy of resources**

1.2.57 **R** The *overall financial adequacy rule* applies to a *firm* on a solo basis whether or not it also applies to the *firm* on a consolidated basis.

1.2.58 **R** The *overall financial adequacy rule* applies to a *firm* on a consolidated basis if the *ICAAP rules* apply to it on a consolidated basis.

- 1.2.59 **R**
- (1) When the *overall financial adequacy rule* applies on a consolidated basis, the *firm* must ensure that at all times its group maintains overall financial resources, including capital resources and liquidity resources, which are adequate, both as to amount and quality, to ensure that there is no significant risk that the liabilities of any members of its group cannot be met as they fall due.
 - (2) The group referred to in (1) is the relevant group as defined in ■ GENPRU 1.2.49 R.
 - (3) The members of the group referred to in (1) must be identified in accordance with ■ GENPRU 1.2.49 R.

Documentation of risk assessments

- 1.2.60 **R**
- A *firm* must make a written record of the assessments required under this section. These assessments include assessments carried out on a consolidated basis and on a solo basis. In particular it must make a written record of:
- (1) the major sources of risk identified in accordance with ■ GENPRU 1.2.30R (2) (Main requirement relating to risk processes, strategies and systems);
 - (2) how it intends to deal with those risks; and
 - (3) details of the stress tests and scenario analyses carried out, including any assumptions made in relation to scenario design, and the resulting financial resources estimated to be required in accordance with the *general stress and scenario testing rule*.

- 1.2.61 **R**
- A *firm* must retain the records of its assessments referred to in ■ GENPRU 1.2.60 R for at least three years.

- 1.2.62 **G**
- Where a *firm* assesses the adequacy of its *CRR* in its particular circumstances in accordance with ■ BIPRU 2.2 (Internal capital adequacy standards) as a basis for deciding what financial resources are adequate, it should include this in the documentation produced in accordance with ■ GENPRU 1.2.60 R.

Additional guidance on stress tests and scenario analyses

- 1.2.63 **G**
- The *general stress and scenario testing rule* requires a *firm* to carry out stress tests and scenario analyses as part of its obligations under the *overall Pillar 2 rule*. Both stress tests and scenario analyses are undertaken by a *firm* to further a better understanding of the vulnerabilities that it faces under adverse conditions. They are based on the analysis of the impact of a range of events of varying nature, severity and duration. These events can be financial, operational or legal or relate to any other risk that might have an economic impact on the *firm*.

- 1.2.64 **G**
- Stress testing typically refers to shifting the values of individual parameters that affect the financial position of a *firm* and determining the effect on the *firm's* financial position.

- 1.2.65 **G** Scenario analysis typically refers to a wider range of parameters being varied at the same time. Scenario analyses often examine the impact of adverse events on the *firm's* financial position, for example, simultaneous movements in a number of risk categories affecting all of a *firm's* business operations, such as business volumes, investment values and interest rate movements.
- 1.2.66 **G** There are three broad purposes of stress testing and scenario analysis. Firstly, it can be used as a means of quantifying how much capital might be absorbed if an adverse event or events occurred. As such it represents a simple 'what if' approach to estimating exposure to risks. This might be a proportionate approach to risk management for an unsophisticated business. Secondly, it can be used to provide a check on the outputs and accuracy of risk models; particularly, in identifying non-linear effects when aggregating risks. Thirdly, it can be used to explore the sensitivities in longer term business plans and how capital needs might change over time.
- 1.2.67 **G** [deleted]
- 1.2.68 **G** Subject to **■ GENPRU 1.2.76 G**, the purpose of stress tests and scenario analyses under the *general stress and scenario testing rule* is to test the adequacy of overall financial resources. Scenarios need only be identified, and their impact assessed, in so far as this facilitates that purpose. In particular, the nature, depth and detail of the analysis depend, in part, upon the *firm's* capital strength and the robustness of its risk prevention and risk mitigation measures.
- 1.2.69 **G** Both stress testing and scenario analyses are forward-looking analysis techniques, which seek to anticipate possible losses that might occur if an identified risk crystallises. In applying them, a *firm* should decide how far forward to look. This should depend upon:
- (1) how quickly it would be able to identify events or changes in circumstances that might lead to a risk crystallising resulting in a loss; and
 - (2) after it has identified the event or circumstance, how quickly and effectively it could act to prevent or mitigate any loss resulting from the risk crystallising and to reduce exposure to any further adverse event or change in circumstance.
- 1.2.70 **G** Where a firm is exposed to *market risk*, the time horizon over which stress tests and scenario analyses should be carried out will depend on, among other things, the maturity and liquidity of the *positions* stressed. For example, for the *market risk* arising from the holding of investments, this will depend upon:
- (1) the extent to which there is a regular, open and transparent market in those assets, which would allow fluctuations in the value of the investment to be more readily and quickly identified; and
 - (2) the extent to which the market in those assets is sufficiently liquid (and would remain liquid in the changed circumstances contemplated in the stress test or scenario analysis) to allow the *firm*, if needed, to

sell, hedge or otherwise mitigate the risks relating to its holding so as to prevent or reduce exposure to future price fluctuations. In devising stress tests and scenario analyses for *market risk*, a *BIPRU firm* should also take into account ■ BIPRU 7.1.17 R to ■ BIPRU 7.1.20 G.

1.2.71 **G** In identifying scenarios, and assessing their impact, a *firm* should take into account, where material, how changes in circumstances might impact upon:

- (1) the nature, scale and mix of its future activities; and
- (2) the behaviour of *counterparties*, and of the *firm* itself, including the exercise of choices (for example, options embedded in financial instruments or *contracts of insurance*).

1.2.72 **G** In determining whether it would have adequate financial resources in the event of each identified realistic adverse scenario, a *firm* should:

- (1) only include financial resources that could reasonably be relied upon as being available in the circumstances of the identified scenario; and
- (2) take account of any legal or other restriction on the use of financial resources.

1.2.73 **G** (1) [deleted]

(1A) [deleted]

(2) [deleted]

(3) [deleted]

(4) [deleted]

(5) [deleted]

Capital planning.....

1.2.73A **G** (1) In identifying an appropriate range of adverse circumstances and events in accordance with ■ GENPRU 1.2.42R (2):

- (a) a *firm* will need to consider the cycles it is most exposed to and whether these are general economic cycles or specific to particular markets, sectors or industries;
- (b) for the purposes of ■ GENPRU 1.2.42R (2)(a), the amplitude and duration of the relevant cycle should include a severe downturn scenario based on forward looking hypothetical events, calibrated against the most adverse movements in individual risk drivers experienced over a long historical period;
- (c) the adverse scenarios considered should in general be acyclical and, accordingly, the scenario should not become more severe during a downturn and less severe during an upturn. However, the *FCA* does expect scenarios to be updated with relevant new economic data on a pragmatic basis to ensure that the scenario continues to be relevant; and

- (d) the adverse scenarios considered should reflect a *firm's* risk tolerance of the adverse conditions through which it expects to remain a going concern.
- (2) In making the estimate required by ■ GENPRU 1.2.42R (3), a *firm* should project both its *capital resources* and its required *capital resources* over a time horizon of 3 to 5 years, taking account of its business plan and the impact of relevant adverse scenarios. In making the estimate, the *firm* should consider both the *capital resources* required to meet its *CRR* and the *capital resources* needed to meet the *overall financial adequacy rule*. The *firm* should make these projections in a manner consistent with its risk management processes and systems as set out in ■ GENPRU 1.2.37 R.
- (3) In projecting its financial position over the relevant time horizon, the *firm* should:
- (a) reflect how its business plan would “flex” in response to the adverse events being considered, taking into account factors such as changing consumer demand and changes to new business assumptions;
 - (b) consider the potential impact on its stress testing of dynamic feedback effects and second order effects of the major sources of risk identified in accordance with ■ GENPRU 1.2.30R (2);
 - (c) estimate the effects on the *firm's* financial position of the adverse event without adjusting for management actions;
 - (d) separately, identify any realistic management actions that the *firm* could and would take to mitigate the adverse effects of the stress scenario; and
 - (e) estimate the effects of the stress scenario on the *firm's* financial position after taking account of realistic management actions.
- (4) A *firm* should identify any realistic management actions intended to maintain or restore its capital adequacy. These could include ceasing to transact new business after a suitable period has elapsed, balance sheet shrinkage, restricting distribution of profits or raising additional capital. A *firm* should reflect management actions in its projections only where it could and would take such actions, taking account of factors such as market conditions in the stress scenario and any effects upon the *firm's* reputation with its counterparties and investors. The combined effect on capital and retained earnings should be estimated. In order to assess whether prospective management actions in a stress scenario would be realistic and to determine which actions the *firm* would and could take, the *firm* should take into account any preconditions that might affect the value of management actions as risk mitigants and analyse the difference between the estimates in (3)(c) and (3)(e) in sufficient detail to understand the implications of taking different management actions at different times, particularly where they represent a significant divergence from the *firm's* business plan.
- (5) The *firm* should document its stress testing and scenario analysis policies and procedures, as well as the results of its tests in accordance with ■ GENPRU 1.2.60 R. These records should be included within the *firm's* ICAAP submission document.

- (6) The *FCA* will review the *firm's* records referred to in (5) as part of its *SREP*. The purpose of examining these is to enable the *FCA* to judge whether a *firm* will be able to continue to meet its *CRR* and the *overall financial adequacy rule* throughout the projection period.
- (7) If, after taking account of realistic management actions, a *firm's* stress testing management plan shows that the *firm's* projected *capital resources* are less than those required to continue to meet its *CRR* or less than those needed to continue to meet the *overall financial adequacy rule* over the projection period, the *FCA* may require the *firm* to set out additional countervailing measures and off-setting actions to reduce such difference or to restore the *firm's* capital adequacy after the stress event.
- (8) The *firm's* senior management or *governing body* should be actively involved and engaged in all relevant stages of the *firm's* stress testing and scenario analysis programme. This would include establishing an appropriate stress testing programme, reviewing the programme's implementation (including the design of scenarios) and challenging, approving and actioning the results of the stress tests.
- (9) [deleted]

1.2.73B G The *FCA* may formulate macroeconomic and financial market scenarios which a *firm* may use as an additional input to its *ICAAP* submission. In addition, the *FCA* may also ask a *firm* to apply specific scenarios directly in its *ICAAP* submission.

1.2.73C G [deleted]

1.2.74 G A *firm* may consider scenarios in which expected future profits will provide capital reserves against future risks. However, it would only be appropriate to take into account profits that can be foreseen with a reasonable degree of certainty as arising before the risk against which they are being held could possibly arise. In estimating future reserves, a *firm* should deduct future dividend payment estimates from projections of future profits.

1.2.75 G

- (1) [deleted]
- (2) Stress and scenario analyses should, in the first instance, be aligned with the risk appetite of the *firm*, as well as the nature, scale and complexity of its business and of the risks that it bears. The calibration of the stress and scenario analyses should be reconciled to a clear statement setting out the premise upon which the *firm's* internal capital assessment under the *overall Pillar 2 rule* is based.
- (3) [deleted]
- (4) In identifying adverse circumstances and events in accordance with ■ GENPRU 1.2.42R (2), a *firm* should consider the results of any reverse stress testing conducted in accordance with ■ SYSC 20. Reverse stress testing may be expected to provide useful information about the *firm's* vulnerabilities and variations around the most likely ruin scenarios for the purpose of meeting the *firm's* obligations under

■ GENPRU 1.2.42 R. In addition, such a comparison may help a *firm* to assess the sensitivity of its financial position to different stress calibrations.

1.2.76 **G** A *firm* should use the results of its stress testing and scenario analysis not only to assess capital needs, but also to decide if measures should be put in place to minimise the adverse effect on the *firm* if the risk covered by the stress or scenario test actually materialises. Such measures might be a contingency plan or might be more concrete risk mitigation steps.

1.2.77 **G** Additional *guidance* on stress tests and scenario analyses for the assessment of *capital resources* is available in ■ BIPRU 2.2 (Internal capital adequacy standards).

1.2.78 **G** [deleted]

1.2.78A **G** ■ BIPRU 12 sets out the main *Handbook* provisions in relation to *liquidity risk* for a *BIPRU firm*.

Pension obligation risk

1.2.79 **G** ■ GENPRU 1.2.80 G to ■ GENPRU 1.2.86 G contain *guidance* on the assessment required by ■ GENPRU 1.2.30R (2)(k) for a *firm* exposed to pension obligation risk as defined in ■ GENPRU 1.2.31R (5).

1.2.80 **G** The pension scheme itself (i.e. the scheme's assets and liabilities) is not the focus of the risk assessment but rather the *firm's* obligations towards the pension scheme . A *firm* should include in its estimate of financial resources

both its expected obligations to the pension scheme and any increase in obligations that may arise in a stress scenario.

- 1.2.81** **G** If a *firm* has a current funding obligation in excess of normal contributions or there is a risk that such a funding obligation will arise then, when calculating available capital resources, it should reverse out any accounting deficit and replace this in its capital adequacy assessment with its best estimate, calculated in discussion with the scheme's actuaries or trustees, of the cash that will need to be paid into the scheme in addition to normal contributions over the foreseeable future. This may differ from the approach taken in assessing pension scheme risks for the purposes of calculating resources to meet the *CRR*, where a *firm* may not need to consider funding obligations beyond the next five years.
- 1.2.82** **G** A *firm* should also assess the risks that may increase its current funding obligations towards the pension scheme and that might lead to the *firm* not being able to pay its other liabilities as they fall due.
- 1.2.83** **G** A *firm* may wish to consider the following scenarios:
- (1) one in which the *firm* gets into difficulties with an effect on its ability to fund the pension scheme; and
 - (2) one in which the pension scheme position deteriorates (for example, because investment returns fall below expected returns or because of increases in life expectancy) with an effect on the *firm's* funding obligations; taking into account the management actions the *firm* could and would take.
- 1.2.83A** **G** A *firm* is expected to determine where the scope of any stress test impacts upon its pension obligation risk and estimate how the relevant measure of pension obligation risk will change in the scenario in question. For example, in carrying out stress tests under ■ GENPRU 1.2.42 R a *firm* must consider how a stress scenario, such as an economic recession, would impact on the *firm's* current obligations towards its pension scheme and any potential increase in those obligations. Risks such as interest rate risk or reduced investment returns may have a direct impact on a *firm's* financial position as well as an indirect impact resulting from an increase in the *firm's* pension scheme obligations. Both effects should be taken into account in a *firm's* estimate of financial resources under ■ GENPRU 1.2.30 R.
- 1.2.84** **G** Scenarios in which a *firm's* employees suffer a loss or members of a pension scheme suffer a loss do not necessarily affect the *firm's* ability to pay its liabilities as they fall due.
- 1.2.85** **G** A *firm* should consider issues such as:
- (1) the extent to which trustees of the pension scheme or a pension regulator (such as the one created under the Pensions Act 2004) can compel a certain level of contributions or a one-off payment in adverse financial situations or in order to meet the minimum legal

requirements under the scheme's trust deed and rules or under the applicable laws relating to the pension scheme;

- (2) whether the valuation bases used to set pension scheme contribution rates are consistent with the *firm's* current business plans and anticipated changes in the workforce; and
- (3) which valuation basis is appropriate given the expected investment return on scheme assets and actions the *firm* can take if those returns do not materialise.

1.2.86 G A *firm* should carry out analyses only to a degree of sophistication and complexity which is commensurate with the materiality of its pension risks.

Group risk (BIPRU firm only)

1.2.87 G ■ GENPRU 1.2.88G to ■ GENPRU 1.2.91G contain additional *guidance* on the assessment required by ■ GENPRU 1.2.30R (2)(I) (Group risk).

1.2.88 G A *firm* should include in the written record referred to in ■ GENPRU 1.2.60 R a description of the broad business strategy of the *UK consolidation group* or the *non-EEA sub-group* of which it is a member, the group's view of its principal risks and its approach to measuring, managing and controlling the risks. This description should include the role of stress testing, scenario analysis and contingency planning in managing risk at the solo and consolidated level.

1.2.89 G A *firm* should satisfy itself that the systems (including IT) of the *UK consolidation group* or the *non-EEA sub-group* of which it is a member are sufficiently sound to support the effective management and, where applicable, the quantification of the risks that could affect the *UK consolidation group* or the *non-EEA sub-group*, as the case may be.

1.2.90 G In performing stress tests and scenario analyses, a *firm* should take into account the risk that its *group* may have to bring back on to its consolidated balance sheet the assets and liabilities of off-balance sheet entities as a result of reputational contagion, notwithstanding the appearance of legal risk transfer.

1.2.91 G A *firm* should carry out stress tests and scenario analyses to a degree of sophistication which is commensurate with the complexity of its group and the nature of its *group* risk.

1.3 Valuation

Application

- 1.3.1 **R** (1) [deleted]
- (2) This section of the *Handbook* applies to a *BIPRU firm*.
- (3) [deleted]

1.3.1A **R**

Purpose

- 1.3.2 **G** This section sets out, for the purposes of *GENPRU* and *BIPRU*, *rules* and *guidance* as to how a *firm* should recognise and value assets, liabilities, *exposures*, equity and income statement items.
- 1.3.3 **G** (1) In the case of a *BIPRU firm*, this section implements Articles 64(4) and 64(5) of the *Banking Consolidation Directive* (Own funds) and Article 33 and Part B of Annex VII of the *Capital Adequacy Directive*.
- (2) [deleted]

General requirements: Accounting principles to be applied

- 1.3.4 **R** Subject to ■ GENPRU 1.3.9 R to ■ GENPRU 1.3.10 R and ■ GENPRU 1.3.36 R, except where a *rule* in *GENPRU*, *BIPRU* or *INSPRU* provides for a different method of recognition or valuation, whenever a *rule* in *GENPRU* or *BIPRU* refers to an asset, liability, *exposure*, equity or income statement item, a *firm* must, for the purpose of that *rule*, recognise the asset, liability, *exposure*, equity or income statement item and measure its value in accordance with whichever of the following are applicable:
- (1) [deleted]
- (2) Financial Reporting Standards issued by the Financial Reporting Council;
- (3) Statements of Recommended Practice, issued by industry or sectoral bodies recognised for this purpose by the Financial Reporting Council;
- (4) [deleted]

(5) *international accounting standards*;

(6) the Companies Act 1985; and

(7) the Companies Act 2006;

as applicable to the *firm* for the purpose of its external financial reporting (or as would be applicable if the *firm* was a company with its head office in the *United Kingdom*).

1.3.5

G

Except where a *rule* in *GENPRU* or *BIPRU* makes a different provision, ■ GENPRU 1.3.4 R applies whenever a *rule* in *GENPRU* or *BIPRU* refers to the value or amount of an asset, liability, *exposure*, equity or income statement item, including:

- (1) whether, and when, to recognise or de-recognise an asset or liability;
- (2) the amount at which to value an asset, liability, *exposure*, equity or income statement item; and
- (3) which description to place on an asset, liability, *exposure*, equity or income statement item.

1.3.6

G

In particular, unless an exception applies, ■ GENPRU 1.3.4 R should be applied for the purposes of *GENPRU* or *BIPRU* to determine how to account for:

- (1) netting of amounts due to or from the *firm*;
- (2) the securitisation of assets and liabilities (see also ■ GENPRU 1.3.7 G);
- (3) leased tangible assets;
- (4) assets transferred or received under a sale and repurchase or *stock lending* transaction; and
- (5) assets transferred or received by way of initial or variation margin under a *derivative* or similar transaction.

General requirements: Adjustments to accounting values.....

1.3.9

R

For the purposes of *GENPRU* or *BIPRU*, except where a *rule* in *GENPRU* or *BIPRU* provides for a different method of recognition or valuation:

- (1) when a *firm*, upon initial recognition, designates its liabilities as at fair value through profit or loss, it must always adjust any value calculated in accordance with ■ GENPRU 1.3.4 R by subtracting any unrealised gains or adding back in any unrealised losses which are not attributable to changes in a benchmark interest rate;
- (2) in respect of a *defined benefit occupational pension scheme*:
 - (a) a *firm* must derecognise any *defined benefit asset*;
 - (b) a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*.

1.3.10 **R** An election made under ■ GENPRU 1.3.9R (2) must be applied consistently for the purposes of *GENPRU* or *BIPRU* in respect of any one financial year.

1.3.11 **G** A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *appropriate regulator* the reasons for any difference between the *deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme*.

1.3.12 **G** The provisions of ■ GENPRU 1.3.9 R to ■ GENPRU 1.3.10 R and ■ GENPRU 1.3.36 R apply only to the extent that the items referred to in those paragraphs would otherwise be recognised under the accounting requirements applicable to the *firm*. Some of those requirements may only be relevant to a *firm* subject to *international accounting standards*.

General requirements: Methods of valuation and systems and controls

1.3.13 **R**

- (1) Except to the extent that *GENPRU* or *BIPRU* provide for another method of valuation, ■ GENPRU 1.3.14 R to ■ GENPRU 1.3.34 R (Marking to market, Marking to model, Independent price verification or Valuation adjustments) apply:
 - (a) for the purposes set out in ■ GENPRU 1.3.41 R;
 - (b) for the purposes set out in ■ GENPRU 1.3.39 R; and
 - (c) to any balance sheet position measured at market value or fair value.
- (2) A *firm* must establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates.
- (3) Systems and controls under (2) must include at least the following elements:
 - (a) documented policies and procedures for the process of valuation, including clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, month-end and ad-hoc verification procedures, and, in the case of a *BIPRU firm*, guidelines for the

- use of unobservable inputs reflecting the *firm's* assumptions of what market participants would use in pricing the *position*; and
- (b) reporting lines for the department accountable for the valuation process that are:
 - (i) clear and independent of the front office; and
 - (ii) ultimately to a main board executive director.

General requirements: Marking to market

1.3.14 **R** Wherever possible, a *firm* must use mark to market in order to measure the value of the investments and positions to which this *rule* applies under ■ GENPRU 1.3.13 R and ■ GENPRU 1.3.38 R to ■ GENPRU 1.3.41 R. Marking to market is valuation (on at least a daily basis in the case of the *trading book* positions of a *BIPRU firm*) at readily available close out prices from independent sources.

1.3.15 **R** For the purposes of ■ GENPRU 1.3.14 R, examples of readily available close out prices include exchange prices, screen prices, or quotes from several independent reputable brokers.

- 1.3.16** **R**
- (1) When marking to market, a *firm* must use the more prudent side of bid/offer unless the *firm* is a significant market maker in a particular position type and it can close out at the mid-market price.
 - (2) When calculating the current *exposure* value of a credit risk *exposure* for *counterparty credit risk* purposes:
 - (a) a *firm* must use the more prudent side of bid/offer or the mid-market price and the *firm* must be consistent in the basis it chooses; and
 - (b) where the difference between the more prudent side of bid/offer and the mid-market price is material, the *firm* must consider making adjustments.

General requirements: Marking to model

1.3.17 **R** Where marking to market is not possible, a *firm* must (in the case of a *BIPRU firm*, conservatively) use mark to model in order to measure the value of the investments and positions to which this *rule* applies under ■ GENPRU 1.3.13 R and ■ GENPRU 1.3.38 R to ■ GENPRU 1.3.41 R. Marking to model is any valuation which has to be benchmarked, extrapolated or otherwise calculated from a market input. ■ GENPRU 1.3.18 R to ■ GENPRU 1.3.25 R apply when marking to model.

1.3.18 **R** When the model used is developed by the *firm*, that model must be:

- (1) based on appropriate assumptions which have been assessed and challenged by suitably qualified parties independent of the development process;

- (2) independently tested, including validation of the mathematics, assumptions, and software implementation; and
- (3) (in the case of a *BIPRU firm*) developed or approved independently of the front office.

- 1.3.19 **R** A *firm* must ensure that its senior management are aware of the positions which are subject to mark to model and understand the materiality of the uncertainty this creates in the reporting of the performance of the business of the *firm* and the risks to which it is subject.
- 1.3.20 **R** A *firm* must source market inputs in line with market prices so far as possible and assess the appropriateness of the market inputs for the position being valued and the parameters of the model on a frequent basis.
- 1.3.21 **R** A *firm* must use generally accepted valuation methodologies for particular products where these are available.
- 1.3.22 **R** A *firm* must establish formal change control procedures, hold a secure copy of the model, and periodically use that model to check valuations.
- 1.3.23 **R** A *firm* must ensure that its risk management functions are aware of the weaknesses of the models used and how best to reflect those in the valuation output.
- 1.3.24 **R** A *firm* must periodically review the model to determine the accuracy of its performance.
- 1.3.25 **R** Examples of periodical review are assessing the continued appropriateness of the assumptions, analysis of profit and loss versus risk factors and comparison of actual close out values to model outputs.

General requirements: Independent price verification.....

- 1.3.26 **R** In addition to marking to market or marking to model, a *firm* must perform independent price verification. This is the process by which market prices or model inputs are regularly verified for accuracy and independence.
- 1.3.27 **G** For independent price verification, where independent pricing sources are not available or pricing sources are more subjective (for example, only one available broker quote), prudent measures such as valuation adjustments may be appropriate.
- 1.3.28 **R** In the case of the *trading book* positions of a *BIPRU firm*, while daily marking to market may be performed by dealers, verification of market prices and model inputs must be performed by a unit independent of the dealing room, at least monthly (or, depending on the nature of the market/trading activity, more frequently).

General requirements: Valuation adjustments

- 1.3.29** **R** The recognition of any gains or losses arising from valuations subject to ■ GENPRU 1.3.13 R and ■ GENPRU 1.3.38 R to ■ GENPRU 1.3.41 R must be recognised for the purpose of calculating *capital resources* in accordance with ■ GENPRU 1.3.14 R to ■ GENPRU 1.3.34 R (Marking to market, Marking to model, Independent price verification or Valuation adjustments). However if *GENPRU* or *BIPRU* provide for another treatment of such gains or losses, that other treatment must be applied.
- 1.3.30** **R** A *firm* must establish and maintain procedures for considering valuation adjustments. These procedures must be compliant with the requirements set out in ■ GENPRU 1.3.33 R.
- 1.3.31** **R** A *firm* using third-party valuations, or marking to model, must consider whether valuation adjustments are necessary.
- 1.3.32** **R** A *firm* must consider the need for making adjustments for less liquid positions and, on an ongoing basis, review their continued appropriateness in accordance with the requirements set out in ■ GENPRU 1.3.33 R. Less liquid positions could arise from both market events and institution-related situations e.g. concentration positions and/or stale positions.
- 1.3.33** **R**
- (1) This paragraph sets out the requirements referred to in ■ GENPRU 1.3.30 R and ■ GENPRU 1.3.32 R.
 - (2) A *firm* must consider the following adjustments: unearned credit spreads, close-out costs, operational risks, early termination, investing and funding costs, future administrative costs and, where appropriate, model risk.
 - (3)
 - (a) In the case of a *BIPRU firm*, a *firm* must establish and maintain procedures for calculating adjustments to the current valuation of less liquid positions. Those adjustments must, where necessary, be in addition to any changes to the value of the position required for financial reporting purposes and must be designed to reflect the illiquidity of the position.
 - (b) A *firm* must consider several factors when determining whether a valuation adjustment is necessary for less liquid positions. These factors include the amount of time it would take to hedge out the position/risks within the position; the average and volatility of bid/offer spreads; the availability of market quotes (number and identity of market makers); the average and volatility of trading volumes; market concentrations; the ageing of positions; the extent to which valuation relies on marking to model and the impact of other model risks.

- (4) With regard to complex products including, but not limited to, *securitisation exposures* and *nth-to-default credit derivatives*, a *BIPRU firm* must explicitly consider the need for valuation adjustments for model risk arising from using a valuation which may be incorrect or the risk from using unobservable calibration parameters in the valuation model.

1.3.34 **R** If the result of making adjustments under **■ GENPRU 1.3.29 R** to **■ GENPRU 1.3.33 R** is a valuation which differs from the fair value determined in accordance with **■ GENPRU 1.3.4 R**, a *firm* must reconcile the two valuations.

1.3.35 **G** Reconciliation differences under **■ GENPRU 1.3.34 R** should not be reflected in the valuations under **■ GENPRU 1.3** but should be disclosed to the *FCA* in prudential returns. *Firms* which are subject to the reporting requirement under **■ SUP 16.16** should disclose those reconciliation differences in the Prudent Valuation Return which they are required to submit to the *FCA* under **■ SUP 16.16.4 R**.

1.3.35A **G**

Specific requirements: BIPRU firms

1.3.36 **R** Adjustments to accounting values

- (1) For the purposes of *GENPRU* and *BIPRU*, the adjustments in (2) and (3) apply to values calculated pursuant to **■ GENPRU 1.3.4 R** in addition to those required by **■ GENPRU 1.3.9 R** to **■ GENPRU 1.3.10 R**.
- (2) A *BIPRU firm* must not recognise either:
- the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost; or
 - any unrealised gains or losses on debt instruments held, or formerly held, in the available-for-sale category.
- (3) A *BIPRU firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.
- (4) The items referred to in (2) and (3) must be excluded from *capital resources*.

1.3.37 **G** Provisions for equity instruments held in the available-for-sale category can be found in **■ GENPRU 2.2.185 R**.

Trading book and other fair-valued positions, and revaluations

1.3.38 **R** to **■ GENPRU 1.3.40 R** apply only to a *BIPRU firm*.

- 1.3.39 **R** Both *trading book* positions and other fair-valued positions are subject to prudent valuation rules as specified in ■ GENPRU 1.3.14 R to ■ GENPRU 1.3.34 R (Marking to market, Marking to model, Independent price verification, Valuation adjustments or, in the case of an insurer or a UK ISPV, valuation adjustments or reserves). In accordance with those *rules*, a *firm* must ensure that the value applied to each of its *trading book* positions and other fair-valued positions appropriately reflects the current market value. This value must contain an appropriate degree of certainty having regard to the dynamic nature of *trading book* positions, the demands of prudential soundness and the mode of operation and purpose of capital requirements in respect of *trading book* positions and other fair-valued positions.
- 1.3.40 **R** *Trading book* positions must be re-valued at least daily.



1.4 Actions for damages

General insurance business: Community co-insurance operations -

1.4.1

R

A contravention of the rules in GENPRU does not give rise to a right of action by a private person under section 138D of the Act (and each of those rules is specified under section 138D(3) of the Act as a provision giving rise to no such right of action).

Chapter 2

Capital



2.1 Calculation of capital resources requirements

Application

- 2.1.1 R This section applies to a BIPRU firm.
- 2.1.1A R
- 2.1.2 G The scope of application of this section is not restricted to *firms* that are subject to the relevant *EU* Directives.
- 2.1.3 R
 - (1) This section applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.
 - (2) [deleted]
- 2.1.4 G The adequacy of a *firm's capital resources* needs to be assessed in relation to all the activities of the *firm* and the risks to which they give rise.
- 2.1.5 G The requirements in this section apply to a *firm* on a solo basis.

Purpose

- 2.1.6 G *Principle 4* requires a *firm* to maintain adequate financial resources.
 - GENPRU 2 sets out provisions that deal specifically with the adequacy of that part of a *firm's* financial resources that consists of *capital resources*. The

adequacy of a *firm's capital resources* needs to be assessed both by that *firm* and the *appropriate regulator*. Through its *rules*, the *FCA* sets minimum *capital resources requirements* for *firms*. It also reviews a *firm's* own assessment of its capital needs, and the processes and systems by which that assessment is made, in order to see if the minimum *capital resources requirements* are appropriate (see ■ GENPRU 1.2 (Adequacy of financial resources) and ■ BIPRU 2.2 (Internal capital adequacy standards)).

2.1.7 **G** This section sets *capital resources requirements* for a *firm*. ■ GENPRU 2.2 (Capital resources) sets out how, for the purpose of meeting *capital resources requirements*, the amounts or values of capital, assets and liabilities are to be determined. More detailed *rules* relating to capital, assets and liabilities are set out in ■ GENPRU 1.3 (Valuation) and, for a *BIPRU firm*, *BIPRU*.

2.1.8 **G** (1) [deleted]

(2) This section also implements the third paragraph of article 95(2) of the *EU CRR* applying the provisions of the *Capital Adequacy Directive* and *Banking Consolidation Directive* concerning the level of *capital resources* which a *BIPRU firm* is required to hold. In particular it implements (in part) article 75 of the *Banking Consolidation Directive* and Articles 5, 9, 10 and 18 of the *Capital Adequacy Directive*.

(3) [deleted]

2.1.8A **G**

Monitoring requirements

2.1.9 **R** A *firm* must at all times monitor whether it is complying with the *main BIPRU firm Pillar 1 rules* and be able to demonstrate that it knows at all times whether it is complying with those *rules*.

2.1.10 **G** For the purposes of ■ GENPRU 2.1.9 R, a *firm* should have systems in place to enable it to be certain whether it has adequate *capital resources* to comply with the *main BIPRU firm Pillar 1 rules* at all times. This does not necessarily mean that a *firm* needs to measure the precise amount of its *capital resources* and its *CRR* on a daily basis. A *firm* should, however, be able to demonstrate the adequacy of its *capital resources* at any particular time if asked to do so by the *FCA*.

2.1.11 **R** A *firm* must notify the *FCA* immediately of any breach, or expected breach, of the *main BIPRU firm Pillar 1 rules*.

Additional capital requirements

2.1.12 **G** The *FCA* may impose a higher capital requirement than the minimum requirement set out in this section as part of the *firm's Part 4A permission* (see ■ GENPRU 1.2 (Adequacy of financial resources) and ■ BIPRU 2.2 (Internal capital adequacy standards)).

Main requirement: BIPRU firms

- 2.1.40 **R** A *BIPRU firm* must maintain at all times *capital resources* equal to or in excess of the amount specified in the table in ■ GENPRU 2.1.45 R (Calculation of the variable capital requirement for a *BIPRU firm*).
- 2.1.41 **R** A *BIPRU firm* must maintain at all times *capital resources* equal to or in excess of the *base capital resources requirement* (see the table in ■ GENPRU 2.1.48 R).
- 2.1.42 **R** At the time that it first becomes a *BIPRU firm*, a *firm* must hold *initial capital* of not less than the *base capital resources requirement* applicable to that *firm*.
- 2.1.43 **G** The purpose of the *base capital resources requirement* for a *BIPRU firm* is to act as a minimum capital requirement or floor. It has been written as a separate requirement as there are restrictions in ■ GENPRU 2.2 (Capital resources) on the types of capital that a *BIPRU firm* may use to meet the *base capital resources requirement* which do not apply to some other parts of the capital requirement calculation. In order to preserve the *base capital resources requirement's* role as a floor rather than an additional requirement, ■ GENPRU 2.2.60 R allows a *BIPRU firm* to meet the *base capital resources requirement* with capital that is also used to meet the variable capital requirements in ■ GENPRU 2.1.40 R.
- 2.1.44 **G** The *base capital resources requirement* and the variable capital requirement in ■ GENPRU 2.1.40 R are together called the *capital resources requirement (CRR)* in the case of a *BIPRU firm*.

Calculation of the variable capital requirement for a BIPRU firm

2.1.45 **R** This table belongs to ■ GENPRU 2.1.40 R
FCA

Firm category	Capital requirement
<i>BIPRU firm</i> (including <i>collective portfolio management investment firm</i>)	the higher of (1) and (2):
	(1) the sum of:
	(a) the <i>credit risk capital requirement</i> ; and (b) the <i>market risk capital requirement</i> ; and
	(2) the <i>fixed overheads requirement</i> .

Adjustment of the variable capital requirement calculation for collective portfolio management investment firms

2.1.46 **R** When a *collective portfolio management investment firm* calculates the *credit risk capital requirement* and the *market risk capital requirement* for the purpose of calculating the variable capital requirement under **■ GENPRU 2.1.40 R** it must do so only in respect of *designated investment business*. For this purpose *managing an AIF* or *managing a UCITS* is excluded from *designated investment business*.

Calculation of the base capital resources requirement for a BIPRU firm

2.1.47 **R** The amount of a *BIPRU firm's base capital resources requirement* is set out in the table in **■ GENPRU 2.1.48 R**.

Table: Base capital resources requirement for a BIPRU firm

2.1.48 **R** This table belongs to **■ GENPRU 2.1.47 R**

Firm category	Amount: Currency equivalent of
<i>BIPRU firm (but not a collective portfolio management investment firm)</i>	€50,000

2.1.48A **G** A *collective portfolio management investment firm* is required to maintain *base own funds requirement* of €125,000 (in line with **■ IPRU-INV-link-11.3.1R(1)**).

Definition of BIPRU firm

2.1.49 **G** The Capital Adequacy Directive sets out various categories of *investment firms* subject to differing levels of initial capital. For the purpose of the third paragraph of article 95(2) of the *EU CRR*, a *BIPRU firm* falls into the category in article 5(3) of the Capital Adequacy Directive. In summary, a *BIPRU firm*:

- (1) does not provide the *ancillary service* of safekeeping and administration of *financial instruments* for the account of *clients*, including custodianship and related services such as cash/collateral management, and is not authorised to do so;
- (2) is not authorised to provide the following *investment services*:
 - (a) to deal in any *financial instruments* for its own account;
 - (b) to underwrite issues of *financial instruments* on a firm commitment basis;
 - (c) to place *financial instruments* without a firm commitment basis; and
 - (d) to operate a *multilateral trading facility*;
- (3) is authorised to provide one or more of the following *investment services*:
 - (a) the execution of investors' orders for *financial instruments*; or
 - (b) the management of individual portfolios of investments in *financial instruments*;

- (4) may be authorised to provide one or more of the following *investment services*:
 - (a) reception and transmission of investors' orders for *financial instruments*; or
 - (b) investment advice; and
- (5) does not hold clients' money and/or securities and is not authorised to do so (it should have a *limitation or requirement* prohibiting the holding of client money and its permission should not include *safeguarding and administering investments*).

Calculation of the credit risk capital requirement (BIPRU firm only)

2.1.51 **R** A BIPRU firm must calculate its *credit risk capital requirement* as the sum of:

- (1) the *credit risk capital component*; and
- (2) the *counterparty risk capital component*.
- (3) [deleted]

Calculation of the market risk capital requirement (BIPRU firm only)

2.1.52 **R** (1) A BIPRU firm must calculate its *market risk capital requirement* as the sum of:

- (a) the *interest rate PRR* (including the basic *interest rate PRR* for equity derivatives set out in ■ BIPRU 7.3 (Equity PRR and basic interest rate PRR for equity derivatives));
- (b) the *equity PRR*;
- (c) the *commodity PRR*;
- (d) the *foreign currency PRR*;
- (e) the *option PRR*; and
- (f) the *collective investment undertaking PRR*.

(2) Any amount calculated under ■ BIPRU 7.1.9 R - ■ BIPRU 7.1.13 R (Instruments for which no PRR treatment has been specified) must be allocated between the *PRR* charges in (1) in the most appropriate manner.

Calculation of the fixed overheads requirement

2.1.53 **R** 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 2.1.54 R.

2.1.54 **R** For the purpose of ■ GENPRU 2.1.53 R, and subject to ■ GENPRU 2.1.55 R to ■ GENPRU 2.1.57 R, a BIPRU firm's relevant fixed expenditure is the amount described as total expenditure in its most recent audited *annual report and*

accounts, less the following items (if they are included within such expenditure):

- (1) staff bonuses, except to the extent that they are guaranteed;
- (2) employees' and directors' shares in profits, except to the extent that they are guaranteed;
- (3) other appropriations of profits;
- (4) shared commission and fees payable which are directly related to commission and fees receivable, which are included within total revenue;
- (5) interest charges in respect of borrowings made to finance the acquisition of the *firm's readily realisable investments*;
- (6) interest paid to customers on *client money*;
- (7) interest paid to counterparties;
- (8) fees, brokerage and other charges paid to *clearing houses*, exchanges and *intermediate brokers* for the purposes of *executing*, registering or clearing transactions;
- (9) foreign exchange losses; and
- (10) other variable expenditure.

2.1.55 **R** The relevant fixed expenditure of a *firm* in the following circumstances is:

- (1) where its most recent audited *annual report and accounts* do not represent a twelve month period, an amount calculated in accordance with **GENPRU 2.1.54 R**, pro-rated so as to produce an equivalent annual amount; and
- (2) where it has not completed twelve months' trading, an amount based on forecast expenditure included in the budget for the first twelve months' trading, as submitted with its application for *authorisation*.

2.1.56 **R** A *firm* must adjust its relevant fixed expenditure calculation so far as necessary if and to the extent that since the date covered by the most recent audited *annual report and accounts* or (if **GENPRU 2.1.55R (2)** applies) since the budget was prepared:

- (1) its level of fixed expenditure changes materially; or
- (2) its *regulated activities* comprised within its *permission* change.

2.1.57 **R** 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.

2.1.58 **G** For the purpose of ■ GENPRU 2.1.57 R, the *FCA* would consider as material 10% of a *firm's* expenditure incurred on its behalf by third parties.

2.1.59 **G** For the purpose of ■ GENPRU 2.1.54 R to ■ 2.1.57 R, fixed expenditure is expenditure which is inelastic relative to fluctuations in a *firm's* levels of business. Fixed expenditure is likely to include most salaries and staff costs, office rent, payment for the rent or lease of office equipment, and insurance *premiums*. It may be viewed as the amount of funds which a *firm* would require to enable it to cease business in an orderly manner, should the need arise. This is not an exhaustive list of such expenditure and a *firm* will itself need to identify (taking appropriate advice where necessary) which costs amount to fixed expenditure.

Calculation of base capital resources requirement for banks authorised before 1993

- 2.1.60 **R**
- (1) This *rule* applies to a *bank* that meets the following conditions:
 - (a) on 31 December 2006 it had the benefit of IPRU(BANK) rule 3.3.12 (Reduced minimum capital requirement for a *bank* that is a *credit institution* which immediately before 1 January 1993 was authorised under the Banking Act 1987);
 - (b) the relevant amount (as referred to in IPRU(BANK) rule 3.3.12) applicable to it was below €5 million as at 31 December 2006; and
 - (c) on 1 January 2007 it did not comply with the *base capital resources requirement* as set out in the table in ■ GENPRU 2.1.48 R (€5 million requirement).
 - (2) Subject to (3), the applicable *base capital resources requirement* as at any time (the "relevant time") is the higher of:
 - (a) the relevant amount applicable to it under IPRU(BANK) rule 3.3.12 as at 31 December 2006 as adjusted under ■ GENPRU 2.1.62R (2); and
 - (b) the highest amount of eligible *capital resources* which that *bank* has held between 1 January 2007 and the relevant time.
 - (3) This *rule* ceases to apply when:
 - (a) that *bank's* eligible *capital resources* at any time since 1 January 2007 equal or exceed €5 million; or
 - (b) a *person* (other than an existing controller) becomes the *parent undertaking* of that *bank*.
 - (4) If this *rule* ceases to apply under (3)(a) it continues not to apply if the *bank's* eligible *capital resources* later fall below €5 million.

2.1.61 **G** Where two or more *banks* merge, all of which individually have the benefit of ■ GENPRU 2.1.60 R, the *PRA* may agree in certain circumstances that the *base capital resources requirement* for the *bank* resulting from the merger may be the sum of the aggregate *capital resources* of the merged *banks*, calculated at the time of the merger, provided this figure is less than €5 million.

2.1.62 **R** For the purpose of ■ GENPRU 2.1.60 R:

- (1) an existing controller of a *bank* means:
 - (a) a *person* who has been a *parent undertaking* of that *bank* since 31 December 2006 or earlier; or
 - (b) a *person* who became a *parent undertaking* of that *bank* after 31 December 2006 but who, when he became a *parent undertaking* of that *bank*, was a *subsidiary undertaking* of an existing controller of that *bank*;
- (2) the relevant amount of capital as referred to in ■ GENPRU 2.1.60R (2)(a) is adjusted by identifying the time as of which the amount of capital it was obliged to hold under IPRU(BANK) rule 3.3.12 as referred to in ■ GENPRU 2.1.60R (2)(a) was fixed and then recalculating the capital resources it held at that time in accordance with the definition of eligible *capital resources* (as defined in (3)); and
- (3) eligible *capital resources* mean *capital resources* eligible under ■ GENPRU 2.2 (Capital resources) to be used to meet the *base capital resources requirement*.

2.2 Capital resources

Application

2.2.1 **R** This section applies to a *BIPRU firm*.

2.2.1A **R**

Purpose

2.2.2 **G** ■ GENPRU 2.1 (Calculation of capital resources requirement) sets out minimum *capital resources requirements* for a *firm*. This section (■ GENPRU 2.2) sets out how, for the purpose of these requirements, *capital resources* are defined and measured.

2.2.4 **G** This section also implements minimum EC standards for the composition of *capital resources* required to be held by a *BIPRU firm*. In particular it implements the third paragraph of article 95(2) of the *EU CRR*, applying Articles 56 – 61, Articles 63 – 64, Article 66 and Articles 120 – 122 of the *Banking Consolidation Directive* (2006/48/EC) and Articles 12 – 16, Article 17 (in part), Article 22(1)(c) (in part) and paragraphs 13 - 15 of Part B of Annex VII of the *Capital Adequacy Directive* (2006/49/EC).

Contents guide

2.2.5 **G** The table in ■ GENPRU 2.2.6 G sets out where the main topics in this section can be found.

Table: Arrangement of GENPRU 2.2

2.2.6 **G** This table belongs to ■ GENPRU 2.2.5 G

Topic	Location of text
Application and purpose of the <i>rules</i> in this section	GENPRU 2.2.1 R to GENPRU 2.2.4 G
<i>BIPRU firms</i> that only have simple types of <i>capital resources (simple capital issuers)</i>	GENPRU 2.2.7 G
Principles underlying the definition of <i>capital resources</i>	GENPRU 2.2.8 G
Which method of calculating <i>capital resources</i> applies to which type of <i>firm</i>	GENPRU 2.2.17 R to GENPRU 2.2.19 R
Purpose of the limits on the use of different forms of capital	GENPRU 2.2.24 G
Use of higher tier capital in lower tiers	GENPRU 2.2.25 R to GENPRU 2.2.28 R
Calculation of <i>capital resources</i> for <i>BIPRU firms</i>	GENPRU 2.2.20 G to GENPRU 2.2.21 G; GENPRU 2 Annex 4 to GENPRU 2 Annex 6
Limits on the use of different forms of capital for <i>BIPRU firms</i> (certain types of <i>capital resources</i> cannot be used for certain purposes)	GENPRU 2.2.44 R to GENPRU 2.2.45 R; GENPRU 2.2.47 R to GENPRU 2.2.48 R
Limits on the use of different forms of capital for <i>BIPRU firms (capital resources gearing rules)</i>	GENPRU 2.2.29 R to GENPRU 2.2.31 G; GENPRU 2.2.46 R; GENPRU 2.2.50 R
Example of how the <i>capital resources</i> calculation for <i>BIPRU firms</i> works	GENPRU 2.2.51 G to GENPRU 2.2.59 G
Capital used to meet the <i>base capital resources requirement</i> for <i>BIPRU firms</i>	GENPRU 2.2.60 R to GENPRU 2.2.61 G
Notification of issuance of <i>capital instruments</i> .	GENPRU 2.2.61A R to GENPRU 2.2.61H G
<i>Tier one capital instruments: general</i>	GENPRU 2.2.9 G to GENPRU 2.2.10 G; GENPRU 2.2.62 R to GENPRU 2.2.69 G; GENPRU 2.2.80 R to GENPRU 2.2.82 G
<i>Tier one capital: payment of coupons (BIPRU firm only)</i>	GENPRU 2.2.69A R to GENPRU 2.2.69F G
<i>Core tier one capital: permanent share capital</i>	GENPRU 2.2.83 R to GENPRU 2.2.84A G
General conditions for eligibility of <i>capital instruments</i> as <i>core tier one capital (BIPRU firm only)</i>	GENPRU 2.2.83A R to GENPRU 2.2.83D G; GENPRU 2.2.84A G
<i>Core tier one capital: exception to eligibility criteria (building societies only)</i>	GENPRU 2.2.83E R to GENPRU 2.2.83H G

Topic	Location of text
<i>Core tier one capital</i> : profit and loss account and other reserves: material applicable to all <i>firms</i>	GENPRU 2.2.85 R; GENPRU 2.2.87 R to GENPRU 2.2.89 G; GENPRU 2.2.91 G
<i>Core tier one capital</i> : profit and loss account and other reserves: material specific to <i>BIPRU firms</i>	GENPRU 2.2.86 R; GENPRU 2.2.90 R; GENPRU 2.2.92 G
<i>Core tier one capital</i> : provisions relating to partnerships and <i>limited liability partnerships</i>	GENPRU 2.2.93 R to GENPRU 2.2.100 R
<i>Core tier one capital</i> : share premium account	GENPRU 2.2.101 R
<i>Core tier one capital</i> : externally verified interim net profits	GENPRU 2.2.102 R to GENPRU 2.2.103 G
<i>Hybrid capital</i> (excluding issues through <i>SPVs</i>) (<i>BIPRU firm</i> only)	GENPRU 2.2.115A R to GENPRU 2.2.119 G
<i>Hybrid capital</i> (issues through <i>SPVs</i>) (<i>BIPRU firm</i> only)	GENPRU 2.2.123 R to GENPRU 2.2.137 R
<i>Tier one capital</i> : conversion ratio	GENPRU 2.2.138 R to GENPRU 2.2.144 G
<i>Tier one capital</i> : requirement to have sufficient unissued stock	GENPRU 2.2.145 R
Deductions from <i>tier one capital resources</i>	GENPRU 2.2.155 R to GENPRU 2.2.156 G
<i>Tier two capital</i>	GENPRU 2.2.11 G; GENPRU 2.2.157 G to GENPRU 2.2.197 G
Deductions from <i>tier one capital resources</i> and <i>tier two capital resources</i>	GENPRU 2.2.208 R to GENPRU 2.1.216G; GENPRU 2.2.217 R to GENPRU 2.2.220 R; GENPRU 2.2.236 R to GENPRU 2.2.240 G
<i>Tier three capital</i>	GENPRU 2.2.12 G; GENPRU 2.2.241 R to GENPRU 2.2.249 R
Deductions from total <i>capital resources</i>	GENPRU 2.2.14 G to GENPRU 2.2.16 G; GENPRU 2.2.259 R to GENPRU 2.2.62 R
The effect of swaps	GENPRU 2.2.198 R to GENPRU 2.2.201 R
<i>Step-ups</i> (<i>tier one capital</i> and <i>tier two capital</i>)	GENPRU 2.2.146 R to GENPRU 2.2.154 G
Redemption of <i>tier one instruments</i>	GENPRU 2.2.64R (3); GENPRU 2.2.70 R to GENPRU 2.2.79 G
Purchases of <i>tier one instruments</i> : <i>BIPRU firm</i> only	GENPRU 2.2.79A R to GENPRU 2.2.79H G; GENPRU 2.2.79L G
Redemption of <i>tier two instruments</i>	GENPRU 2.2.172 R to GENPRU 2.2.174 R; GENPRU 2.2.177 R to GENPRU 2.2.178 R (<i>upper tier two instruments</i>); GENPRU 2.2.194 R to GENPRU 2.2.197 G (<i>lower tier two instruments</i>)
Non-standard capital instruments	GENPRU 2.2.13 G
Standard form documentation for subordinated debt	GENPRU 2.2.164 G
Public sector guarantees	GENPRU 2.2.276 R

Topic	Location of text
Simple capital issuers	
2.2.7	<p>G Parts of this section are irrelevant to a <i>BIPRU firm</i> whose <i>capital resources</i> consist of straightforward <i>capital instruments</i>.</p>
Principles underlying the definition of capital resources	
2.2.8	<p>G The <i>FCA</i> has divided its definition of capital into categories, or tiers, reflecting differences in the extent to which the <i>capital instruments</i> concerned meet the purpose and conform to the characteristics of capital listed in ■ GENPRU 2.2.9 G. The <i>FCA</i> generally prefers a <i>firm</i> to hold higher quality capital that meets the characteristics of permanency and loss absorbency that are features of <i>tier one capital</i>. <i>Capital instruments</i> falling into <i>core tier one capital</i> can be included in a <i>firm's</i> regulatory capital without limit. Typically, other forms of capital are either subject to limits (see the <i>capital resources gearing rules</i>) or, in the case of some specialist types of capital, may only be included with the express consent of the <i>FCA</i> (which takes the form of a <i>waiver</i> under section 138A of the <i>Act</i>). Details of the individual components of capital are set out in the <i>capital resources table</i>.</p>
Tier one capital	
2.2.9	<p>G <i>Tier one capital</i> typically has the following characteristics:</p> <ol style="list-style-type: none"> (1) it is able to absorb losses; (2) it is permanent or (in the case of a <i>BIPRU firm</i>) available when required; (3) it ranks for repayment upon winding up, administration or similar procedure after all other debts and liabilities; and (4) it has no fixed costs, that is, there is no inescapable obligation to pay dividends or interest.
2.2.10	<p>G The forms of capital that qualify for <i>Tier one capital</i> are set out in the <i>capital resources table</i> and include, for example, <i>share</i> capital, reserves, partnership and <i>sole trader</i> capital, verified interim net profits and, for a <i>mutual</i>, the <i>initial fund</i> plus permanent members' accounts. <i>Tier one capital</i> is divided into <i>core tier one capital</i> and <i>hybrid capital</i>. <i>Hybrid capital</i> is further divided into the different stages B1, B2 and C of the calculation in the <i>capital resources table</i>.</p>
Upper and lower tier two capital	
2.2.11	<p>G <i>Tier two capital</i> includes forms of capital that do not meet the requirements for permanency and absence of fixed servicing costs that apply to <i>tier one capital</i>. <i>Tier two capital</i> includes, for example:</p> <ol style="list-style-type: none"> (1) capital which is perpetual (that is, has no fixed term) but cumulative (that is, servicing costs cannot be waived at the issuer's option, although they may be deferred – for example, cumulative <i>preference</i>

shares); only perpetual *capital instruments* may be included in *upper tier two capital*;

- (2) capital which is not perpetual (that is, it has a fixed term) or which may have fixed servicing costs that cannot generally be either waived or deferred (for example, most subordinated debt); such capital should normally be of a medium to long-term maturity (that is, an original maturity of at least five years); dated *capital instruments* are included in *lower tier two capital*;
- (3) (for *BIPRU firms*) certain revaluation reserves such as reserves arising from the revaluation of land and buildings, including any net unrealised gains for the fair valuation of equities held in the available-for-sale financial assets category; and
- (4) (for *BIPRU firms*) general/collective provisions.

Tier three capital

2.2.12 **G** *Tier three capital* consists of forms of capital conforming least well to the characteristics of capital listed in ■ GENPRU 2.2.9 G: either subordinated debt of short maturity (*upper tier three capital*) or net *trading book* profits that have not been externally verified (*lower tier three capital*).

Non-standard capital instruments

2.2.13 **G** There may be examples of *capital instruments* that, although based on a standard form, contain structural features that make the *rules* in this section difficult to apply. In such circumstances, a *firm* may seek individual *guidance* on the application of those *rules* to the *capital instrument* in question. See SUP 9 (Individual guidance) for the process to be followed when seeking individual *guidance*.

Deductions from capital

2.2.14 **G** Deductions should be made at the relevant stage of the calculation of *capital resources* to reflect capital that may not be available to the *firm* or assets of uncertain value (for example, holdings of intangible assets and assets).

2.2.15 **G** Deductions should also be made, in the case of certain *BIPRU firms* for *illiquid assets* (see ■ GENPRU 2.2.19 R).

2.2.16 **G** A full list of deductions from *capital resources* is shown in the *capital resources table* applicable to the *firm*.

Which method of calculating capital resources applies to which type of firm

2.2.17 **R** A firm must calculate its *capital resources* in accordance with the version of the *capital resources table* applicable to the *firm*, subject to the *capital resources gearing rules*. The version of the *capital resources table* that applies to a *firm* is specified in the table in ■ GENPRU 2.2.19 R.

2.2.18 **R** In the case of a *BIPRU firm* the *capital resources table* also sets out how the *capital resources requirement* is deducted from *capital resources* in order to decide whether its *capital resources* equal or exceed its *capital resources requirement*.

Table: Applicable capital resources calculation

2.2.19 **R** This table belongs to ■ GENPRU 2.2.17 R

Type of firm	Location of rules	Remarks
<i>BIPRU firm</i> without an <i>investment firm consolidation waiver</i>	GENPRU 2 Annex 4 (Deducts <i>material holdings</i>)	Applies to a <i>BIPRU firm</i> not using GENPRU 2 Annex 5 or GENPRU 2 Annex 6
<i>BIPRU firm</i> without an <i>investment firm consolidation waiver</i>	GENPRU 2 Annex 5 (Deducts <i>illiquid assets</i>)	A <i>BIPRU firm</i> must give one <i>Month's</i> prior notice to the <i>FCA</i> before starting to use or stopping using this method
<i>BIPRU firm</i> with an <i>investment firm consolidation waiver</i>	GENPRU 2 Annex 6 (Deducts <i>illiquid assets</i> and <i>material holdings</i>)	A <i>firm</i> with an <i>investment firm consolidation waiver</i> must use this method. No other <i>BIPRU firm</i> may use it.

Calculation of capital resources: Which rules apply to BIPRU firms

2.2.20 **G** ■ GENPRU 2.2.19 R sets out three different methods of calculating *capital resources* for *BIPRU firms*. The differences between the three methods relate to whether and how *material holdings* and *illiquid assets* are deducted when calculating *capital resources*. The method depends on whether a *firm* has an *investment firm consolidation waiver*. If a *firm* does have such a *waiver*, it should deduct *illiquid assets*, own *group material holdings* and certain contingent liabilities. If a *firm* does not have such a *waiver*, it should choose to deduct either *material holdings* or, subject to notifying the *FCA*, *illiquid assets*.

2.2.21 **G** A consequence of a *firm* deducting all of its *illiquid assets* under ■ GENPRU 2 Annex 5 is that it is allowed a higher limit on short term subordinated debt under ■ GENPRU 2.2.49 R.

Limits on the use of different forms of capital: General

2.2.24 **G** As the various components of capital differ in the degree of protection that they offer the *firm* and its *customers* and *consumers*, restrictions are placed on the extent to which certain types of capital are eligible for inclusion in a

firm's capital resources. These rules are called the capital resources gearing rules.

Limits on the use of different forms of capital: Use of higher tier capital in lower tiers

2.2.25 R A firm may include in a lower stage of capital, capital resources which are eligible for inclusion in a higher stage of capital if the capital resources gearing rules would prevent the use of that capital in that higher stage of capital. However:

- (1) the capital resources gearing rules applicable to that lower stage of capital apply to higher stage of capital included in that lower stage of capital; and
- (2) (subject to ■ GENPRU 2.2.26 R and ■ GENPRU 2.2.26A R) the rules in GENPRU governing the eligibility of capital in that lower stage of capital continue to apply.

2.2.26 R An item of tier one capital which is included in a firm's tier two capital resources under ■ GENPRU 2.2.25 R is not subject to the requirement to obtain a legal opinion in ■ GENPRU 2.2.159R (12).

2.2.26A R A dated item of tier one capital which is included in a BIPRU firm's tier two capital resources under ■ GENPRU 2.2.25 R is not subject to the requirement to have no fixed maturity date in ■ GENPRU 2.2.177R (1).

2.2.27 R [deleted]

2.2.28 R In the case of a BIPRU firm, the requirement to obtain a legal opinion in ■ GENPRU 2.2.159R (12) does not apply to hybrid capital treated under ■ GENPRU 2.2.25 R but the requirements to obtain a legal opinion in ■ GENPRU 2.2.118 R continue to apply.

Limits on the use of different forms of capital: Limits relating to tier one capital applicable to BIPRU firms

2.2.30A R In relation to the tier one capital resources of a BIPRU firm, calculated at stage F of the calculation in the capital resources table (Total tier one capital after deductions):

- (1) no more than 50% may be accounted for by hybrid capital;
- (2) no more than 35% may be accounted for by hybrid capital included at stages B2 and C of the calculation in the capital resources table; and
- (3) no more than 15% may be accounted for by hybrid capital included at stage C of the calculation in the capital resources table.

Limits on the use of different forms of capital: Limits relating to tier one capital: Purpose of the requirements

2.2.31 **G** The purpose of the requirements in ■ GENPRU 2.2.30AR (1) is to ensure that the *firm's tier one capital resources* includes a minimum proportion of *core tier one capital* which provides the highest quality capital. Within the 50% limit on non-core *tier one capital*

(1) [deleted]

(2) ■ GENPRU 2.2.30AR (2) and ■ GENPRU 2.2.30AR (3) place further sub-limits on the amounts of *hybrid capital* included at stages B2 and C of the calculation in the *capital resources table* that a *BIPRU firm* may include in its *tier one capital resources*.

These limits are necessary to ensure that most of a *firm's tier one capital* comprises items of capital of the highest quality.

2.2.42 **R** [deleted]

2.2.43 **G** [deleted]

Limits on the use of different kinds of capital: Purposes for which tier three capital may not be used (BIPRU firm only)

2.2.44 **R** *Tier one capital and tier two capital* are the only type of *capital resources* that a *BIPRU firm* may use for the purpose of meeting:

(1) the *credit risk capital component*;

(2) [deleted]

(3) the *counterparty risk capital component*; and

(4) the *base capital resources requirement*.

2.2.45 **R** ■ GENPRU 2.2.44 R (and the *capital resources gearing rules* that relate to it) also applies for the purposes of any other requirement in the *Handbook* for which it is necessary to calculate the *capital resources* of a *BIPRU firm*, except for the purposes described in ■ GENPRU 2.2.47 R and except as may otherwise be stated in the relevant part of the *Handbook*.

Limits on the use of different kinds of capital: Tier two limits (BIPRU firm only)

2.2.46 **R** For the purpose of ■ GENPRU 2.2.44 R:

(1) the amount of the items which may be included in a *BIPRU firm's tier two capital resources* must not exceed the amount calculated at stage F of the calculation in the *capital resources table* (Total tier one capital after deductions); and

- (2) the amount of the items which may be included in a *BIPRU firm's lower tier two capital resources* must not exceed 50% of the amount calculated at stage F of the calculation in the *capital resources table*.

Limits on the use of different kinds of capital: Purposes for which tier three capital may be used (BIPRU firm only)

2.2.47

R

For the purposes of meeting:

- (1) the *market risk capital requirement*; and
- (2) [deleted]
- (3) the *fixed overheads requirement* ;

a *BIPRU firm* may only use the following parts of its *capital resources*:

- (4) *tier one capital* to the extent that it is not required to meet the requirements in ■ GENPRU 2.2.44 R (■ GENPRU 2.2.48 R explains how to calculate how much *tier one capital* is required to meet the requirements in ■ GENPRU 2.2.44 R);
- (5) *tier two capital* to the extent that it:
 - (a) comes within the limits in ■ GENPRU 2.2.46 R (100% limit for *tier two capital resources* and 50% limit for *lower tier two capital resources*); and
 - (b) it is not required to meet the requirements in ■ GENPRU 2.2.44 R; (■ GENPRU 2.2.48 R explains how to calculate how much *tier two capital* is required to meet the requirements in ■ GENPRU 2.2.44 R);
- (6) *tier two capital* that cannot be used for the purposes in ■ GENPRU 2.2.44 R because it falls outside the limits in ■ GENPRU 2.2.46 R; and
- (7) *tier three capital*.

2.2.48

R

The amount of *tier one capital* and *tier two capital* that is not used to meet the requirements in ■ GENPRU 2.2.44 R as referred to in ■ GENPRU 2.2.47R (4) and ■ (5)(5) is equal to the amount calculated at stage N of the calculation in the *capital resources table* (Total tier one capital plus tier two capital after deductions) less the parts of the *capital resources requirement* deducted immediately after stage N of the *capital resources table* (the parts of the *capital resources requirements* listed in ■ GENPRU 2.2.44 R).

Limits on the use of different kinds of capital: Combined tier two and tier three limits (BIPRU firm only)

2.2.49

R

For the purpose of meeting the requirements in ■ GENPRU 2.2.47R (1) to ■ GENPRU 2.2.47R (3) and subject to ■ GENPRU 2.2.50 R, a *BIPRU firm* must not include any item in either:

- (1) its *tier two capital resources* falling within ■ GENPRU 2.2.47R (6) (excess *tier two capital*); or

(2) its upper tier three capital resources;

to the extent that the sum of (1) and (2) would exceed 250% of the amount resulting from the following calculation:

(3) calculate the amount at stage F of the calculation in the *capital resources table* (Total tier one capital after deductions); and

(4) deduct from (3) those parts of the *firm's tier one capital* used to meet the requirements in ■ GENPRU 2.2.44R (1) and ■ (2) as established by ■ GENPRU 2.2.48 R.

2.2.50 **R** In relation to a *BIPRU firm* which calculates its *capital resources* under ■ GENPRU 2 Annex 4 (Capital resources table for a BIPRU investment firm deducting material holdings), the figure of 200% replaces that of 250% in ■ GENPRU 2.2.49 R.

Example of how the capital resources calculation for BIPRU firms works

2.2.51 **G** ■ GENPRU 2.2.52 G to ■ GENPRU 2.2.59 G illustrate how to calculate a *BIPRU firm's capital resources* and how the *capital resources gearing rules* work. In this example the *BIPRU firm* has a combined credit, operational and counterparty risk requirement of £100 (of which £10 is due to counterparty risk) and a market risk requirement of £90, making a total capital requirement of £190. Its *capital resources* are as set out in the table in ■ GENPRU 2.2.52 G.

Table: Example of the calculation of the capital resources of a BIPRU firm

2.2.52 **G** This table belongs to ■ GENPRU 2.2.51 G

Description of the stage of the capital resources calculation	Stage in the <i>capital resources table</i>	Amount (£)
Total <i>tier one capital</i> after deductions	Stage F	80
Total <i>tier two capital</i>	Stage K	80
Deductions	Stage M	(20)
Total <i>tier one capital</i> and <i>tier two capital</i> after deductions	Stage N	140
<i>Upper tier three capital</i> (this example assumes the <i>firm</i> has no <i>lower tier three capital</i> (trading book profits))	Stage Q	50
Total <i>capital resources</i>	Stage T	190

2.2.53 **G** [deleted]

2.2.54 **G** In the example in the table in ■ GENPRU 2.2.52 G the *firm* has total *tier one capital* after deductions of £80. Its *tier two capital* of £80 is therefore the maximum permitted under ■ GENPRU 2.2.46 R (Tier two limits), that is 100% of *tier one capital*.

2.2.55 **G** The combined credit, operational and counterparty risk capital requirement is deducted after stage N of the *capital resources table* and the market risk requirement following stage T of the *capital resources table*. These calculations are shown in the table in ■ GENPRU 2.2.56 G.

Table: Example of how capital resources of a BIPRU firm are measured against its capital resources requirement

2.2.56 **G** This table belongs to ■ GENPRU 2.2.55 G

Description of the stage of the capital resources calculation	Stage in the <i>capital resources table</i>	Amount (£)
Total <i>tier one capital</i> and <i>tier two capital</i> after deductions	Stage N	140
Credit and counterparty risk requirement		(100)
<i>Tier one capital</i> and <i>tier two capital</i> available to meet market risk requirement		40
<i>Tier three capital</i>	Stage Q	50
Total capital available to meet market risk requirement		90
Market risk requirement		(90)
Market risk requirement met subject to meeting gearing limit set out in GENPRU 2.2.49 R – see GENPRU 2.2.57 G		

2.2.57 **G** The gearing limit in ■ GENPRU 2.2.49 R (Combined tier two and tier three limits) requires that the *upper tier three capital* used to meet the market risk requirement does not exceed 250% of the relevant *tier one capital*.

2.2.58 **G** In this example it is assumed that the maximum possible amount of *tier one capital* is carried forward to meet the market risk requirement. There are other options as to the allocation of *tier one capital* and *tier two capital* to the credit and counterparty risk requirement.

In order to calculate the relevant *tier one capital* for the *upper tier three* gearing limit in accordance with ■ GENPRU 2.2.49 R it is first necessary to allocate *tier one capital* and *tier two capital* to the individual credit and counterparty risk requirements. This allocation process underlies the calculation of the overall amount referred to in ■ GENPRU 2.2.48 R. The calculation in ■ GENPRU 2.2.49 R (3) and ■ GENPRU 2.2.49 R (4) then focuses on the *tier one* element of this earlier calculation.

In this worked example, if it is assumed that the counterparty risk requirement has been met by *tier one capital*, the relevant *tier one capital* for gearing is £50. This is because the deductions of £20 and the credit risk requirement of £90 have been met by *tier two capital* in the first instance. However, the total sum of deductions and credit risk requirement exceed the *tier two capital* amount of £80 by £30. Hence the £80 of *tier one capital* has been reduced by £30 to leave £50.

In practical terms, the same result is achieved for the relevant *tier one capital* for gearing by taking the amount carried forward to meet market risk of £40

and adding back the £10 in respect of the counterparty risk requirement. Again, there are other options as to the allocation to credit and counterparty risk of the constituent elements of Stage N of the *capital resources table*.

The outcome of these calculations can be summarised as follows:

- (1) the relevant *tier one capital* for the gearing calculation is £50;
- (2) 250% of the relevant *tier one capital* is £125; and
- (3) the *upper tier three capital* used to meet market risk is £50.

2.2.59 **G** The 250% gearing limit is met as the limit of £125 is greater than the *upper tier three capital* of £50 used in this example.

Capital used to meet the base capital resources requirement (BIPRU firm only)

2.2.60 **R** A BIPRU firm may use the *capital resources* used to meet the *base capital resources requirement* to meet any other part of the *capital resources requirement*.

2.2.61 **G** The explanation for **GENPRU 2.2.60 R** can be found in **GENPRU 2.1.43 G** (Base capital resources requirement). In brief the reason is that the *base capital resources requirement* is not in practice meant to act as an additional capital resources requirement. It is meant to act as a floor to the *capital resources requirement*.

Notification of issuance of capital instruments

2.2.61A **R** This section applies to a *firm* intending to issue a *capital instrument* on or after 1 March 2012 for inclusion in its *capital resources*.

2.2.61B **R** A *firm* must notify the FCA in writing of its intention to issue a *capital instrument* which it intends to include within its *capital resources* at least one *month* before the intended date of issue, unless there are exceptional circumstances which make it impracticable to give such a period of notice, in which event the *firm* must give as much notice as is practicable in those circumstances. When giving notice, a *firm* must:

- (1) provide details of the amount of capital the *firm* is seeking to raise through the intended issue and whether the capital is intended to be issued to external investors or within its *group*;
- (2) identify the stage of the *capital resources table* the *capital instrument* is intended to fall within;
- (3) include confirmation from a *senior manager* of the *firm* responsible for authorising the intended issue that the *capital instrument* complies with the *rules* applicable to instruments included in the stage of the *capital resources table* identified in (2); and
- (4) provide a copy of the term sheet and details of any features of the *capital instrument* which are novel, unusual or different from a

capital instrument of a similar nature previously issued by the *firm* or widely available in the market or not specifically contemplated by ■ GENPRU 2.2.

This *rule* does not apply to a *firm* which intends to issue a *capital instrument* listed in ■ GENPRU 2.2.61E R

2.2.61C **R** A *firm* must provide a further notification to the *FCA* in writing including all the information required in ■ GENPRU 2.2.61BR (1) to ■ (4) as soon as it proposes any change to the intended date of issue, amount of issue, type of investors, stage of capital or any other feature of the *capital instrument* to that previously notified to the *FCA*.

2.2.61D **R** If a *firm* proposes to establish a debt securities program for the issue of *capital instruments* for inclusion within its *capital resources*, it must:

- (1) notify the *FCA* of the establishment of the program; and
- (2) provide the information required by ■ GENPRU 2.2.61BR (1) to ■ (4)

at least one *month* before the first proposed drawdown. Any changes must be notified to the *FCA* in accordance with ■ GENPRU 2.2.61C R.

2.2.61E **R** The *capital instruments* to which ■ GENPRU 2.2.61B R does not apply are:

- (1) ordinary *shares* which:
 - (a) are the most deeply subordinated *capital instrument* issued by the *firm*;
 - (b) meet the criteria set out in ■ GENPRU 2.2.83R (2) and ■ (3) and, for a *BIPRU firm*, ■ GENPRU 2.2.83A R; and
 - (c) are the same as ordinary *shares* previously issued by the *firm*;
- (2) debt instruments issued from a debt securities program, provided that program was notified to the *FCA* prior to its first drawdown, in accordance with ■ GENPRU 2.2.61D R; and
- (3) *capital instruments* which are not materially different in terms of their characteristics and eligibility for inclusion in a particular tier of capital to *capital instruments* previously issued by the *firm*.

2.2.61F **R** A *firm* must notify the *FCA* in writing, no later than the date of issue, of its intention to issue a *capital instrument* listed in ■ GENPRU 2.2.61E R which it intends to include within its *capital resources*. When giving notice, a *firm* must:

- (1) provide the information set out at ■ GENPRU 2.2.61BR (1) to ■ (3); and
- (2) confirm that the terms of the *capital instrument* have not changed since the previous issue by the *firm* of that type of *capital instrument*.

2.2.61G **G** ■ GENPRU 2.2.61B R provides that, in exceptional circumstances, a *firm* may provide less than one *month's* notice of the intended issue. The *FCA* is unlikely to consider circumstances to be exceptional unless they are such that there is a risk of a *firm's capital resources* falling below its *capital resources requirement* if a one-month notification period is observed. In such circumstances, a *firm* should notify the *FCA* as soon as it has resolved to issue further capital, and provide details of its circumstances and why it is not possible to provide one *month's* notice of the intended issue.

2.2.61H **G** Details of the notification to be provided by a *BIPRU firm* in relation to *capital instruments* issued by another *undertaking* in its *group* for inclusion in its *capital resources* or the *consolidated capital resources* of its *UK consolidation group* or *non-EEA sub-group* are set out in ■ BIPRU 8.6.1A R to ■ BIPRU 8.6.1F R.

Tier one capital: General

2.2.62 **R** A *firm* may not include a *capital instrument* in its *tier one capital resources* unless it complies with the following conditions:

- (1) it is included in one of the categories in ■ GENPRU 2.2.63 R;
- (2) it complies with the conditions set out in ■ GENPRU 2.2.64 R;
- (3) it is not excluded under ■ GENPRU 2.2.65 R (Connected transactions); and
- (4) it is not excluded by any of the *rules* in ■ GENPRU 2.2.

2.2.63 **R** The categories referred to in ■ GENPRU 2.2.62R (1) are:

- (1) *permanent share capital*;
- (2) *eligible partnership capital*;
- (3) *eligible LLP members' capital*;
- (4) *sole trader capital*;
- (5) [deleted]
- (6) [deleted]
- (7) [deleted]
- (8) *hybrid capital*.

General conditions for eligibility as tier one capital

2.2.64 **R** The conditions that an item of capital of a *firm* must comply with under ■ GENPRU 2.2.62R (2) are as follows:

- (1) it is issued by the *firm*;

- (2) it is fully paid and the proceeds of issue are immediately and fully available to the *firm*;
- (3) it:
 - (a) cannot be redeemed at all or can only be redeemed on a winding up of the *firm*; or
 - (b) complies with the conditions in ■ GENPRU 2.2.70 R (Basic requirements for redeemability);
- (4) the item of capital meets the following conditions in relation to any *coupon*:
 - (a) the *firm* is under no obligation to pay a *coupon*; or
 - (b) (if the *firm* is obliged to pay the *coupon*) the *coupon* is payable in the form of an item of capital that is:
 - (i) *core tier one capital*
- (5) any *coupon* is either:
 - (a) non-cumulative; or
 - (b) (if it is cumulative) it must, if deferred, be paid by the *firm* in the form of *tier one capital* complying with (4)(b);
- (6) it is able to absorb losses to allow the *firm* to continue trading and:
 - (a) [deleted]
 - (b) it does not, through appropriate mechanisms, hinder the recapitalisation of the *firm*, and in particular it complies with:
 - (i) ■ GENPRU 2.2.80 R to ■ GENPRU 2.2.81 R (Loss absorption);
 - (ii) in the case of *core tier one capital*, ■ GENPRU 2.2.83AR (9) to ■ GENPRU 2.2.83AR (10) (General conditions for eligibility of capital instruments as core tier one capital (BIPRU firm only)); and
 - (iii) in the case of *hybrid capital*, ■ GENPRU 2.2.116 R to ■ GENPRU 2.2.118 R (Other tier one capital: loss absorption);
- (7) the amount of the item included must be net of any foreseeable tax charge at the moment of its calculation or must be suitably adjusted in so far as such tax charges reduce the amount up to which that item may be applied to cover risks or losses;
- (8) it is available to the *firm* for unrestricted and immediate use to cover risks and losses as soon as these occur;
- (9) it ranks for repayment upon winding up, administration or any other similar process:

- (a) [deleted]
- (b) lower than any items of capital that are
 - (i) eligible for inclusion within the *firm's tier two capital resources*; and
 - (ii) not eligible for inclusion within the *firm's tier one capital resources*; and
- (10) the description of its characteristics used in its marketing is consistent with the characteristics required to satisfy (1) to (9).

2.2.65 **R** An item of capital does not qualify for inclusion as *tier one capital* if the issue of that item of capital by the *firm* is connected with one or more other transactions which, when taken together with the issue of that item, could result in that item of capital no longer displaying all of the characteristics set out in ■ GENPRU 2.2.64R (1) to ■ GENPRU 2.2.64R (9).

Guidance on certain of the general conditions for eligibility as tier one capital

2.2.66 **G** ■ GENPRU 2.2.65 R is an example of the general principle in ■ GEN 2.2.1 R (Purposive interpretation). Its purpose is to emphasise that an item of capital does not meet the conditions for inclusion in *tier one capital* if in isolation it does meet those requirements but it fails to meet those requirements when other transactions are taken into account. Examples of such connected transactions might include guarantees or any other side agreement provided to the holders of the *capital instrument* by the *firm* or a connected party or a related transaction designed, for example, to enhance their security or to achieve a tax benefit, but which may compromise the loss absorption capacity or permanence of the original capital item.

2.2.67 **G** ■ GENPRU 2.2.64R (2) is stricter than the Companies Act definition of fully paid, which only requires an undertaking to pay.

2.2.67A **G** The purpose of ■ GENPRU 2.2.64R (4) is to ensure that a *firm* retains flexibility over the payment of *coupons* and can preserve cash in times of financial stress. However, a *firm* may include, as part of the capital instrument terms, a right to make payments of a *coupon* mandatory if an item of capital becomes ineligible to form part of its *capital resources* (e.g. through a change in the relevant *rules*) and the *firm* has notified the *FCA* that the instrument is ineligible.

2.2.68 **G** The *FCA* considers that dividend pushers diminish the quality of capital by breaching the principle of complete discretion over *coupons* set out in ■ GENPRU 2.2.64R (4). A dividend pusher operates so that, in a given period of time, payments must be made on senior securities if payments have previously been made on junior securities or securities ranking *pari passu*. As such, dividend pushers may not be included in the terms of *tier one capital*, unless the *firm* has the option to fund the "pushed payment" in stock.

2.2.68A **R** A *BIPRU firm* must not include a *capital instrument* in its *tier one capital resources* if:

- (1) the *capital instrument* is affected by a dividend stopper; and
- (2) the dividend stopper operates in a way that hinders recapitalisation.

2.2.68B G A dividend stopper prevents the *firm* from paying any *coupon* on more junior or pari passu instruments in a period in which the *firm* omits payments to the holder of the *capital instrument* containing the dividend stopper, and so may hinder the recapitalisation of the *firm* contrary to ■ GENPRU 2.2.64R (6).

2.2.69 G An item of capital does not comply with ■ GENPRU 2.2.64R (10) if it is marketed as a *capital instrument* that would only qualify for a lower level of capital or on the basis that investing in it is like investing in an instrument in a lower tier of capital. For example, an undated *capital instrument* should not be marketed as a dated *capital instrument* if the terms of the *capital instrument* include an option by the issuer to redeem the *capital instrument* at a specified date in the future.

Tier one capital: payment of coupons (BIPRU firm only)

2.2.69A R A *BIPRU firm* must not make a payment of a *coupon* on an item of *hybrid capital* if the *firm* has no distributable reserves.

2.2.69B R A *BIPRU firm* must cancel the payment of a *coupon* on an item of *hybrid capital* if the *BIPRU firm* does not meet its *capital resources requirement* or if the payment of that *coupon* would cause it to breach its *capital resources requirement*.

2.2.69C R A *BIPRU firm* must not pay a *coupon* on an item of *hybrid capital* in the form of *core tier one capital* in accordance with ■ GENPRU 2.2.64R (4)(b) unless:

- (1) the *firm* meets its *capital resources requirement*; and
- (2) such a substituted payment preserves the *firm's* financial resources.

2.2.69D G The *FCA* considers that a *BIPRU firm's* financial resources are not preserved under ■ GENPRU 2.2.69CR (2) unless, among other things, the conditions of the substituted payment are that:

- (1) there is no decrease in the amount of the *firm's core tier one capital*;
- (2) the deferred *coupon* is satisfied without delay using newly issued *core tier one capital* that has an aggregate fair value no more than the amount of the *coupon*;

- (3) the *firm* is not obliged to find new investors for the newly issued instruments; and
- (4) if the holder of the newly issued instruments subsequently sells the instruments and the sale proceeds are less than the value of the *coupon*, the *firm* is not obliged to issue further new instruments to cover the loss incurred by the holder of the instruments.

2.2.69E **R** A *BIPRU firm* must cancel the payment of a *coupon* if circumstances arise whereby the payment of the *coupon* by newly issued instruments, in accordance with **■ GENPRU 2.2.64R (4)(b)**, does not comply with the requirements of **■ GENPRU 2.2.69C R**.

2.2.69F **G**

- (1) In relation to the cancellation or deferral of the payment of a *coupon* in accordance with **■ GENPRU 2.2.64R (4)** and **■ GENPRU 2.2.64R (5)**, **■ GENPRU 2.2.68A R**, or **■ GENPRU 2.2.69B R**, the *FCA* expects that situations where a *coupon* may need to be cancelled or deferred will be resolved through analysis and discussion between the *firm* and the *FCA*. If the *FCA* and the *firm* do not agree on the cancellation or deferral of the payment of a *coupon*, then the *FCA* may consider using its powers under 55J of the *Act* to, on its own initiative, vary a *firm's Part 4A permission* to require it to cancel or defer a *coupon* in accordance with the *FCA's* view of the financial and solvency situation of the *firm*.
- (2) In considering a *firm's* financial and solvency situation, the *FCA* will normally take into account, among other things, the following:
 - (a) the *firm's* financial and solvency position before and after the payment of the *coupon*, in particular whether that payment, or other foreseeable internal and external events or circumstances, may increase the risk of the *firm* breaching its *capital resources requirement* or the *overall financial adequacy rule*;
 - (b) an appropriately stressed capital plan, covering 3-5 years, which includes the effect of the proposed payment of the *coupon*; and
 - (c) an evaluation of the risks to which the *firm* is or might be exposed and whether the level of *tier one capital* ensures the coverage of those risks, including stress tests on the main risks showing potential loss under different scenarios.
- (3) If the *BIPRU firm* is required to cancel or defer the payment of a *coupon* by the *FCA*, it may still be able to pay the *coupon* by way of newly issued *core tier one capital* in accordance with **■ GENPRU 2.2.64R (4)(b)** and **■ GENPRU 2.2.69C R**. The *FCA* may consider using its powers under 55J of the *Act* to, on its own initiative, vary a *firm's Part 4A permission* to impose conditions on the use of such a mechanism or to require its cancellation, based on the factors outlined in this *guidance*.

Redemption of tier one instruments

2.2.70 **R** A *firm* may not include a *capital instrument* in its *tier one capital resources*, unless its contractual terms are such that:

- (1) (if it is redeemable other than in circumstances set out in ■ GENPRU 2.2.64R (3)(a) (redemption on a winding up)) it is redeemable only at the option of the *firm* or, in the case of a *BIPRU firm*, on the date of maturity;
- (2) the *firm* cannot exercise that redemption right:
 - (a) before the fifth anniversary of its date of issue; and
 - (b) unless it has given notice to the *FCA* in accordance with ■ GENPRU 2.2.74 R;
 - (c) unless at the time of exercise of that right it complies with the *main BIPRU firm Pillar 1 rules* and will continue to do so after redemption;
- (3) (in the case of a *BIPRU firm* and if it is undated) if it provides for a moderate incentive for the *BIPRU firm* to redeem it, that incentive does not occur before the tenth anniversary of its date of issue; and
- (4) (in the case of a *BIPRU firm* and if it is dated):
 - (a) it has an original maturity date of at least 30 years after its date of issue; and
 - (b) it does not provide an incentive to redeem on any date other than its maturity date.

2.2.70A G In the case of a *BIPRU firm*, an incentive to redeem is a feature of a *capital instrument* that would lead a reasonable market participant to have an expectation that the *firm* will redeem the instrument. The *FCA* considers that interest rate step-ups and principal stock settlements, in conjunction with a call option, are incentives to redeem. Only instruments with moderate incentives to redeem are permitted as *tier one capital*, in accordance with the limited conversion ratio in ■ GENPRU 2.2.138 R and the *rule* on step-ups in ■ GENPRU 2.2.147 R.

2.2.71 R A *firm* may include a term in a *tier one instrument* allowing the *firm* to redeem it before the date in ■ GENPRU 2.2.70R (2)(a) if the following conditions are satisfied:

- (1) the other conditions in ■ GENPRU 2.2.70 R are met;
- (2) the circumstance that entitles the *firm* to exercise that right is a change in the applicable tax treatment or regulatory classification of those instruments;
- (3) the circumstance that entitles the *firm* to exercise that right was not reasonably foreseeable at the date of issue of the *tier one instrument*; and

(4) the *firm's* right is conditional on it obtaining the *FCA's* consent in the form of a *waiver* of ■ GENPRU 2.2.72 R.

- 2.2.72** **R** A *firm* must not redeem a *tier one instrument* in accordance with a term included under ■ GENPRU 2.2.71 R.
- 2.2.73** **G** The purpose of ■ GENPRU 2.2.71 R to ■ GENPRU 2.2.72 R is this. In general a *tier one instrument* should not be redeemable by the *firm* before its fifth anniversary. However there may be circumstances in which it would be reasonable for the *firm* to redeem it before then. ■ GENPRU 2.2.71 R allows the *firm* to include a right to redeem the instrument before the fifth anniversary in certain circumstances. A tax call is an example of a term that may be allowed. ■ GENPRU 2.2.71 R says that the terms of the *tier one instrument* should provide that the *firm* should not be able to exercise that right without the *FCA's* consent. Any such consent will be given in the form of a *waiver* allowing early repayment. Thus although a *firm* may include a right to redeem early in the terms of a *tier one instrument* without the need to apply for a *waiver* the actual exercise of that right will require a *waiver*.
- 2.2.74** **R** A *firm* must not redeem any *tier one instrument* that it has included in its *tier one capital resources* unless it has notified the *FCA* of its intention at least one month before it becomes committed to do so. When giving notice, the *firm* must provide details of its position after such redemption in order to show how it will:
- (1) meet its *capital resources requirement*;
 - (2) have sufficient financial resources to meet the *overall financial adequacy rule*; and
 - (3) in the case of a *BIPRU firm*, not otherwise suffer any undue effects to its financial or solvency conditions.
- 2.2.74A** **G** The *FCA* considers that, in order to comply with ■ GENPRU 2.2.74 R, the *firm* should, at a minimum, provide the *FCA* with the following information:
- (1) a comprehensive explanation of the rationale for the redemption;
 - (2) the *firm's* financial and solvency position before and after the redemption, in particular whether that redemption, or other foreseeable internal and external events or circumstances, may increase the risk of the *firm* breaching its *capital resources requirement*;
 - (3) an appropriately stressed capital plan covering 3-5 years, which includes the effect of the proposed redemption; and
 - (4) an evaluation of the risks to which the *firm* is or might be exposed and whether the level of *tier one capital* ensures the coverage of such risks including stress tests on the main risks showing potential loss under different scenarios.

2.2.74B **R** If a *BIPRU firm* does not comply with its *capital resources requirement* or if the redemption of any dated *tier one instrument* would cause it to breach its *capital resources requirement*, it must suspend the redemption of its dated *tier one instruments*.

2.2.75 **R** If a *firm* gives notice of the redemption or repayment of any *tier one instrument*, the *firm* must no longer include that instrument in its *tier one capital resources*.

Meaning of redemption

2.2.77 **R**

- (1) This *rule* applies to a *tier one instrument*, *tier two instrument* or *tier three instrument* (instrument A) that under its terms is exchanged for or converted into another instrument or is subject to a similar process.
- (2) This *rule* also applies to instrument A if under its terms it is redeemed out of the proceeds of the issue of new securities.
- (3) If the instrument with which instrument A is replaced is included in the *same stage of capital* or a *higher stage of capital* as instrument A, instrument A is treated as not having been redeemed or repaid for the purposes of GENPRU 2.2.
- (4) (3) does not apply to ■ GENPRU 2.2.114 R (Redeemable instrument likely to be repaid etc), ■ GENPRU 2.2.74 R (Notice of redemption of *tier one instruments*), ■ GENPRU 2.2.174 R (Notice of redemption of *tier two instruments*) or ■ GENPRU 2.2.245 R (so far as it relates to notice of redemption of *tier three instruments*).
- (5) (3) only applies if it would be reasonable (taking into account the economic substance) to treat the original instruments as continuing in issue on the same or a more favourable basis. The question of whether that basis is more or less favourable must be judged from the point of view of the adequacy of the *firm's capital resources*.

2.2.78 **R**

- (1) A *share* is not redeemable for the purposes of this section merely because the Companies Act 1985, the Companies (Northern Ireland) Order 1986 or the Companies Act 2006 allows the *firm* that issued it to purchase it.
- (2) A *capital instrument* is not redeemable for the purposes of this section merely because the *firm* that issued it has a right to purchase it similar to the right in (1).

2.2.79 **G** This section generally uses the term repay and redeem interchangeably.

Purchases of tier one instruments: BIPRU firm only

- 2.2.79A** **R** A *BIPRU firm* must not purchase a *tier one instrument* that it has included in its *tier one capital resources* unless:
- (1) the *firm* initiates the purchase;
 - (2) [deleted]
 - (3) the *firm* has given notice to the *FCA* in accordance with **■ GENPRU 2.2.79G R**; and
 - (4) (in the case of *hybrid capital*) it is on or after the fifth anniversary of the date of issue of the instrument.
- 2.2.79B** **G** In exceptional circumstances a *BIPRU firm* may apply for a *waiver* of **■ GENPRU 2.2.79AR (4)** under section 138A (Modification or waiver of rules) of the *Act*.
- 2.2.79C** **R** **■ GENPRU 2.2.79AR (4)** does not apply if:
- (1) the *firm* replaces the *capital instrument* it intends to purchase with a *capital instrument* that is included in a *higher stage of capital* or the *same stage of capital*; and
 - (2) the replacement *capital instrument* has already been issued.
- 2.2.79D** **R** **■ GENPRU 2.2.79AR (4)** does not apply if:
- (1) the *firm* intends to hold the purchased instrument for a temporary period as *market maker*; and
 - (2) the purchased instruments held by the *firm* do not exceed the lower of:
 - (a) 10% of the relevant issuance; or
 - (b) 3% of the *firm's* total issued *hybrid capital*.
- 2.2.79E** **G** In the circumstances provided for in **■ GENPRU 2.2.79D R**, a *firm* would purchase the instrument and, instead of cancelling it, the *firm* would hold the instrument for a temporary period. In that case a *firm* should have in place adequate policies to take into account any relevant regulations and *rules*, which include those relating to market abuse.
- 2.2.79F** **R** For the purposes of calculating its *tier one capital resources*, a *firm* must deduct the amount of any item of *hybrid capital* which it then holds.
- 2.2.79G** **R** A *BIPRU firm* must not purchase a *tier one instrument* in accordance with **■ GENPRU 2.2.79A R** unless it has notified the *FCA* of its intention at least one month before it becomes committed to doing so. When giving notice, the *firm* must provide details of its position after the purchase in order to show

how, over an appropriate timescale, adequately stressed, and without planned recourse to the capital markets, it will:

- (1) meet its *capital resources requirement*; and
- (2) have sufficient financial resources to meet the *overall financial adequacy rule*.

2.2.79H

G

The *FCA* considers that:

- (1) in order to comply with ■ GENPRU 2.2.79G R, the *firm* should, at a minimum, provide the *FCA* with the following information:
 - (a) a comprehensive explanation of the rationale for the purchase;
 - (b) the *firm's* financial and solvency position before and after the purchase, in particular whether the purchase, or other foreseeable internal and external events or circumstances, may increase the risk of the *firm* breaching its *capital resources requirement* or the *overall financial adequacy rule*;
 - (c) an appropriately stressed capital plan covering 3-5 years, which includes the effect of the proposed purchase; and
 - (d) an evaluation of the risks to which the *firm* is or might be exposed and whether the level of *tier one capital* ensures the coverage of such risks including stress tests on the main risks showing potential loss under different scenarios; and
- (2) the proposed purchase should not be on the basis that the *firm* reduces capital on the date of the purchase and then plans to raise new external capital during the following 3-5 years to replace the purchased capital.

2.2.79I

R

A *BIPRU firm* must not announce to the holders of a *tier one instrument* its intention to purchase that instrument unless it has notified that intention to the *FCA* in accordance with ■ GENPRU 2.2.79G R and it has not, during the period of one month from the date of giving notice, received an objection from the *FCA*.

2.2.79J

R

If a *BIPRU firm* announces the purchase of any *tier one instrument*, the *firm* must no longer include that instrument in its *tier one capital resources*.

2.2.79K

R

If a *BIPRU firm* does not comply with its *capital resources requirement*, or if the purchase of any *tier one instrument* would cause it to breach its *capital resources requirement*, it must suspend the purchase of *tier one instruments*.

2.2.79L

G

A *firm* should continue to exclude from its *tier one capital resources* all *tier one instruments* that are the subject of a purchase notification under ■ GENPRU 2.2.79G R and for which the offer to purchase has been declined by the instrument holders unless the purchase offer period has expired.

Loss absorption

- 2.2.80 **R** A *firm* may not include a *share* in its *tier one capital resources* unless (in addition to complying with the other relevant *rules* in ■ GENPRU 2.2):
- (1) (in the case of a *firm* that is a company as defined in the Companies Act 2006 it is "called-up *share capital*" within the meaning given to that term in that Act; or
 - (2) [deleted]
 - (3) (in the case of any other *firm*) it is:
 - (a) in economic terms; and
 - (b) in its characteristics as capital (including loss absorbency, permanency, ranking for repayment and fixed costs);
 substantially the same as called-up *share capital* falling into (1).
- 2.2.81 **R** A *firm* may not include a *capital instrument* other than a *share* in its *tier one capital resources* unless it complies with ■ GENPRU 2.2.80R (3).
- 2.2.82 **G** There are additional loss absorption requirements for *hybrid capital* in ■ GENPRU 2.2.116AR to ■ GENPRU 2.2.118 R (Other tier one capital: loss absorption) and for *core tier one capital* in ■ GENPRU 2.2.83AR (9) to ■ (10) (General conditions for eligibility of capital instruments as core tier one capital).

Core tier one capital: permanent share capital

- 2.2.83 **R** *Permanent share capital* means an item of capital which (in addition to satisfying ■ GENPRU 2.2.64 R) meets the following conditions:
- (1) it is:
 - (a) an ordinary *share*; or
 - (b) a *members' contribution*; or
 - (c) part of the *initial fund* of a *mutual*; or
 - (d) [deleted]
 - (2) any *coupon* on it is not cumulative, the *firm* is under no obligation to pay a *coupon* in any circumstances and the *firm* has the right to choose the amount of any *coupon* that it pays;
 - (3) the terms upon which it is issued do not permit redemption and it is otherwise incapable of being redeemed to at least the same degree as an ordinary *share* issued by a company incorporated under the Companies Act 2006 (whether or not it is such a *share*); and
 - (4) (in the case of a *BIPRU firm*) it meets the conditions set out in ■ GENPRU 2.2.83A R (General conditions for eligibility of capital instruments as core tier one capital (*BIPRU firm* only)).

General conditions for eligibility of capital instruments as core tier one capital (BIPRU firm only)

2.2.83A

R

The conditions that a *BIPRU firm's permanent share capital* must comply with under ■ GENPRU 2.2.83AR (4) or that a *BIPRU firm's eligible partnership capital* or *eligible LLP members' capital* must comply with under ■ GENPRU 2.2.95 R are as follows:

- (1) it is undated;
- (2) the terms upon which it is issued do not give the holder a preferential right to the payment of a *coupon*;
- (3) the terms upon which it is issued do not indicate the amount of any *coupon* that may be payable nor impose an upper limit on the amount of any *coupon* that may be payable;
- (4) the *firm's* obligations under the instrument do not constitute a liability (actual, contingent or prospective) under section 123(2) of the Insolvency Act 1986 and the holder has no right to petition for the winding up or administration of the *firm* or for any similar procedure in relation to the *firm* arising from the non-payment of a *coupon* or any other sums payable under the instrument;
- (5) there is no contractual or other obligation arising out of the terms upon which it is issued that requires the *firm* to repay capital to the holders other than on a liquidation of the *firm*;
- (6) the terms upon which it is issued do not include a dividend pusher or a dividend stopper;
- (7) the *firm* is under no obligation to issue *core tier one capital* or to make a payment in kind in lieu of making a *coupon* payment and non-payment of a *coupon* is not an event of default on the part of the *firm*;
- (8) it is simple and the terms upon which it is issued are clearly defined;
- (9) it is able to fully and unconditionally absorb losses on a non-discretionary basis as soon as they arise to allow the *firm* to continue trading, and it absorbs losses before all *capital instruments* that are not eligible for inclusion in stage A of the *capital resources table* and equally and proportionately with all *capital instruments* that are eligible for inclusion in stage A of the *capital resources table*;
- (10) it ranks for repayment on winding up, administration or any other similar process lower than all other items of capital, and on a liquidation of the *firm* the holders have a claim on the residual assets remaining after satisfaction of all prior claims that is proportional to their holding and do not have a priority claim or a fixed claim for the nominal amount of their holding;
- (11) the *firm* has not provided the holder with a direct or indirect financial contribution specifically to pay for the whole or a part of its subscription or purchase;

- (12) a reasonable person would not think that the *firm* is likely to redeem or purchase it because of the description of its characteristics used in its marketing and in its contractual terms of issue; and
- (13) its issue is not connected with one or more other transactions which, when taken together with its issue, could result in it no longer displaying all of the characteristics set out in ■ GENPRU 2.2.83R (2), ■ GENPRU 2.2.83AR (1) to ■ (12) and (in the case of *permanent share capital*) ■ GENPRU 2.2.83R (3).

2.2.83B **R** A *BIPRU firm* must not include in stage A of the *capital resources table* different classes of the same *share* type (for example "A ordinary shares" and "B ordinary shares") that meet the conditions in ■ GENPRU 2.2.83 R and ■ GENPRU 2.2.83A R but have differences in voting rights, unless it has notified the *FCA* of its intention at least one month before the *shares* are issued or (in the case of existing issued *shares*) the differences in voting rights take effect.

2.2.83C **R** A *BIPRU firm* must not pay a *coupon* on a *tier one instrument* included in stage A of the *capital resources table* if it has no distributable reserves.

2.2.83D **G** A *BIPRU firm* may disclose its dividend policy, provided that the policy only reflects the current intention of the *firm* and does not undermine the *firm's* right to choose the amount of any *coupon* that it pays.

Core tier one capital: exception to eligibility criteria (building societies only)

2.2.83E **R** A *building society* may include in stage A of the *capital resources table* a *capital instrument* that includes in its terms of issue an upper limit on the amount of any *coupon* that may be payable and the prohibition on a *coupon* limit under ■ GENPRU 2.2.83AR (3) does not apply to that *capital instrument*, provided that:

- (1) the *capital instrument* satisfies all other conditions for eligibility as *core tier one capital* set out in ■ GENPRU 2.2.83 R to ■ GENPRU 2.2.83A R;
- (2) the *coupon* limit has been imposed by law or the constitutional documents of the *firm*;
- (3) the objective of the limit is to protect the capital reserves of the *firm*;
- (4) the *firm* continues to have the effective right to choose the amount of any *coupon* that it pays;
- (5) all other *capital instruments* issued by the *firm* and included in stage A of the *capital resources table*:
 - (a) meet the conditions set out in ■ GENPRU 2.2.83R (2), ■ GENPRU 2.2.83R (3) and ■ GENPRU 2.2.83A R (General conditions for eligibility of capital instruments as core tier one capital (BIPRU firm only)); and
 - (b) if subject to a *coupon* limit, are subject to the same *coupon* limit; and

(6) any preferential *coupon* on a *capital instrument* included in stage A of the *capital resources table*, arising as a result of the inclusion of a *coupon limit* on another *capital instrument*, must be restricted to a fixed multiple of the *coupon* payment on the *capital instrument* that is subject to the *coupon limit*. ■ GENPRU 2.2.83AR (2) to ■ (3) do not prevent a *capital instrument* from being included in stage A of the *capital resources table* if the only reason for those prohibitions not being met is that a preferential *coupon* arises, and is restricted, in the manner referred to in this paragraph (6).

2.2.83F **R** A *building society* must not issue a *capital instrument* that includes a *coupon limit* in its terms of issue in accordance with ■ GENPRU 2.2.83E R unless it has notified the *PRA* of its intention to do so at least one month before the intended date of issue.

2.2.83G **G** Under ■ GENPRU 2.2.83ER (4), an effective right means that in practice the *firm* has, and exercises, full discretion to choose the amount of *coupon* that it pays (for example, it has not fettered that discretion by indicating to instrument holders that the *coupon limit* is the standard level of *coupon* they will receive).

2.2.83H **G** The purpose of ■ GENPRU 2.2.83ER (6) is to limit the potential preferential rights that may arise on *capital instruments* that are not subject to a *coupon limit*. The *PRA* considers that "preferential" refers to both priority of *coupon* payment and level of *coupon* payment. Therefore the *PRA* considers that:

- (1) a *coupon* arising on a *capital instrument* which is not subject to an explicit *coupon limit* within its terms of issue is likely to be preferential to a *coupon* on a *capital instrument* included in the *same stage of capital* which is subject to a *coupon limit*; and
- (2) the preference so arising should be restricted so that it is not an unlimited preference.

Core tier one capital: additional information

2.2.84 **G** [deleted]

2.2.84A **G** Under ■ GENPRU 2.2.83AR (13) a *tier one instrument* does not meet the conditions for inclusion as *core tier one capital* if in isolation it does meet those requirements but fails to meet those requirements when other

transactions are taken into account. Examples of those transactions include guarantees, pledges of assets or other side agreements provided by the *firm* to the holder of a *tier one instrument* designed to enhance the legal or economic seniority of the *tier one instrument*.

Core tier one capital: profit and loss account and other reserves: Losses

- 2.2.85 **R**
- (1) Negative amounts, including any interim net losses (but in the case of a *BIPRU firm*, only material interim net losses), must be deducted from profit and loss account and other reserves.
 - (2) For these purposes material interim net losses mean unaudited interim losses arising from a *firm's trading book and non-trading book* business which exceed 10% of the sum of its *capital resources* calculated at stage A (Core tier one capital) in the *capital resources table*.
 - (3) If interim losses as referred to in (2) exceed the 10% figure in (2) then a *BIPRU firm* must deduct the whole amount of those losses and not just the excess.

2.2.85A **R**

Core tier one capital: profit and loss account and other reserves: Losses arising from valuation adjustments (BIPRU firm only)

- 2.2.86 **R**
- (1) This *rule* applies to *trading book* valuation adjustments or reserves referred to in ■ GENPRU 1.3.29 R to ■ GENPRU 1.3.35A G (Valuation adjustments and reserves). It applies to a *BIPRU firm*.
 - (2) When valuation adjustments or reserves give rise to losses of the current financial year, a *firm* must treat them in accordance with ■ GENPRU 2.2.85 R.
 - (3) Valuation adjustments or reserves which exceed those made under the accounting framework to which a *firm* is subject must be treated in accordance with (2) if they give rise to losses and under ■ GENPRU 2.2.248 R (Net interim *trading book* profits) otherwise.

Core tier one capital: profit and loss account and other reserves: Dividends

2.2.87 **R** Dividends must be deducted from reserves as soon as they are foreseeable.

2.2.87A **G** Each *firm* must assess for itself when, in its particular circumstances, dividends are foreseeable. A dividend is foreseeable at the latest:

- (1) in the case of an interim dividend, when it is declared by the *directors*; or
- (2) in the case of a final dividend, when the *directors* approve the dividend to be proposed at the annual general meeting.

Core tier one capital: profit and loss account and other reserves: Capital contributions

2.2.88 **R** A *firm* must account for a capital contribution as an increase in reserves and may, notwithstanding ■ GENPRU 2.2.63 R, count that increase in reserves as *core tier one capital*.

2.2.89 **G** An item of capital qualifies as a capital contribution if it is a gift of capital (and, as such, is not repayable) and a *coupon* is not payable on it.

Core tier one capital: profit and loss account and other reserves: Securitisation (BIPRU firm only)

2.2.90 **R** In the case of a *BIPRU firm* which is the *originator* of a *securitisation*, net gains arising from the capitalisation of future income from the *securitised* assets and providing credit enhancement to *positions* in the *securitisation* must be excluded from profit and loss account and other reserves.

Core tier one capital: profit and loss account and other reserves: Valuation

2.2.91 **G** Profit and loss account and other reserves should be valued in accordance with the *rules* in ■ GENPRU 1.3 (Valuation).

Core tier one capital: profit and loss account and other reserves: Revaluation reserves (BIPRU firm only)

2.2.92 **G** A revaluation reserve is not included as part of a *BIPRU firm's* profit and loss account and other reserves. It is dealt with separately and forms part of a *BIPRU firm's upper tier two capital*.

Core tier one capital: partnership capital account (BIPRU firm only)

2.2.93 **R** *Eligible partnership capital* means a partners' account:

- (1) into which capital contributed by the partners is paid; and
- (2) from which under the terms of the partnership agreement an amount representing capital may be withdrawn by a partner only if:
 - (a) he ceases to be a partner and an equal amount is transferred to another such account by his former partners or any *person* replacing him as their partner;
 - (b) the partnership is wound up or otherwise dissolved; or
 - (c) the *BIPRU firm* has ceased to be *authorised* or no longer has a *Part 4A permission*.

Core tier one capital: Eligible LLP members' capital (BIPRU firm only)

2.2.94 **R** *Eligible LLP members' capital* means a members' account:

- (1) into which capital contributed by the members is paid; and

- (2) from which under the terms of the *limited liability partnership* agreement an amount representing capital may be withdrawn by a member only if:
 - (a) he ceases to be a member and an equal amount is transferred to another such account by his former fellow members or any *person* replacing him as a member;
 - (b) the *limited liability partnership* is wound up or otherwise dissolved; or
 - (c) the *BIPRU firm* has ceased to be *authorised* or no longer has a *Part 4A permission*.

Core tier one capital: Eligible LLP members' and partnership capital accounts (BIPRU firm only)

2.2.95 **R** A *BIPRU firm* that is a partnership or a *limited liability partnership* may not include *eligible partnership capital* or *eligible LLP members' capital* in its *tier one capital resources* unless (in addition to ■ GENPRU 2.2.62 R (General conditions relating to *tier one capital*)) it complies with ■ GENPRU 2.2.83R (2) (Coupons should not be cumulative or mandatory) and ■ GENPRU 2.2.83A R to ■ GENPRU 2.2.83C R (General conditions for eligibility of capital instruments as core tier one capital (BIPRU firm only)). However, ■ GENPRU 2.2.64R (3) (Redemption), ■ GENPRU 2.2.83AR (5) (Capital repayment) and ■ GENPRU 2.2.83AR (12) (Characteristics in contract) are replaced by ■ GENPRU 2.2.93 R or ■ GENPRU 2.2.94 R.

2.2.96 **G** If a *firm* has surplus *eligible partnership capital* or *eligible LLP members' capital* that it wishes to repay in circumstances other than those set out in ■ GENPRU 2.2.93 R or ■ GENPRU 2.2.94 R it may apply to the *FCA* for a *waiver* to allow it to do so. If a *firm* applies for such a *waiver* the information that the *firm* supplies with the application might include:

- (1) a demonstration that the *firm* would have sufficient *capital resources* to meet its *capital resources requirement* immediately after the repayment;
- (2) a demonstration that the *firm* would have sufficient financial resources to meet any *individual capital guidance* and the *firm's* latest assessment under the *overall Pillar 2 rule* immediately after the repayment; and
- (3) a two to three year capital plan demonstrating that the *firm* would be able to meet the requirements in (1) and (2) at all times without needing further capital injections.

Core tier one capital: Other capital items for limited liability partnerships and partnerships (BIPRU firm only)

2.2.97 **R** The items *permanent share capital* and *share premium account* (which form part of *core tier one capital*) do not apply to a *BIPRU firm* that is a partnership or a *limited liability partnership*.

2.2.98 **R** Without prejudice to ■ GENPRU 2.2.62 R (Tier one capital: General), the item other reserves (which forms part of the item profit and loss and other

reserves) applies to a *BIPRU firm* that is a partnership or a *limited liability partnership* to the extent the reserves correspond to reserves that are eligible for inclusion as other reserves in the case of a *BIPRU firm* that is incorporated under the Companies Act 2006.

2.2.99 G A *BIPRU firm* that is a partnership or a *limited liability partnership* should include profit and loss (taking into account interim losses or material interim net losses) in its *core tier one capital*.

Core tier one capital: partnership and limited liability partnership excess drawings (BIPRU firm only)

2.2.100 R A *BIPRU firm* which is a partnership or *limited liability partnership* must deduct at stage E of the calculation in the *capital resources table* (Deductions from tier one capital) the amount by which the aggregate of the amounts withdrawn by its partners or members exceeds the profits of that *firm*. Amounts of *eligible partnership capital* or *eligible LLP members' capital* repaid in accordance with ■ GENPRU 2.2.93 R or ■ GENPRU 2.2.94 R are not included in this calculation.

Core tier one capital: Share premium account

- 2.2.101** R
- (1) A *firm* must include *share* premium account relating to the issue of a *share* forming part of its *core tier one capital* in its *core tier one capital*.
 - (2) A *firm* must include *share* premium account relating to the issue of a *share* forming part of another tier of capital in that other tier.
 - (3) A *firm* that is incorporated under the Companies Act 2006 may include its *share* premium account as *core tier one capital* notwithstanding (2) to the extent that the terms of issue of the *share* concerned provide that any premium is not repayable on redemption.
 - (4) Paragraph (3) applies to a *firm* that is not incorporated under the Companies Act 2006 if its *share* premium account is subject to substantially the same or greater restraints on use than a *share* premium account falling into (3).

Core tier one capital: externally verified interim net profits

2.2.102 R Externally verified interim net profits are interim profits which have been verified by a *firm's* external auditors after deduction of tax, foreseeable dividends and other appropriations.

2.2.103 G A *firm* may include interim profits before a formal decision has been taken only if these profits have been verified, in accordance with the relevant guidance issued by the Financial Reporting Council, by *persons* responsible for the auditing of the accounts.

Core tier one capital: deferred shares (building society only)

2.2.108A R A *building society* may include a *deferred share* at stage A of the calculation in the *capital resources table* if (in addition to satisfying all the other

requirements in relation to *tier one capital*) it is *permanent share capital* and is otherwise equivalent to an ordinary *share* in terms of its capital qualities, taking into account the specific constitution of *building societies* under the Building Societies Act 1986.

2.2.108B **G** The other main provisions relevant to inclusion of a *deferred share* in *tier one capital* are **■** GENPRU 2.2.62 R (Tier one capital: General), **■** GENPRU 2.2.64 R (General conditions for eligibility as tier one capital), **■** GENPRU 2.2.65 R (Connected transactions) and **■** GENPRU 2.2.80 R (Loss absorption).

2.2.111 **R** [deleted]

2.2.112 **G** [deleted]

Other tier one capital: conditions for eligibility for hybrid capital to be included at the different stages B1, B2 and C of the calculation in the capital resources table (BIPRU firm only)

2.2.115A **R** A *BIPRU firm* must not include a *capital instrument* at stage B1 of the calculation in the *capital resources table* unless (in addition to satisfying all the other requirements in relation to *tier one capital* and *hybrid capital*) its contractual terms are such that:

- (1) it cannot be redeemed in cash but can only be converted into *core tier one capital*;
- (2) it must be converted into *core tier one capital* by the *firm* during emergency situations;
- (3) the emergency situations referred to in (2):
 - (a) are clearly defined within the terms of the *capital instrument*, legally certain and transparent; and
 - (b) occur at the latest, and include, when the *BIPRU firm* does not meet its *capital resources requirement*;
- (4) the *FCA* may require its conversion into *core tier one capital* when the *FCA* considers it necessary;
- (5) it may be converted into *core tier one capital* by the *firm* or the holder of the instrument at any time; and
- (6) the maximum number of *capital instruments* which are *core tier one capital* into which it may be converted must:
 - (a) be determined at the date of its issue;
 - (b) be determined on the basis of the market value of those other instruments at the date of its issue;
 - (c) have an aggregate value equal to its par value; and
 - (d) not increase if the price of those other instruments decreases.

- 2.2.115B** **G** The intention of **GENPRU 2.2.115A R** is to ensure that *capital instruments* included in stage B1 of the calculation in the *capital resources table* have the same permanence as *core tier one capital*; the presence of a call option for these instruments may reduce their permanence.
- 2.2.115C** **G**
- (1) In respect of **GENPRU 2.2.115AR (4)**, the *FCA* may require the *firm* to convert the instrument into *core tier one capital* based on its financial and solvency situation. The *FCA* will take into account, among other things, the factors identified at **GENPRU 2.2.69FG (2)**, adjusted to take into account the effects of a conversion rather than payment of a *coupon*.
 - (2) Even if a *firm* meets its *capital resources requirement*, the *FCA* may consider the amount or composition of the *firm's tier one capital* as inadequate to cover the financial and solvency risks of the *firm* in which event the *FCA* may require the *firm* to convert the instrument into *core tier one capital*.
- 2.2.115D** **R** A *BIPRU firm* may include a *capital instrument* at stage B2 of the calculation in the *capital resources table* if (while satisfying all the other requirements in relation to *tier one capital* and *hybrid capital*) it cannot be included at stage B1 of that calculation as it does not satisfy the requirements of **GENPRU 2.2.115A R**.
- 2.2.115E** **G**
- (1) The other main provisions relevant to the eligibility of a *capital instrument* to be included at stages B1 and B2 of the calculation in the *capital resources table* are **GENPRU 2.2.62 R** (Tier one capital: General), **GENPRU 2.2.64 R** (General conditions for eligibility as tier one capital), **GENPRU 2.2.65 R** (Connected transactions), **GENPRU 2.2.68A R** (Dividend stoppers), **GENPRU 2.2.70 R** to **GENPRU 2.2.75 R** (Redemption of tier one instruments), **GENPRU 2.2.80 R** (Loss absorption) and **GENPRU 2.2.116 R** to **GENPRU 2.2.118 R** (Other tier one capital: loss absorption).
 - (2) The *rule* about *hybrid capital* included at stage C of the calculation in the *capital resources table* in **GENPRU 2.2.115F R** is also relevant. *Capital instruments* that would otherwise qualify for inclusion at stages B1 or B2 of the calculation in the *capital resources table* may only be eligible for inclusion at stage C of that calculation.
- 2.2.115F** **R** A *BIPRU firm* may include a *capital instrument* at stage C of the calculation in the *capital resources table*, and must not include it in stage B1 or B2 of that calculation, if (in addition to satisfying all the other requirements in relation to *tier one capital* and *hybrid capital*) it either:
- (1) is dated; or
 - (2) provides an incentive for the *firm* to redeem it, as assessed at the date of its issue.
- 2.2.115G** **G** An incentive to redeem is a feature of a *capital instrument* that would lead a reasonable market participant to have an expectation that the *firm* will redeem the instrument. The effect of **GENPRU 2.2.115FR (2)** is that the

classification of an instrument that provides an incentive to redeem is always assessed at the date of its issue, and it cannot be reclassified.

Other tier one capital: loss absorption

2.2.116A **R** A *BIPRU firm* must not include a *capital instrument* that is not a *share* at stage B1, B2 or C of the calculation in the *capital resources table* unless (in addition to satisfying all the other requirements in relation to *tier one capital* and *hybrid capital*) the *firm's* obligations under the instrument either:

- (1) do not constitute a liability (actual, contingent or prospective) under section 123(2) of the Insolvency Act 1986; or
- (2) do constitute such a liability but the terms of the instrument are such that:
 - (a) any such liability is not relevant for the purposes of deciding whether:
 - (i) the *firm* is, or is likely to become, unable to pay its debts; or
 - (ii) its liabilities exceed its assets;
 - (b) a *person* (including, but not limited to, a holder of the instrument) is not able to petition for the winding up or administration of the *firm* or for any similar procedure in relation to the *firm* on the grounds that the *firm* is or may become unable to pay any such liability; and
 - (c) the *firm* is not obliged to take into account such a liability for the purposes of deciding whether or not the *firm* is, or may become, insolvent for the purposes of section 214 of the Insolvency Act 1986 (Wrongful trading).

2.2.117 **G** The effect of **GENPRU 2.2.116 R** and **GENPRU 2.2.116A R** is that if a *potential tier one instrument* does constitute a liability, this should only be the case when the *firm* is able to pay that liability but chooses not to do so. The holder should agree that the *firm* has no liability (including any contingent or prospective liability) to pay any amount to the extent to which that liability would cause the *firm* to become insolvent if it made the payment or to the extent that its liabilities exceed its assets or would do if the payment were made. The terms of the *capital instrument* should be such that the *directors* can continue to trade in the best interests of the senior creditors even if this prejudices the interests of the holders of the instrument.

2.2.117A **R** A *BIPRU firm* must not include a *capital instrument* at stage B1, B2 or C of the calculation in the *capital resources table* unless (in addition to satisfying all the other requirements in relation to *tier one capital* and *hybrid capital*) its contractual terms provide for a mechanism within the instrument which:

- (1) is clearly defined and legally certain;
- (2) is disclosed and transparent to the market;
- (3) makes the recapitalisation of the *firm* more likely by adequately reducing the potential future outflows to a holder of the *capital instrument* at certain trigger points;

- (4) enables the *firm*, at and after the trigger points, to operate the mechanism; and
- (5) when initiated, operates in one of the following ways:
 - (a) the principal of the instrument is written down permanently; or
 - (b) the principal of the instrument is written down temporarily. During the write-down period any *coupon* payable on the instrument must be cancelled and any related dividend stoppers and pushers must operate in a way that does not hinder recapitalisation; or
 - (c) the instrument is converted into *core tier one capital*. The maximum number of *capital instruments* which are *core tier one capital* into which it must be converted must:
 - (i) be determined at the date of its issue;
 - (ii) be determined on the basis of the market value of those other instruments at the date of its issue;
 - (iii) have an aggregate value no more than 150% of its par value; and
 - (iv) not increase if the share price decreases; or
 - (d) an alternative process applies which has the same or greater effect on the likelihood of recapitalisation as (a), (b), and (c).

2.2.117B R The trigger points required by ■ GENPRU 2.2.117AR (3) must:

- (1) be clearly defined within the instrument and legally certain;
- (2) be disclosed and transparent to the market; and
- (3) be prudent and timely, and include trigger points which occur:
 - (a) before a breach of the *firm's capital resources requirement* and both:
 - (i) when the *firm's* losses lead to a significant reduction of the *firm's* retained earnings or other reserves which causes a significant deterioration of the *firm's* financial and solvency conditions; and
 - (ii) when it is reasonably foreseeable that the events described in (i) will occur; and
 - (b) when the *firm* is in breach of its *capital resources requirement*.

2.2.117C G

- (1) The effects of the mechanisms described in ■ GENPRU 2.2.117A R will be more meaningful if they happen immediately after losses cause a significant deterioration of the financial as well as the solvency situation and even before the reserves are exhausted.
- (2) If a *firm* does not operate the loss absorption mechanism in a prudent and timely way, then the *FCA* may consider

using its powers under 55J of the Act to, on its own initiative, vary the *firm's Part 4A permission* to require it to operate the mechanism.

- 2.2.118 **R** (1) [deleted]
- (2) A *BIPRU firm* may not include a *capital instrument* at stage B1, B2 or C of the calculation in the *capital resources table* unless it has obtained a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the criteria in ■ GENPRU 2.2.62 R (Tier one capital: General), ■ GENPRU 2.2.64R (1) to ■ GENPRU 2.2.64R (9) (General conditions for eligibility as tier one capital) and ■ GENPRU 2.2.80 R to ■ GENPRU 2.2.81 R (Loss absorption) are met.

2.2.118A **G** For the purposes of ■ GENPRU 2.2.118R (2), the focus of the legal opinion in considering ■ GENPRU 2.2.64R (6)(b) should be on whether appropriate mechanisms exist and are designed to operate to ensure that the value of the *hybrid capital instrument* and the position of the *hybrid capital holder* are not enhanced by recapitalisation.

2.2.119 **G** For the purpose of ■ GENPRU 2.2.118 R, an independent legal opinion may be given by an *employee* of that *firm*, but if an *employee* does so he should not be part of the business unit responsible for the transaction (including the drafting of the issue documentation).

Other tier one capital: hybrid capital: indirectly issued tier one capital (BIPRU firm only)

2.2.123 **R** ■ GENPRU 2.2.123 R to ■ GENPRU 2.2.137 R apply to a *BIPRU firm*.

- 2.2.124 **R** (1) ■ GENPRU 2.2.123 R - ■ GENPRU 2.2.137 R apply to capital of a *firm* if:
- (a) either or both of the conditions in (2) are satisfied; and
 - (b) any of the *SPVs* referred to in (2) is a *subsidiary undertaking* of the *firm*.
- (2) The conditions referred to in (1) are:
- (a) that capital is issued to an *SPV*; or
 - (b) the subscription for the capital issued by the *firm* is funded directly or indirectly by an *SPV*.
- (3) A *BIPRU firm* may not include capital coming within this *rule* in its *capital resources* unless the requirements in the following *rules* are satisfied:
- (a) (if (2)(a) applies and (2)(b) does not) ■ GENPRU 2.2.127 R, ■ GENPRU 2.2.129 R and ■ GENPRU 2.2.132 R; or
 - (b) (in any other case) ■ GENPRU 2.2.133 R.

2.2.125 **R** A *BIPRU firm* may only count capital to which ■ GENPRU 2.2.124 R applies at stage C of the calculation in the *capital resources table*.

- 2.2.126** **R** For the purpose of ■ GENPRU 2.2, an *SPV* is, in relation to a *BIPRU firm*, any *undertaking* whose main activity is to raise funds for that *firm* or for a *group* to which that *BIPRU firm* belongs.
- 2.2.127** **R** The *SPV* referred to in ■ GENPRU 2.2.124R (2)(a) must satisfy the following conditions:
- (1) it is controlled by the *firm* and may not operate independently of the *firm*;
 - (2) the rights of investors in the *SPV* who do not belong to the *group* of the *BIPRU firm* in question are not such as to affect the ability of the *firm* to control the *SPV*;
 - (3) all or virtually all of its *exposures* (calculated by reference to the amount) consist of *exposures* to the *firm* or to that *firm's group*; and
 - (4) it is incorporated under, and governed by, the laws and jurisdiction of England and Wales, Scotland or Northern Ireland.
- 2.2.128** **G** An *SPV* could take the form of a limited partnership. In such an arrangement, holders of a *capital instrument* issued by the *SPV* which do not belong to the *group* of the *BIPRU firm* in question should have no right to participate in the management of the partnership, whether under the partnership's constitutional documents or the transaction documents. In general, this means that they should be treated as limited partners. It is expected that the general partner, having control of the *SPV*, would be the *firm*.
- 2.2.128A** **R** ■ GENPRU 2.2.127R (4) does not apply if the *firm* has conducted a properly reasoned analysis confirming that any potential risks, including legal and operational risks, associated with cross-border issues, which undermine the quality of the capital for the issuer, that arise from an *SPV* not being incorporated under or governed by the laws and jurisdiction of England and Wales, Scotland or Northern Ireland, are adequately mitigated.
- 2.2.128B** **R** The analysis must be set out in writing and dated before the date of issue of the *capital instrument* and the *firm* must be able to show that the analysis has been fully considered as part of its decision to proceed with the issue. The analysis must be conducted by a person or persons appropriately qualified to assess the relevant risks and that person may be an independent adviser or an employee of the *firm* who is not part of the business unit responsible for the transaction (including the drafting of the issue documentation).

- 2.2.129** **R** The *SPV* referred to in ■ GENPRU 2.2.124R (2)(a) must fund its subscription for the capital issued by the *firm* by the issue of capital that satisfies the following conditions:
- (1) it must comply with the conditions for qualification as *tier one capital*, as amended by ■ GENPRU 2.2.130 R, as if the *SPV* was itself a *firm* seeking to include that capital in its *tier one capital resources*;
 - (2) (a) its terms must include an obligation on the *firm* that, in the event of a collapse of the *SPV* structure, and if the mechanism contained within the instrument under ■ GENPRU 2.2.117A R is a conversion, the *firm* must substitute the *capital instrument* issued by the *SPV* with *core tier one capital* issued by the *firm*; and
(b) there must be no obstacle to the *firm's* issue of new securities;
 - (3) the conversion ratio in respect of the substitution described in (2) must be fixed when the *SPV* issues the *capital instrument*;
 - (4) to the extent that investors have the benefit of an obligation by a *person* other than the *SPV*:
 - (a) that obligation must be one owed by a member of the *firm's* group; and
 - (b) the extent of that obligation must be no greater than would be permitted by *GENPRU* if that obligation formed part of the terms of a *capital instrument* issued by that member which complied with the *rules* in *GENPRU* relating to *tier one capital* included at stage C of the calculation in the *capital resources table*; and
 - (5) if the *SPV* structure collapses, the holder of it has no better a claim against the *firm* than a holder of the same type of instrument directly issued by the *firm*.
- 2.2.130** **R** For the purpose of ■ GENPRU 2.2.129 R and ■ GENPRU 2.2.132 R, ■ GENPRU 2.2.118 R (Requirement to obtain a legal opinion) does not apply.
- 2.2.131** **R** In relation to the obligation to substitute described in ■ GENPRU 2.2.129R (2), a *firm* must take all reasonable steps to ensure that it has at all times authorised and unissued *capital instruments* which are *core tier one capital* (and the authority to issue them) sufficient to discharge its obligation to substitute.
- 2.2.131A** **G** ■ GENPRU 2.2.129R (2) and ■ GENPRU 2.2.131 R allow a *firm* to replace the capital issued by the *SPV* with *capital instrument* which are *core tier one capital*.
- 2.2.132** **R** The capital which the *firm* seeks to include in its *capital resources* under ■ GENPRU 2.2.124R (3)(a) must satisfy the following conditions:
- (1) it meets the conditions for inclusion in *tier one capital* (subject to ■ GENPRU 2.2.130 R);
 - (2) its first call date (if any) must not arise before that on the instrument issued by the *SPV*; and

- 2.2.133 **R**
- (3) its terms relating to repayment must be the same as those of the instrument issued by the *SPV*.
- (1) This rule deals with any transaction:
- under which an *SPV* directly or indirectly funds the subscription for capital issued by the *firm* as described in ■ GENPRU 2.2.124 R; or
 - that is directly or indirectly funded by a transaction in (1)(a).
- (2) Each *undertaking* that is a party to a transaction to which this *rule* applies (other than the *firm*) must be a *subsidiary undertaking* of the *firm*.
- (3) Each *SPV* that is a party to a transaction to which this *rule* applies must comply with ■ GENPRU 2.2.127 R.
- (4) Any capital to which (1) applies (other than the capital that is to be included in the *firm's capital resources*) must be in the form of capital that complies with ■ GENPRU 2.2.129R (1) and ■ GENPRU 2.2.129R (4), whether or not issued by an *SPV*.
- (5) The obligations in ■ GENPRU 2.2.129R (2) and ■ GENPRU 2.2.129R (3) only apply to capital issued by an *SPV* at the end of the chain of transactions beginning with the issue of capital by the *firm* referred to in ■ GENPRU 2.2.124 R.
- (6) ■ GENPRU 2.2.132 R applies to the capital issued by the *firm* as referred to in ■ GENPRU 2.2.124 R. For these purposes references in ■ GENPRU 2.2.132 R to the instrument issued by the *SPV* are to the instrument referred to in (5).
- 2.2.134 **G**
- The purpose of ■ GENPRU 2.2.133 R is to deal with a capital-raising under which the capital raised by a special purpose vehicle is passed through a number of *undertakings* before it is invested in the *firm*. If the *capital resources* of the *firm* fall below, or are likely to fall below, its *capital resources requirement* the *firm* should replace the capital issued by that first special purpose vehicle with a *tier one instrument* directly issued by the *firm* which complies with ■ GENPRU 2.2.129R (2).
- 2.2.135 **R**
- A *firm* which satisfies the conditions for the inclusion of capital set out in ■ GENPRU 2.2.124 R, must, in addition, if that transaction is in any respect unusual, notify the *FCA* at least one *Month* in advance of the date on which the *firm* intends to include that capital in its *capital resources*.
- 2.2.136 **G**
- The *FCA* is likely to consider as unusual a transaction which involves the raising by the *firm* of *tier one capital* through a *subsidiary undertaking* of that *firm* that is not an *SPV*. The *FCA* would expect a *firm* to request individual *guidance* in such circumstances.

2.2.137 **R** A *firm* must ensure that, in relation to a transaction falling within
 ■ GENPRU 2.2.124 R:

- (1) the marketing document for the transaction contains all the information which a reasonable third party would require to understand the transaction fully and its effect on the financial position of the *firm* and its *group*; and
- (2) the information in (1) and the transaction are easily comprehensible without the need for additional information about the *firm* and its *group*.

Tier one capital: Conversion ratio

2.2.138 **R** (1) This *rule* applies to a *potential tier one instrument* if:

- (a) it is redeemable by the *firm* (ignoring ■ GENPRU 2.2.77 R (Meaning of redemption));
- (b) it provides that if the issuer does not exercise that right or does not do so in specified circumstances the issuer must or may have to redeem it in whole or in part through the issue of *shares* eligible for inclusion in the *firm's tier one capital resources* or the instrument converts or may convert into such *shares*; and
- (c) ■ GENPRU 2.2.77 R means that the obligation in (1)(b) is treated as not being inconsistent with ■ GENPRU 2.2.70R (1) (*Tier one capital* should not be redeemable at the option of the holder).

(2) A *firm* must not include a *potential tier one instrument* to which this *rule* applies in its *tier one capital resources* if:

- (a) the conversion ratio as at the date of redemption may be greater than the conversion ratio as at the time of issue by more than 150%; or
- (b) the market price of the conversion instruments issued in relation to one unit of the original capital item (plus any cash element of the redemption) may be greater than the issue price of that original capital item.

(3) All determinations under this *rule* are made as at the date of issue of the original capital item.

2.2.139 **R** In ■ GENPRU 2.2.138 R to ■ GENPRU 2.2.142 R:

- (1) the original capital item means the capital item that is being redeemed; and
- (2) the conversion instrument means the *tier one capital* to be issued on its redemption.

2.2.140 **R** In ■ GENPRU 2.2.138 R to ■ GENPRU 2.2.142 R, the conversion ratio means the ratio of:

- (1) the number of units of the conversion instrument that the *firm* must issue to satisfy its redemption obligation (so far as it is to be satisfied

by the issue of conversion instruments) in respect of one unit of the original capital item; to

(2) one unit of the original capital item.

2.2.141 **R** In ■ GENPRU 2.2.138 R to ■ GENPRU 2.2.142 R, the conversion ratio as at the date of issue of the original capital item is calculated as if the original capital item were redeemable at that time.

2.2.142 **R** If the conversion instruments or the original capital item are subdivided or consolidated or subject to any other occurrence that would otherwise result in like not being compared with like, the conversion ratio calculation in ■ GENPRU 2.2.138 R must be adjusted accordingly.

2.2.143 **G**

- (1) The significance of the limitations on conversion in ■ GENPRU 2.2.138R (2) can be seen in the example in this paragraph.
- (2) A *firm* issues innovative notes with a par value of £100 each. The terms of the instrument provide that if the instrument is not called at par at the first call date the notes convert into a variable number of ordinary *shares*.
- (3) If the market price of the ordinary *shares* is 400 pence per share on the day of issue of the innovative notes then the maximum number of ordinary *shares* (M) that a single £100 par value innovative note can be converted into is calculated as follows:
 - (a) $M = \text{Par value of innovative instrument} * 150\% / \text{market value of ordinary share}$;
 - (b) $M = £100 * 1.5 / £4 = 37.5 \text{ shares}$.
- (4) The practical effect is that conversion will result in the holder of an innovative capital note receiving ordinary *shares* equal to the par value of that note only when the market price of the ordinary *shares* remains above half the market price of the *shares* at the date of issue of the notes.
- (5) If the market price of the ordinary *shares* fell by half to 200 pence, the maximum permitted number of *shares* (37.5) would have to be issued in order to give an investor in the innovative note ordinary *shares* with a market value equal to £100. If the market price of the ordinary *shares* fell below 200 pence, the issue of the maximum permitted number of ordinary *shares* would have a market value below £100.

2.2.144 **G**

- (1) In addition to the maximum conversion ratio of 150% ■ GENPRU 2.2.138R (2)(b) does not permit a *firm* to issue *shares* that would have a market value that exceeds the issue price of the instrument being redeemed.

- (2) In the example in ■ GENPRU 2.2.143 G, if the market value of the ordinary *shares* was 250 pence at the conversion date, the maximum number of ordinary *shares* that may be issued to satisfy the redemption of one of the £100 par value innovative notes would be 40 (= £100 / £2.5).

Tier one capital: Requirement to have sufficient unissued stock

2.2.145

R

- (1) This *rule* applies to a *potential tier one instrument* of a *firm* where either:

- (a) the redemption proceeds; or
- (b) any *coupon* on that capital item;

can be satisfied by the issue of another *capital instrument*.

- (2) A *firm* may only include an item of capital to which this *rule* applies in its *tier one capital resources* if the *firm* has authorised and unissued *capital instruments* of the kind in question (and the authority to issue them):

- (a) that are sufficient to satisfy all such payments then due; and
- (b) are of such amount as is prudent in respect of such payments that could become due in the future.

Step-ups: calculating the size of a step-up

2.2.146

R

- (1) Where a *rule* in this section says that a particular treatment applies to an item of capital that is subject to a *step-up* of a specified amount, the question of whether that *rule* is satisfied must be judged by reference to the cumulative amount of all *step-ups* since the issue of that item of capital rather than just by reference to a particular *step-up*.

- (2) Where a *step-up* arises through a change from paying a *coupon* on a debt instrument to paying a dividend on a *share* issued in settlement of the *coupon*, any net cost to the *firm* arising from the different tax treatment of the dividend compared to the tax treatment of interest may be ignored for the purpose of assessing the effect of that *step-up*.

Step-ups: Limits on the amount of step-ups on tier one and two capital

2.2.147

R

- (1) A *firm* may not include in its *tier one capital resources* a *tier one instrument* that is or may be subject to a *step-up* that does not meet the definition of moderate in the press release of the Basle Committee on Banking Supervision of 27th October 1998 called "Instruments eligible for inclusion in Tier 1 capital".
- (2) For the purpose of (1) the words in that press release "than, at national supervisory discretion, either" are replaced by "than the higher of the following two amounts".
- (3) The calculations required by this *rule* and ■ GENPRU 2.2.151 R must be carried out as at the date of issue of the relevant instrument.

(4) A BIPRU firm may not include a capital instrument in its tier one capital resources if it is redeemable and subject to more than one step-up.

2.2.148 **G** The effect of ■ GENPRU 2.2.147 R is that for inclusion in tier one capital resources, step-ups in instruments should be moderate. A moderate step-up for these purposes is one which results in an increase over the initial rate that is no greater than the higher of the following two amounts:

- (1) 100 basis points, less the swap spread between the initial index basis and the stepped-up index basis; or
- (2) 50% of the initial credit spread, less the swap spread between the initial index basis and the stepped-up index basis.

2.2.149 **G** If a coupon paid on an item of capital is initially set at a specified spread above an index (the initial index basis), and the coupon moves to being set relative to another index (the stepped up index basis), there will be an implied step-up (positive or negative) even if the specified spread does not change. This is because each index may itself include a spread relative to the risk free rate and this spread may differ between the two indexes. The deduction of the swap spread in ■ GENPRU 2.2.148G (1) and ■ (2) above adjusts for this difference.

2.2.150 **G** Where the step-up involves a conversion from fixed to floating (or vice versa), or a switch in basis index, the swap spread should be fixed at pricing date, reflecting the differential in pricing between indices at the time. The significance of deducting the swap spread can be seen by the following example:

- (1) the pricing date:
 - (a) 10 year gilts (G) = 5.5% (the initial index basis);
 - (b) 3 month LIBOR is the stepped up index basis and the 10 year mid swap rate (L) = 5.9%;
 - (c) initial fixed coupon rate = G + 200bp;
 - (d) swap spread = 0.4% (= 5.9% - 5.5%);
 - (e) initial fixed coupon rate = 7.5%;
 - (f) the swap spread shows that there is 40bps of spread in the stepped up index basis relative to the initial index basis; and
 - (g) the initial fixed coupon rate of 7.5% is equivalent to the mid swap rate + 160bp, or L + 200bp – the swap spread;
- (2) pricing of stepped-up rate at year 10 with step-up of 100bp without deducting swap spread:
 - (a) stepped-up floating rate = L + 200 + 100bp step-up = 8.9%; and
 - (b) effective step-up from initial fixed rate of 140bp (= 8.9% - 7.5%); and
- (3) pricing of stepped-up rate at year 10 with step-up of 100bp with deduction of the swap spread:

- (a) *stepped-up floating coupon rate* = L + 200 less 40bp swap spread (difference between 5.5% and 5.9%) + 100bp step-up = 8.5%
- (b) effective *step-up* from initial rate of 100bp (= 8.5% - 7.5%).
- 2.2.151** **R** (1) Subject to (2), if a *tier two instrument* is or may be subject to a *step-up* that does not meet the definition of moderate in the press release of the Basle Committee on Banking Supervision referred to in ■ GENPRU 2.2.147R (1) as adjusted under ■ GENPRU 2.2.147R (2), the first date that a *step-up* can take effect is deemed to be its final maturity date if that date is before its actual maturity date.
- (2) If a *tier two instrument*:
- (a) is or may be subject to a *step-up* during the period beginning on the fifth anniversary of the date of issue of that item and ending immediately before the tenth anniversary of the date of issue; and
- (b) the *step-up* or possible *step-up* is one which may result in an increase over the initial rate that is greater than 50 basis points, less the swap spread between the initial index basis and the stepped-up index basis (all these terms must be interpreted in accordance with ■ GENPRU 2.2.147 R);
- the first date that a *step-up* can take effect is deemed to be its final maturity date if that date is before its actual maturity date.
- 2.2.152** **R** An instrument does not breach ■ GENPRU 2.2.147 R or as the case may be, is not subject to a deemed maturity date under ■ GENPRU 2.2.151 R, even though it is or may be subject to a *step-up* that exceeds the amount specified in those *rules* if:
- (1) the instrument is fungible with other instruments (the "existing stock") that are included in the *firm's tier one capital resources* (in the case of ■ GENPRU 2.2.147 R) or *tier two capital resources* (in the case of ■ GENPRU 2.2.151 R);
- (2) (if there has been no more than one previous issue of the existing stock) the existing stock complied with those limits on its date of issue;
- (3) (if there has been more than one previous issue of the existing stock) the first such issue of the existing stock complied with those limits on its date of issue; and
- (4) the result of the *step-up* on the instrument to which this *rule* applies is that the *coupon* on that instrument and the *coupon* on the existing stock is the same.
- 2.2.153** **R** (1) A *firm* must not include in its *tier one capital resources* a *potential tier one instrument* that is or may become subject to a *step-up* if that *step-up* can arise earlier than the tenth anniversary of the date of issue of that item of capital.
- (2) A *firm* must not include in its *tier two capital resources* a *capital instrument* that is or may become subject to a *step-up* if that *step-up*

can arise earlier than the fifth anniversary of the date of issue of that item of capital.

- 2.2.154 G Debt instruments containing embedded options, e.g. issues containing options for the interest rate after the *step-up* to be at a margin over the higher of two (or more) reference rates, or for the interest rate in the previous period to act as a floor, may affect the funding costs of the borrower and imply a *step-up*. In such circumstances, a *firm* may wish to seek individual *guidance* on the application of the *rules* relating to *step-ups* to the *capital instrument* in question. See ■ SUP 9 (Individual guidance) for the process to be followed when seeking individual *guidance*.

Deductions from tier one: Intangible assets

- 2.2.155 R A *firm* must deduct from its *tier one capital resources* the value of intangible assets.

- 2.2.156 G Intangible assets include goodwill as defined in accordance with the requirements referred to in ■ GENPRU 1.3.4 R (General requirements: accounting principles to be applied) applicable to the *firm*. The treatment of deferred acquisition cost assets for *BIPRU firms* is dealt with in ■ GENPRU 1.3 (Valuation); they should not be deducted as an intangible asset.

- 2.2.156A G Intangible assets include goodwill as defined in accordance with the requirements referred to in ■ GENPRU 1.3.4 R (General requirements: accounting principles to be applied) applicable to the *firm*.

Tier two capital: General

- 2.2.157 G *Tier two capital resources* are split into upper and lower tiers. A major distinction between *upper* and *lower tier two capital* is that, except as provided by ■ GENPRU 2.2.26A R for *BIPRU firms*, only perpetual instruments may be included in *upper tier two capital* whereas dated instruments, such as fixed term *preference shares* and dated subordinated debt, may be included in *lower tier two capital*.

- 2.2.158 G *Tier two instruments* are *capital instruments* that combine the features of debt and equity in that they are structured like debt, but exhibit some of the loss absorption and funding flexibility features of equity.

General conditions for eligibility as tier two capital instruments

- 2.2.159 R A *capital instrument* must not form part of the *tier two capital resources* of a *firm* unless it meets the following conditions:

- (1) the claims of the creditors must rank behind those of all unsubordinated creditors;
- (2) the only events of default must be non-payment of any amount falling due under the terms of the *capital instrument* or the winding-up of the *firm* and any such event of default must not prejudice the subordination in (1);

- (3) to the fullest extent permitted under the laws of the relevant jurisdictions, the remedies available to the subordinated creditor in the event of non-payment or other breach of the terms of the *capital instrument* must (subject to ■ GENPRU 2.2.161 R) be limited to petitioning for the winding-up of the *firm* or proving for the debt in the liquidation or administration;
- (4) any:
 - (a) remedy permitted by (3);
 - (b) remedy that cannot be excluded under the laws of the relevant jurisdictions as referred to in (3);
 - (c) remedy permitted by ■ GENPRU 2.2.161 R; and
 - (d) terms about repayment as referred to in (5);must not prejudice the matters in (1) and (2) and in particular any damages permitted by (b) or (c) and repayment obligation must be subordinated in accordance with (1);
- (5) without prejudice to (1), the debt must not become due and payable before its stated final maturity date (if any) except on an event of default complying with (2) or as permitted by ■ GENPRU 2.2.172 R (Repayment at the option of the issuer) or ■ GENPRU 2.2.194R (2) (Repayment of *lower tier two capital* at the option of the holder) and any remedy described in (4)(a) to (c) must not prejudice this requirement;
- (6) the debt agreement or terms of the *capital instrument* are governed by the law of England and Wales, or of Scotland or of Northern Ireland;
- (7) to the fullest extent permitted under the laws of the relevant jurisdictions, creditors must waive their right to set off amounts they owe the *firm* against subordinated amounts included in the *firm's capital resources* owed to them by the *firm*;
- (8) the terms of the *capital instrument* must be set out in a written agreement that contains terms that provide for the conditions set out in (1) to (7);
- (9) the debt must be unsecured and fully paid up;
- (10) the description of its characteristics used in its marketing is consistent with the characteristics required to satisfy (1) to (9);
- (11) the amount of the item included must be net of any foreseeable tax charge at the moment of its calculation or must be suitably adjusted in so far as such tax charges reduce the amount up to which that item may be applied to cover risks or losses; and
- (12) the *firm* has obtained a properly reasoned independent legal opinion from an appropriately qualified individual stating that the requirements in (1) to (7) and (insofar as it relates to whether the *capital instrument* is unsecured) (9) have been met.

2.2.160 **R** A holder of a non-deferred share of a *building society* must be treated as a senior unsecured creditor of that *building society* for the purpose of ■ GENPRU 2.2.159 R.

General conditions for eligibility as tier two capital instruments: Additional remedies

2.2.161 **R** A *capital instrument* may be included in a *firm's tier two capital resources* even though the remedies available to the subordinated creditor go beyond those referred to in ■ GENPRU 2.2.159R (3), if the following conditions are satisfied:

- (1) those remedies are not available for failure to pay any amount of principal, interest or expenses or in respect of any other payment obligation; and
- (2) those remedies do not in substance amount to remedies to recover payment of the amounts in (1).

2.2.162 **G** If damages are a remedy that cannot be excluded as referred to in ■ GENPRU 2.2.159R (3) those damages should be subordinated in accordance with ■ GENPRU 2.2.159R (1). Damages permitted by ■ GENPRU 2.2.161 R should also be subordinated in accordance with ■ GENPRU 2.2.159R (1).

General conditions for eligibility as tier two capital instruments: Alternative governing laws

2.2.163 **R** ■ GENPRU 2.2.159R (6) does not apply if the *firm* has obtained a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the same degree of subordination has been achieved under the law that governs the debt and the agreement as that which would have been achieved under the laws of England and Wales, Scotland, or Northern Ireland.

General conditions for eligibility as tier two capital instruments: Standard form documentation

2.2.164 **G** The *FCA* is more concerned that the subordination provisions listed in ■ GENPRU 2.2.159 R should be effective than that they should follow a particular form. The *FCA* does not, therefore, prescribe that the loan agreement or *capital instrument* should be drawn up in a standard form.

Guidance on the general conditions for eligibility as tier two capital instruments

2.2.165 **G** For the purposes of ■ GENPRU 2.2.159R (5) the debt agreement or terms of the instrument should not contain any clause which might require early repayment of the debt (e.g. cross default clauses, negative pledges and restrictive covenants). A cross default clause is a clause which says that the loan goes into default if any of the borrower's other loans go into default. It is intended to prevent one creditor being repaid before other creditors, e.g. obtaining full repayment through the courts. A negative pledge is a clause which puts the loan into default if the borrower gives any further charge over its assets. A restrictive covenant is a term of contract that directly, or

indirectly, could lead to early repayment of the debt. Some covenants, e.g. relating to the provision of management information or ownership restrictions, are likely to comply with ■ GENPRU 2.2.159R (3) as long as monetary redress is ruled out, or any payments are covered by the subordination clauses.

2.2.166 **G** ■ GENPRU 2.2.159R (3) allows a *capital instrument* to form part of the *tier two capital resources* even though the laws of the relevant jurisdiction do not allow remedies to be limited in the way described there. For example it is not possible to limit certain remedies in the case of an issue in the United States that is SEC-registered and subject to the provisions of the Trust Indenture Act.

2.2.167 **G** The purpose of ■ GENPRU 2.2.159R (7) is to ensure that all of the *firm's* assets are available to *consumers* ahead of subordinated creditors. The waiver should apply both before and during liquidation or administration.

2.2.168 **G** The *guidance* in ■ GENPRU 2.2.119 G (Employee may give legal opinion) also applies for the purpose of ■ GENPRU 2.2.159R (12) and ■ GENPRU 2.2.163 R.

Tier two capital instruments: Connected transactions

2.2.169 **R** An item of capital does not comply with ■ GENPRU 2.2.159 R (General conditions for eligibility as tier two *capital instruments*) or ■ GENPRU 2.2.177 R (Upper tier two capital: General) if the issue of that item of capital by the *firm* is connected with one or more other transactions which, when taken together with the issue of that item, could result in that item of capital no longer displaying all of the characteristics set out in whichever of those *rules* apply.

2.2.170 **G** ■ GENPRU 2.2.66 G (*Guidance* on ■ GENPRU 2.2.65 R) applies to ■ GENPRU 2.2.169 R in the same way as it does to ■ GENPRU 2.2.65 R (The equivalent of ■ GENPRU 2.2.169 R in relation to *tier one capital*).

Amendment of tier two instruments

2.2.171 **R** A *firm* must not amend the terms of the capital or the documents referred to in ■ GENPRU 2.2.159R (8) unless:

- (1) at least one *Month* before the amendment is due to take effect, the *firm* has given the *FCA* notice in writing of the proposed amendment and the *FCA* has not objected; and
- (2) that notice includes confirmation that the legal opinions referred to in ■ GENPRU 2.2.159R (12) and, if applicable, ■ GENPRU 2.2.163 R (General conditions for eligibility as tier two *capital instruments*: Alternative governing laws) and ■ GENPRU 2.2.181 R (Legal opinions for *upper tier two instruments*), continue in full force and effect in relation to the terms of the debt and documents after any proposed amendment.

Redemption of tier two instruments

2.2.172 **R** A *tier two instrument* may be redeemable at the option of the *firm*, but any term of the instrument providing for the *firm* to have the right to exercise such an option must not provide for that right to be exercisable earlier than the fifth anniversary of the date of issue of the instrument.

2.2.173 **R** ■ GENPRU 2.2.71 R to ■ GENPRU 2.2.73 G (*Tier one instruments* may be redeemed by the issuer before the fifth anniversary in limited circumstances) apply to ■ GENPRU 2.2.172 R in the same way as they do to ■ GENPRU 2.2.70 R (The issuer should not redeem *tier one capital* before the fifth anniversary).

2.2.174 **R** In relation to a *tier two instrument*, a *firm* must notify the :

(1) [deleted]

(2) [deleted]

FCA one *month* before it becomes committed to the proposed repayment (unless that *firm* intends to repay an instrument on its final maturity date). When giving notice, the *firm* must provide details of its position after such repayment in order to show how it will:

(3) meet its *capital resources requirement*; and

(4) have sufficient financial resources to meet the *overall financial adequacy rule*.

Tier two capital: step-ups

2.2.175 **G** The *rules and guidance* in ■ GENPRU 2.2.146 R to ■ GENPRU 2.2.154 G on *step-ups* cover *tier two capital* as well as *tier one capital*.

Upper tier two capital: General

2.2.176 **G** Examples of *capital instruments* which may be eligible to count in *upper tier two capital resources* include the following:

(1) perpetual cumulative *preference shares*;

(2) perpetual subordinated debt; and

(3) other instruments that have the same economic characteristics as (1) or (2).

2.2.177 **R** A *capital instrument* must (in addition to meeting the requirements of the *rules* about eligibility for inclusion in *tier two capital*) meet the following conditions before it can be included in a *firm's upper tier two capital resources*:

(1) it must have no fixed maturity date;

- (2) the terms of the instrument must provide for the *firm* to have the option to defer any *coupon* on the debt, except that the *firm* need not have that right in the case of a *coupon* payable in the form of an item of capital that is included in the *same stage of capital* or a *higher stage of capital* as that first item of capital;
- (3) the terms of the instrument must provide for the loss-absorption capacity of the *capital instrument* and unpaid *coupons*, whilst enabling the *firm* to continue its business;
- (4) it meets the conditions in ■ GENPRU 2.2.169 R (Connected transactions) and ■ GENPRU 2.2.180 R (Loss absorption); and
- (5) the terms of the instrument are such that either the instrument or debt is not redeemable or repayable or it is repayable or redeemable only at the option of the *firm*.

2.2.178 **R** If a *firm* gives notice of the redemption or repayment of an *upper tier two instrument*, the *firm* must no longer include it in its *upper tier two capital resources*.

- 2.2.179** **G**
- (1) The purpose of ■ GENPRU 2.2.177R (2) is to ensure that a *firm* which issues an item of capital with a *coupon* retains flexibility over the payments of such *coupon* and can preserve cash in times of financial stress. However, a *firm* may include, as part of the capital instrument terms, a right to make payments of a *coupon* mandatory if an item of capital becomes ineligible to form part of its *capital resources* (for example, through a change in the relevant *rules*) and the *firm* has notified the *FCA* that the instrument is ineligible.
 - (2) For the purpose of ■ GENPRU 2.2.177R (2), ■ GENPRU 2.2.68 G (Dividend pushers) applies equally in relation to the inclusion of an instrument in *upper tier two capital resources*.
 - (3) ■ GENPRU 2.2.26A R provides an exception, in the case of a *BIPRU firm*, to the *rule* that instruments must have no fixed maturity date to be eligible for *upper tier two capital resources*.

Upper tier two capital: Loss absorption

2.2.180 **R** A *capital instrument* may only be included in *upper tier two capital resources* if a *firm's* obligations under the instrument either:

- (1) do not constitute a liability (actual, contingent or prospective) under section 123(2) of the Insolvency Act 1986; or
- (2) do constitute such a liability but the terms of the instrument are such that:
 - (a) any such liability is not relevant for the purposes of deciding whether:
 - (i) the *firm* is, or is likely to become, unable to pay its debts; or
 - (ii) its liabilities exceed its assets;

- (b) a *person* (including but not limited to a holder of the instrument) is not able to petition for the winding up or administration of the *firm* or for any similar procedure in relation to the *firm* on the grounds that the *firm* is or may become unable to pay any such liability; and
- (c) the *firm* is not obliged to take into account such a liability for the purposes of deciding whether or not the *firm* is, or may become, insolvent for the purposes of section 214 of the Insolvency Act 1986 (wrongful trading).

Upper tier two capital: Legal opinions

2.2.181 **R** A *firm* may not include an *upper tier two instrument* in its *upper tier two capital resources* unless it has obtained a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the criteria in **■ GENPRU 2.2.177R (3)** and **■ GENPRU 2.2.180 R (Loss absorption)** are met. This *rule* does not apply to a perpetual cumulative *preference share*.

Upper tier two capital: Guidance

2.2.182 **G** **■ GENPRU 2.2.180 R** is an example of the general principle in **■ GENPRU 2.2.177R (3)**.

2.2.183 **G** The *guidance* in **■ GENPRU 2.2.117 G** (There should be no liability to the extent that the *firm* would become insolvent, etc) also applies for the purpose of **■ GENPRU 2.2.180 R**.

2.2.184 **G** The *guidance* in **■ GENPRU 2.2.119 G** (Employee may give legal opinion) also applies for the purpose of **■ GENPRU 2.2.181 R**.

Upper tier two capital: Revaluation reserves (BIPRU firm only)

- 2.2.185** **R**
- (1) This *rule* applies to a *BIPRU firm*.
 - (2) A *BIPRU firm* must, in relation to equities held in the available-for-sale financial assets category:
 - (a) deduct any net losses at stage E of the calculation in the *capital resources table* (Deductions from tier one capital); and
 - (b) include any net gains (after deduction of deferred tax) in revaluation reserves at stage G of the calculation in the *capital resources table* (Upper tier two capital).
 - (3) A *BIPRU firm* must include any net gains, after deduction of deferred tax, on revaluation reserves of investment properties at stage G of the calculation in the *capital resources table*. A *firm* must include any losses on such revaluation reserves in profit and loss account and other reserves.
 - (4) A *BIPRU firm* must include any net gains, after deduction of deferred tax, on revaluation reserves of land and buildings at stage G of the calculation in the *capital resources table*. A *firm* must include any losses on such revaluation reserves in profit and loss account and other reserves.

- (5) (2) only applies to a *firm* to the extent that the category of asset referred to in that paragraph exists under the accounting framework that applies to the *firm* as referred to in ■ GENPRU 1.3.4 R (General requirements: accounting principles to be applied).
- (6) (3) and (4) apply to a *firm* whatever the accounting treatment of those items is under the accounting framework that applies to the *firm* as referred to in ■ GENPRU 1.3.4 R.

2.2.186 **G** Subject to ■ GENPRU 2.2.185 R, a *BIPRU firm* should value its revaluation reserves in accordance with the *rules* in ■ GENPRU 1.3 (Valuation).

Upper tier two capital: General/collective provisions (BIPRU firm only)

2.2.187 **R** A *BIPRU firm* which adopts the *standardised approach* to credit risk may include general/collective provisions in its *tier two capital resources* only if:

- (1) they are freely available to the *firm*;
- (2) their existence is disclosed in internal accounting records; and
- (3) their amount is determined by the management of the *firm*, verified by independent auditors and notified to the *FCA*.

2.2.188 **R** The value of general/collective provisions which a *firm* may include in its *tier two capital resources* as referred to in ■ GENPRU 2.2.187 R may not exceed 1.25% of the sum of the following:

- (1) the *market risk capital requirement* multiplied by a factor of 12.5; and
- (2) the sum of *risk weighted assets* under the *standardised approach* for credit risk.

2.2.189 **R** Where a *firm* is unable to determine whether collective/general provisions relate only to *exposures* on either the *standardised approach* or the *IRB approach*, that *firm* must allocate them on a basis which is reasonable and consistent.

Upper tier two capital: Surplus provisions (BIPRU firm only)

2.2.190 **R** A *BIPRU firm* calculating *risk weighted exposure amounts* under the *IRB approach* may include in its *upper tier two capital resources* positive amounts resulting from the calculation in ■ BIPRU 4.3.8 R (Treatment of expected loss amounts), up to 0.6% of the *risk weighted exposure amounts* calculated under that approach.

2.2.191 **R** A *BIPRU firm* calculating *risk weighted exposure amounts* under the *IRB approach* may not include in its *capital resources* value adjustments and provisions included in the calculation in ■ BIPRU 4.3.8 R (Treatment of expected loss amounts under the *IRB approach* for *trading book exposures*) or value adjustments and provisions for *exposures* that would otherwise have

been eligible for inclusion in general/collective provisions other than in accordance with ■ GENPRU 2.2.190 R.

2.2.192 **R** For the purpose of ■ GENPRU 2.2.190 R and ■ GENPRU 2.2.191 R, *risk weighted exposure amounts* must not include those calculated in respect of *securitisation positions* which have a *risk weight* of 1250%.

2.2.193 **R** If a *BIPRU firm* calculates *risk weighted exposure amounts* under the *IRB approach* for the purposes of ■ BIPRU 14 (Capital requirements for settlement and counterparty risk) it must not include valuation adjustments referred to in ■ BIPRU 14.2.18 R (1) (Treatment of expected loss amounts) in its *capital resources* except in accordance with that *rule*.

Lower tier two capital

2.2.194 **R** A *firm* may include a *capital instrument* in its *lower tier two capital resources* if (in addition to meeting the requirements of the *rules* about eligibility for inclusion in *tier two capital*) either the holder has no right to repayment or it satisfies either of the following conditions:

- (1) it has an original maturity of at least five years; or
- (2) it is redeemable on notice from the holder, but the period of notice of repayment required to be given by the holder is five years or more.

2.2.195 **G** A *firm* may include perpetual *capital instruments* that do not meet the conditions in ■ GENPRU 2.2.177 R (Eligibility conditions for *upper tier two capital*) in *lower tier two capital resources* if they meet the general conditions described in ■ GENPRU 2.2.159 R (General conditions for eligibility as *tier two capital instruments*).

2.2.196 **R**

- (1) For the purposes of calculating the amount of a *lower tier two instrument* which may be included in a *firm's capital resources*:
 - (a) in the case of an instrument with a fixed maturity date, in the final five years to maturity; and
 - (b) in the case of an instrument with or without a fixed maturity date but where five years' or more notice of redemption or repayment has been given, in the final five years to the date of redemption or repayment;
 the principal amount must be amortised on a straight line basis.
- (2) If a *firm* gives notice of the redemption or repayment of a *lower tier two instrument* and (1) does not apply, the *firm* must no longer include it in its *lower tier two capital resources*.

2.2.197 **G** If a *firm* wishes to include in *lower tier two capital resources* an instrument with or without a fixed maturity date but where less than five years' notice of redemption or repayment has been given, it should seek individual *guidance* from the *FCA*.

The effect of swaps on debt capital

- 2.2.198** **R** ■ GENPRU 2.2.198 R to ■ GENPRU 2.2.201 R apply to a *tier one instrument*, *tier two instrument* or *tier three instrument* of a *firm* that is treated as a liability under the accounting framework to which it is subject as referred to in ■ GENPRU 1.3.4 R (General requirements: accounting principles to be applied) (a "debt instrument").
- 2.2.199** **R** A *firm* must recognise for the purpose of this section any effect that changes in exchange rates or interest rates have on a debt instrument (as defined in ■ GENPRU 2.2.198 R) under the accounting framework to which the *firm* is subject as referred to in ■ GENPRU 1.3.4 R (General requirements: accounting principles to be applied).
- 2.2.200** **R** A *firm* must recognise, in accordance with ■ GENPRU 2.2.201 R, the effect of a *foreign currency hedge* on a debt instrument (as defined in ■ GENPRU 2.2.198 R) denominated in a *foreign currency* or of an interest rate hedge on a fixed rate *coupon* debt instrument if:
- (1) the accounting framework to which the *firm* is subject as referred to in ■ GENPRU 1.3.4 R (General requirements: accounting principles to be applied) provides for a fair value hedge accounting relationship between a liability and its related hedge;
 - (2) such a relationship exists under that accounting framework between that debt instrument and that hedge;
 - (3) (if the debt instrument is a *tier one instrument*) the *firm's* obligations under that hedge comply with the conditions in ■ GENPRU 2.2.64 R to ■ GENPRU 2.2.65 R (General conditions for eligibility as tier one capital);
 - (4) (if the debt instrument is a *tier two instrument* or an *upper tier three instrument*) the *firm's* obligations under that hedge comply with the conditions in ■ GENPRU 2.2.159 R to ■ GENPRU 2.2.169 R (General conditions for eligibility as tier two capital instruments) as modified, in the case of an *upper tier three instrument*, by ■ GENPRU 2.2.244 R (Application of *tier two capital rules* to *tier three capital debt*) except as follows:
 - (a) ■ GENPRU 2.2.159R (9) only applies to the extent that it requires that hedge to be unsecured; and
 - (b) ■ GENPRU 2.2.159R (12) (legal opinion) does not apply.
- 2.2.201** **R** A *firm* must recognise the effect of a hedge as referred to in ■ GENPRU 2.2.200 R by including the net accounting fair value of the hedging instrument in the valuation of the debt instrument (as defined in ■ GENPRU 2.2.198 R).

Deductions from tiers one and two: Qualifying holdings (bank or building society only)

- 2.2.202** **R** ■ GENPRU 2.2.202 R to ■ GENPRU 2.2.207 R only apply to a *bank* or *building society*.

- 2.2.203** **R** A *qualifying holding* is a direct or indirect holding of a *bank* or *building society* in a non-financial *undertaking* which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that *undertaking*.
- 2.2.204** **R** For the purpose of **■ GENPRU 2.2.203 R**, a non-financial *undertaking* is an *undertaking* other than:
- (1) a *credit institution* or *financial institution*;
 - (2) an *undertaking* whose exclusive or main activities are a direct extension of banking or concern services ancillary to banking, such as leasing, factoring, the management of unit trusts, the management of data processing services or any other similar activity; or
 - (3) an *insurer*.
- 2.2.205** **R** The amount of *qualifying holdings* that a *bank* or *building society* must deduct in the calculation in the *capital resources table* is:
- (1) (if the *firm* has one or more *qualifying holdings* that exceeds 15% of its relevant *capital resources*) the sum of such excesses; and
 - (2) to the extent not already deducted in (1), the amount by which the sum of each of that *firm's* *qualifying holdings* exceeds 60% of its relevant *capital resources*.
- 2.2.206** **R** The relevant *capital resources* of a *firm* mean for the purposes of this *rule* the sum of the amount of *capital resources* calculated at stages L (Total tier one capital plus tier two capital) and Q (Total tier three capital) of the calculation in the *capital resources table* as adjusted in accordance with the following:
- (1) the *firm* must not take into account the items referred to in any of the following:
 - (a) **■ GENPRU 2.2.190 R** to **■ GENPRU 2.2.193 R** (surplus provisions); or
 - (b) **■ GENPRU 2.2.236 R** (*expected loss* amounts and other negative amounts); or
 - (c) **■ GENPRU 2.2.237 R** (*securitisation positions*);
 - (2) the *firm* must make the deductions to be made at stage S of the calculation in the *capital resources table* (Deductions from total capital); and
 - (3) the *firm* need not deduct any *excess trading book position* under (2).
- 2.2.207** **R** The following are not included as *qualifying holdings*:
- (1) *shares* that are not held as investments; or

(2) *shares* that are held temporarily during the normal course of underwriting; or

(3) *shares* held in a *firm's* name on behalf of others.

Deductions from tiers one and two: Material holdings (BIPRU firm only)

2.2.208 **R** ■ GENPRU 2.2.208 R to ■ GENPRU 2.2.216 G only apply to a *BIPRU firm*.

- 2.2.209 **R**
- (1) Subject to (2) and (3), a *material holding* is:
- (a) a *BIPRU firm's* holdings of *shares* and any other interest in the capital of an individual *credit institution* or *financial institution* (held in the *non-trading book* or the *trading book* or both) exceeding 10% of the *share capital* of the issuer, and, where this is the case, any holdings of subordinated debt of the same issuer are also included as a *material holding*; the full amount of the holding is a *material holding*; or
 - (b) a *BIPRU firm's* holdings of *shares*, any other interest in the capital and subordinated debt in an individual *credit institution* or *financial institution* (held in the *non-trading book* or the *trading book* or both) not deducted under (a) if the total amount of such holdings exceeds 10% of that *firm's capital resources* at stage N (Total tier one capital plus tier two capital after deductions) of the calculation in the *capital resources table* (calculated before deduction of its *material holdings*); only the excess amount is a *material holding*; or
 - (c) a *bank* or *building society's* aggregate holdings in the *non-trading book* of *shares*, any other interest in the capital, and subordinated debt in all *credit institutions* or *financial institutions* not deducted under (a) or (b) if the total amount of such holdings exceeds 10% of that *firm's capital resources* at stage N of the calculation in the *capital resources table* (calculated before deduction of its *material holdings*); only the excess amount is a *material holding*; or
 - (d) a *material insurance holding*.
- (2) If a *BIPRU firm* holds *shares* in the capital of Business Growth Fund plc or another *financial institution* which makes *venture capital investments* (in this section and its related annexes, a "Venture Capital Investor") and the following conditions are met:
- (a) the sole business of the Venture Capital Investor is the making of *venture capital investments* together with the performance of *ancillary activities* in relation to the administration of the *venture capital investments*;
 - (b) none of the *venture capital investments* made by the Venture Capital Investor is an investment (direct or indirect) in:
 - (i) a *credit institution*; or
 - (ii) a *financial institution* the principal activity of which is to perform any activity other than the acquisition of holdings in other *undertakings*;

(c) the relevant proportion of the Venture Capital Investor is included in the *firm's UK consolidation group* in accordance with ■ BIPRU 8.5; and

(d) the *firm* assigns a *risk weight* to its *exposure* to the Venture Capital Investor as if it were an *equity exposure* to which the simple *risk weight* approach is applied as set out in ■ BIPRU 4.7.9 R to ■ BIPRU 4.7.12 R (and in calculating its *capital resources requirement* the *firm* must assign a *risk weight* to that *exposure* in accordance with those *rules* and notwithstanding that those *rules* would not otherwise apply to that calculation);

the Venture Capital Investor may be ignored for the purposes of determining whether there is a *material holding*.

(3) If a *BIPRU firm* holds *shares* in the capital of a *subsidiary undertaking* which is a *financial institution* solely by reason of its principal activity being the acquiring of holdings and which in turn holds (directly or indirectly) *shares* in the capital of a Venture Capital Investor (in this section and its related annexes, a "Venture Capital Holding Company") and the following conditions are met:

(a) the Venture Capital Investor meets the conditions in (2)(a) and (b);

(b) the Venture Capital Holding Company is included in the *firm's UK consolidation group* in accordance with ■ BIPRU 8.5;

(c) the proportion of the value of the Venture Capital Holding Company attributable to investment in Venture Capital Investors and the proportion of the value of the Venture Capital Holding Company attributable to investment in other investments can be identified and valued on a regular basis; and

(d) the *firm* assigns a *risk weight* to its *exposure* to the proportion of the Venture Capital Holding Company that represents the value of its investment in Venture Capital Investors as if it were an *equity exposure* to which the simple *risk weight* approach is applied as set out in ■ BIPRU 4.7.9 R to ■ BIPRU 4.7.12 R (and in calculating its *capital resources requirement* the *firm* must assign a *risk weight* to that *exposure* in accordance with those *rules* and notwithstanding that those *rules* would not otherwise apply to that calculation);

the proportion of the *firm's* investment in the Venture Capital Holding Company that represents the value of its investment in Venture Capital Investors may be ignored for the purposes of determining whether there is a *material holding*. The proportion of the *firm's* investment in the Venture Capital Holding Company that represents the value of other investments is a *material holding*.

2.2.210 **G** For the purpose of the definition of a *material holding*, *share capital* includes *preference shares*. *Share premium* should be taken into account when determining the amount of *share capital*.

2.2.211 **R** When calculating the size of its *material holdings* a *firm* must only include an actual holding (that is, a long cash position). A *firm* must not net such holdings with a short position.

- 2.2.212** **R** A *material insurance holding* means the holdings of a *BIPRU firm* of items of the type set out in **■ GENPRU 2.2.213 R** in any:
- (1) *insurance undertaking*; or
 - (2) *insurance holding company*;
- that fulfils one of the following conditions:
- (3) it is a *subsidiary undertaking* of that *firm*; or
 - (4) that *firm* holds a *participation* in it.
- 2.2.213** **R** An item falls into this provision for the purpose of **■ GENPRU 2.2.212 R** if it is:
- (1) an *ownership share*; or
 - (2) an item of "basic own funds" as defined in the PRA Rulebook: Glossary.
- 2.2.214** **R** The amount to be deducted with respect to each *material insurance holding* is the higher of:
- (1) the book value of the *material insurance holding*; and
 - (2) the *solo capital resources requirement* for the *insurance undertaking* or *insurance holding company* in question calculated in accordance with:
 - (a) for an *insurer* that is a *Solvency II firm*, the PRA Rulebook: Solvency II Firms; and
 - (b) for an *insurer* other than in (a), the PRA Rulebook: Non-Solvency II Firms.
- 2.2.215** **R** For the purpose of the definition of a *material holding*, holdings must be valued using the valuation method which the holder uses for its external financial reporting purposes.
- 2.2.216** **G**
- (1) This paragraph gives *guidance* on how the calculation under **■ GENPRU 2.2.214R (1)** should be carried out where an *insurance undertaking* is accounted for using the embedded value method.
 - (2) On acquisition, any "goodwill" element (that is, the difference between the acquisition value according to the embedded value method and the actual investment) should be deducted from *tier one capital resources*.
 - (3) The embedded value should be deducted from the total of *tier one capital resources* and *tier two capital resources*.
 - (4) Post-acquisition, where the embedded value of the *undertaking* increases, the increase should be added to reserves, while the new embedded value is deducted from total *capital resources*.

2.2.216A **G**

- (5) This means that the net impact on the level of total *capital resources* is zero, although *tier two capital resources* headroom will increase with any increase in *tier one capital resources* reserves.
- (6) Embedded value is the value of the *undertaking* taking into account the present value of the expected future inflows from existing life assurance business.
- (1) This paragraph gives *guidance* as to the amount to be deducted at Part 2 of stage M (Deductions from the totals of tier one and two) of ■ GENPRU 2 Annex 2 (Capital resources table for a bank) and ■ GENPRU 2 Annex 3 (Capital resources table for a building society) in respect of investments in *subsidiary undertakings* and *participations* (excluding any amount which is already deducted as *material holdings* or *qualifying holdings*).
- (2) The effect of those *rules* is to achieve the deduction of all investments in *subsidiary undertakings* and *participations* for *banks* and *building societies* by ensuring that amounts not already deducted under other *rules* are accounted for at this stage of the calculation of *capital resources*, except where the investment has been made in:
 - (a) a Venture Capital Investor and the conditions in ■ GENPRU 2.2.209R (2) are met; or
 - (b) a Venture Capital Holding Company and the conditions in ■ GENPRU 2.2.209R (3) are met;
- (3) The following investments in *subsidiary undertakings* and *participations* should be deducted at this stage:
 - (a) those not deducted in Part 1 of stage M because of the operation of the thresholds in ■ GENPRU 2.2.205 R (on qualifying holdings) and ■ GENPRU 2.2.209 R (on material holdings); and
 - (b) those which do not meet the definition of *qualifying holding* or *material holding*, but excluding investments in Venture Capital Investors which are ignored in accordance with ■ GENPRU 2.2.209R (2) and investments in Venture Capital Holding Companies which are ignored in accordance with ■ GENPRU 2.2.209R (3), for the purposes of determining whether there is a *material holding*.
- (4) For example, an investment in an *undertaking* which is not a *qualifying holding* under ■ GENPRU 2.2.204R (2) (on the definition of a non-financial undertaking), that is whose exclusive or main activities are a direct extension of banking or concern services ancillary to banking, such as leasing, factoring, the management of unit trusts, the management of data processing services or any other similar activity, should be deducted at this stage.

Deductions from tiers one and two: Reciprocal cross holdings (BIPRU firm only)

2.2.217 **R**

..... ■ GENPRU 2.2.217 R to ■ GENPRU 2.2.220 R apply to a *BIPRU firm*.

2.2.218 **R** A *BIPRU firm* must deduct at stage M of the calculation in the *capital resources table* (Deductions from the totals of tier one and two) any *reciprocal cross-holdings*. However a *BIPRU firm* must not deduct such holdings to the extent that they fall to be deducted at Part 1 of stage M of the calculation in the *capital resources table* (Deductions for *material holdings, qualifying holdings* and certain other items).

2.2.219 **R** A *reciprocal cross-holding* means a holding of the *BIPRU firm* of *shares*, any other interest in the capital, and subordinated debt, whether in the *trading* or *non-trading* book, in:

- (1) a *credit institution*; or
- (2) a *financial institution*;

that satisfies the following conditions:

- (3) the holding is the subject of an agreement or arrangement between the *BIPRU firm* and either the issuer of the instrument in question or a member of a *group* to which the issuer belongs;
- (4) under the terms of the agreement or arrangement described in (3) the issuer invests in the *BIPRU firm* or in a member of the *group* to which that *BIPRU firm* belongs; and
- (5) the effect of that agreement or arrangement on the capital position of the *BIPRU firm*, the issuer, or any member of a *group* to which either belongs, under any relevant rules is significantly more beneficial than it is in economic terms, taking into account the agreement or arrangement as a whole.

2.2.220 **R** For the purpose of **GENPRU 2.2.219 R**, a relevant rule means a *rule* in *GENPRU, BIPRU* or *INSPRU* or any other capital adequacy or solvency requirements of the *FCA* or any other regulator, territory or country.

Deductions from tiers one and two: Connected lending of a capital nature (bank only)

2.2.221 **R**

- (1) **GENPRU 2.2.221 R** to **GENPRU 2.2.235 G** only apply to a bank.
- (2) If a *firm* has elected to ignore an investment in a Venture Capital Investor or a Venture Capital Holding Company in accordance with **GENPRU 2.2.209R (2)** or **(3)**, for the purposes of determining whether there is a *material holding*, **GENPRU 2.2.221 R** to **GENPRU 2.2.233 R** do not apply to any lending by the *firm* to that Venture Capital Investor or Venture Capital Holding Company, provided that any lending to the Venture Capital Holding Company is made to and deployed by the *firm* solely in connection with the Venture Capital Investor.

2.2.222 **R** *Connected lending of a capital nature* means all lending within **GENPRU 2.2.227 R** or **GENPRU 2.2.229 R** and guarantees within **GENPRU 2.2.231 R** or **GENPRU 2.2.233 R**.

- 2.2.223** **R** A *bank* must not deduct any item as *connected lending of a capital nature* to the extent that it falls to be deducted at Part 1 of stage M of the calculation in the *capital resources table* (Deductions for *material holdings*, *qualifying holdings* and certain other items) or as a *reciprocal cross-holding*.
- 2.2.224** **R** For the purpose of the *rules* in this section about *connected lending* of a capital nature and in relation to a *bank*, a *connected party* means another *person* ("P") who fulfils at least one of the following conditions and is not solo-consolidated with the *bank* under **■ BIPRU 2.1** (Solo consolidation):
- (1) P is *closely related* to the *bank*; or
 - (2) P is an *associate* of the *bank*; or
 - (3) the same *persons* significantly influence the *governing body* of P and the *bank*.
- 2.2.225** **R** For the purpose of **■ GENPRU 2.2.224 R**, in relation to a *person* ("P") to which a *bank* has an *exposure* when P is acting on his own behalf and also an *exposure* to P when P acts in his capacity as a trustee, custodian or general partner of an investment trust, unit trust, venture capital or other investment fund, pension fund or similar fund (a "fund") the *bank* may choose to treat this latter *exposure* as an *exposure* to the fund, unless such treatment would be misleading.
- 2.2.226** **G** **■ BIPRU 10.3.13 G** (*Guidance on exposures to trustees*) applies to **■ GENPRU 2.2.225 R**.
- 2.2.227** **R** A loan is *connected lending of a capital nature* if:
- (1) it is made by the *bank* to a *connected party*; and
 - (2) it falls into **■ GENPRU 2.2.228 R**.
- 2.2.228** **R** A loan falls into this *rule* for the purposes of **■ GENPRU 2.2.227 R** (2) if, whether through contractual, structural, reputational or other factors:
- (1) based on the terms of the loan and the other knowledge available to the *bank*, the borrower would be able to consider it from the point of view of its characteristics as capital as being similar to *share* capital or subordinated debt; or
 - (2) the position of the lender from the point of view of maturity and repayment is inferior to that of the senior unsecured and unsubordinated creditors of the borrower.

- 2.2.229** **R** A loan is also connected lending of a capital nature if:
- (1) it funds directly or indirectly a loan to a connected party of the *bank* falling into **GENPRU 2.2.228 R** or an investment in the capital of a connected party of the *bank*; and
 - (2) it falls into **GENPRU 2.2.228 R**.
- 2.2.230** **G** It is likely that a loan is not *connected lending of a capital nature* if:
- (1) it is secured by collateral that is eligible for the purposes of *credit risk mitigation* under the *standardised approach* to credit risk as set out in **BIPRU 5.4** (Financial collateral) and **BIPRU 5.5** (Other funded credit risk mitigation); or
 - (2) it is repayable on demand (and should be treated as such for accounting purposes by the borrower and lender) and the *bank* can demonstrate that there are no potential obstacles to exercising the right to repay, whether contractual or otherwise.
- 2.2.231** **R** A guarantee is *connected lending of a capital nature* if it is a guarantee by the *bank* of a loan from a third party to a connected party of the *bank* and:
- (1) the loan meets the requirements of **GENPRU 2.2.228 R**; or
 - (2) the rights that the *bank* would have against the borrower with respect to the guarantee meet the requirements of **GENPRU 2.2.228 R** (2).
- 2.2.232** **R** A guarantee is also *connected lending of a capital nature* if it is a guarantee by the *bank* of a loan falling into **GENPRU 2.2.229 R** (1); and
- (1) the loan meets the conditions in **GENPRU 2.2.228 R**; or
 - (2) the guarantee meets the conditions in **GENPRU 2.2.231 R** (2).
- 2.2.233** **R** The amount of a guarantee that constitutes *connected lending of a capital nature* that a *firm* must deduct is the amount guaranteed.
- 2.2.234** **G** A loan may initially fall outside the definition of *connected lending of a capital nature* but later fall into it. For example, if the initial lending to a connected party is subsequently downstreamed to another connected party the relationship between the *bank* and the ultimate borrower may be such that, looking at the arrangements as a whole, the *undertaking* to which the *bank* lends is able to regard the loan to it as being capable of absorbing losses.
- 2.2.235** **G** Lending to a connected party will not normally be *connected lending of a capital nature* where that party:
- (1) is acting as a vehicle to pass funding to an unconnected party; and

- (2) has no other creditors whose claims could be senior to those of the lender.

Deductions from tiers one and two: Expected losses and other negative amounts (BIPRU firm only)

2.2.236 **R** A BIPRU firm calculating *risk weighted exposure amounts* under the IRB approach must deduct:

- (1) any negative amounts arising from the calculation in ■ BIPRU 4.3.8 R (Treatment of expected loss amounts); and
- (2) any *expected loss* amounts calculated in accordance with ■ BIPRU 4.7.12 R (*Expected loss* amounts under the simple risk weight approach to calculating *risk weighted exposure amounts* for exposures belonging to the *equity exposure IRB exposure class*) or ■ BIPRU 4.7.17 R (*Expected loss* amounts under the PD/LGD approach).

Deductions from tiers one and two: Securitisation positions (BIPRU firm only)

2.2.237 **R** A BIPRU firm calculating *risk weighted exposure amounts* under the IRB approach or the *standardised approach* to credit risk must deduct from its *capital resources* the following:

- (1) the exposure amount of *securitisation positions* which receive a *risk weight* of 1250% under ■ BIPRU 9 (Securitisation), unless the *firm* includes the *securitisation positions* in its calculation of *risk weighted exposure amounts* (see ■ BIPRU 9.10 (Reduction in risk-weighted exposure amounts)); and
- (2) the exposure amount of *securitisation positions* in the *trading book* that would receive a *risk weight* of 1250% if they were in the *firm's non-trading book*.

Deductions from tiers one and two: Special treatment of material holdings and other items (BIPRU firm only)

2.2.238 **R** ■ GENPRU 2.2.238 R to ■ GENPRU 2.2.241 R apply to a BIPRU firm and relate to the deductions in respect of:

- (1) *material holdings*;
- (2) *expected loss* amounts and other negative amounts referred to in ■ GENPRU 2.2.236 R; and
- (3) *securitisation positions* referred to in ■ GENPRU 2.2.237 R.

2.2.239 **R** (1) The treatment in the *capital resources table* of the deductions in ■ GENPRU 2.2.238 R only has effect for the purpose of the *capital resources gearing rules*.

- (2) In other cases (3) and (4) apply.

(3) A *BIPRU firm* making the deductions described in ■ GENPRU 2.2.238 R must deduct 50% of the total amount of those deductions at stage E (Deductions from tier one capital) and 50% at stage J (Deductions from tier two capital) of the calculation in the *capital resources table* after the application of the *capital resources gearing rules*.

(4) To the extent that half of the total of:

- (a) *material holdings*;
- (b) *expected loss* amounts and other negative amounts; and
- (c) *securitisation positions*;

exceeds the amount calculated at stage I (Total tier two capital) of that calculation, a *firm* must deduct that excess from the amount calculated at stage F (Total tier one capital after deductions) of the *capital resources table*.

2.2.240 **G** The alternative calculation in ■ GENPRU 2.2.239 R (3) to ■ (4) is only relevant to ■ BIPRU 11 (Pillar 3 disclosures) and certain reporting requirements under *SUP*. However the deduction of *material holdings* at Part 2 of stage E of the *capital resources table* in the case of a *BIPRU firm* with an *investment firm consolidation waiver* has effect for all purposes.

Tier three capital: upper tier three capital resources (BIPRU firm only)

2.2.241 **R** ■ GENPRU 2.2.241 R to ■ GENPRU 2.2.245 R only apply to a *BIPRU firm*.

2.2.242 **R** A *BIPRU firm* may include subordinated debt in its *upper tier three capital resources* only if:

- (1) it has an original maturity of at least two years or is subject to at least two years' notice of repayment; and
- (2) payment of interest or principal is permitted only if, after that payment, the *firm's capital resources* would be not less than its *capital resources requirement*.

2.2.243 **R** A *BIPRU firm* which includes subordinated debt in its *tier three capital resources* must notify the *FCA* one month in advance of all payments of either interest or principal made when the *firm's capital resources* are less than 120% of its *capital resources requirement*.

2.2.244 **R** The *rules* in the table in ■ GENPRU 2.2.245 R apply to short term subordinated debt that a *BIPRU firm* includes in its *tier three capital resources* in the same way that they apply to a *firm's tier two capital resources* with the adjustments in that table.

2.2.245 **R** Table: Application of tier two capital rules to tier three debt

This table belongs to ■ GENPRU 2.2.244 R

<i>Tier two capital rule</i>	Adjustment
<p>GENPRU 2.2.159 R (General conditions for eligibility as tier two capital)</p> <p>GENPRU 2.2.161 R (Additional remedies)</p> <p>GENPRU 2.2.163 R (Legal opinion where debt subject to a law of a country outside the <i>United Kingdom</i>)</p> <p>GENPRU 2.2.169 R (Ineligibility as <i>tier two capital</i> owing to connected transactions)</p> <p>GENPRU 2.2.171 R (Amendments to terms of the <i>capital instrument</i>)</p> <p>GENPRU 2.2.172 R to GENPRU 2.2.173 R (Redeemability at the option of the issuer)</p> <p>GENPRU 2.2.174 R (Notification of redemption)</p> <p>References in the <i>rules</i> in the first column to the fifth anniversary are amended so as to refer to the second anniversary.</p>	<p>The references in GENPRU 2.2.159 R (5) (Capital must not become repayable prior to stated maturity date except in specified circumstances) to repayment at the option of the holder are replaced by a reference to GENPRU 2.2.242R (1) (<i>Upper tier three capital</i> should have maturity or notice period of at least two years)</p> <p>The reference in GENPRU 2.2.159 R (10) (Description of <i>tier two capital</i> in marketing documents) to GENPRU 2.2.265R</p> <p>The reference to GENPRU 2.2.177 R (General eligibility conditions for <i>upper tier two capital</i>) does not apply</p>

Tier three capital: lower tier three capital resources (BIPRU firm only)

- 2.2.246 **R** ■ GENPRU 2.2.246 R to ■ GENPRU 2.2.249 R only apply to a *BIPRU firm*.
- 2.2.247 **R** A *BIPRU firm's* net interim *trading book* profits mean its net *trading book* profits adjusted as follows:
- (1) they are net of any foreseeable charges or dividends and less net losses on its other business; and
 - (2) a *firm* must not take into account items that have already been included in the calculation of *capital resources* as part of the calculation of the following items:
 - (a) interim net profits (see stage (A) of the *capital resources table*); or
 - (b) interim net losses or material interim net losses (see stage (A) of the *capital resources table*); or
 - (c) profit and loss and other reserves (see stage (A) of the *capital resources table*).

2.2.248 **R** *Trading book* profits and losses, other than those losses to which ■ GENPRU 2.2.86R (2) (Valuation adjustment and reserves) refers, originating from valuation adjustments or reserves as referred to in ■ GENPRU 1.3.29 R to ■ GENPRU 1.3.35A G (Valuation adjustments or reserves) must be included in the calculation of net interim *trading book* profits and be added to or deducted from *tier three capital resources*.

2.2.249 **R** *Trading book* valuation adjustments or reserves as referred to in ■ GENPRU 1.3.29 R to ■ GENPRU 1.3.35A G which exceed those made under the accounting framework to which a *firm* is subject must be treated in accordance with ■ GENPRU 2.2.248 R if not required to be treated under ■ GENPRU 2.2.86R (2).

Deductions from total capital: Illiquid assets (BIPRU investment firm only)

2.2.259 **R** ■ GENPRU 2.2.259 R to ■ GENPRU 2.2.262 G only apply to a *BIPRU firm*.

2.2.260 **R** *Illiquid assets* means illiquid assets including

- (1) tangible fixed assets (except land and buildings if they are used by a *firm* as security for loans, but this exclusion is only up to the value of the principal outstanding on the loans); or
- (2) any holdings in the *capital resources* of *credit institutions* or *financial institutions*, except to the extent that:
 - (a) they have already been deducted as a *material holding*; or
 - (b) they are *shares* which are included in a *firm's trading book* and included in the calculation of the *firm's market risk capital requirement*; or
- (3) holdings of other *securities* which are not *readily realisable securities*; or
- (4) deficiencies of net assets in *subsidiary undertakings*; or
- (5) deposits which are not repayable within 90 days (except for payments in connection with margined *futures* or *options* contracts); or
- (6) loans and other amounts owed to a *firm* except where they are due to be repaid within 90 days; or
- (7) physical stocks except for *positions* in *physical commodities* which are included in the calculation of a *firm's commodity PRR*.

2.2.261 **G** If a loan or other amount owing to a *firm* was originally due to be paid more than 90 days from the date of the making of the loan or the incurring of the payment obligation, as the case may be, it may be treated as liquid for the purposes of ■ GENPRU 2.2.260R (6) where through the passage of time the remaining time to the contractual repayment date falls below 90 days.

2.2.262 **G** If a loan or other amount is due to be paid within 90 days (whether measured by reference to original or remaining maturity), a *firm* should consider whether it can reasonably expect the amount owing to be paid within that period. If the *firm* cannot reasonably expect it to be paid within that period the *firm* should treat it as illiquid.

Deductions from total capital: Excess trading book position (bank or building society only)

2.2.263 **R** ■ GENPRU 2.2.263 R to ■ GENPRU 2.2.265 R only apply to a *bank* or *building society*.

2.2.264 **R**

(1) The *excess trading book position* is the excess of:

(a) a *bank* or *building society's* aggregate net long (including notional) *trading book positions* in *shares*, subordinated debt or any other interest in the capital of *credit institutions* or *financial institutions*;

over;

(b) 25% of that *firm's capital resources* calculated at stage T (Total capital after deductions) of the *capital resources table* (calculated before deduction of the *excess trading book position*).

(2) Only the excess amount calculated under (1) must be deducted.

2.2.265 **R** The *standard market risk PRR rules* apply for establishing what is a net *position* and the amount and value of that *position* for the purposes of ■ GENPRU 2.2.264 R, ignoring *rules* which would otherwise exclude such *positions* from ■ BIPRU 7.2 (Interest rate PRR) or ■ BIPRU 7.3 (Equity PRR and basic interest rate PRR for equity derivatives) on the basis that they are to be deducted from a *bank* or *building society's capital resources*, or for any other reason.

2.2.270 **R** [deleted]

2.2.270A **G** [deleted]

2.2.271 **R** [deleted]

2.2.272 **G** [deleted]

2.2.274 **G** [deleted]

Public sector guarantees

2.2.276 **R** A *BIPRU firm* may not include a guarantee from a state or public authority in its *capital resources*.

Capital resources table for an insurer

Capital resources table for a bank

Capital resources table for a building society

Capital resources table for a BIPRU firm deducting material holdings

The capital resources calculation for an investment firm deducting material holdings		
Type of capital	Related text	Stage
Core tier one capital		(A)
<i>Permanent share capital</i>	GENPRU 2.2.83 R	
Profit and loss account and other reserves (taking into account material interim net losses)	GENPRU 2.2.85 R to 2.2.90	
<i>Eligible partnership capital</i>	GENPRU 2.2.93 R; GENPRU 2.2.95 R	
<i>Eligible LLP members' capital</i>	GENPRU 2.2.94 R; GENPRU 2.2.95 R	
<i>Sole trader capital</i>	None	
<i>Share premium account</i>	GENPRU 2.2.101 R	
Externally verified interim net profits	GENPRU 2.2.102 R	
Hybrid capital		
Stage B1	GENPRU 2.2.115A R to GENPRU 2.2.117B R	(B1)
Stage B2	GENPRU 2.2.115D R to GENPRU 2.2.117B R	(B2)
Stage C	GENPRU 2.2.115F R to GENPRU 2.2.117B R	(C)
Total tier one capital before deductions = A + B1 + B2 + C		(D)
Deductions from tier one capital		(E)
Investments in own <i>shares</i>	None	
Intangible assets	GENPRU 2.2.155 R	
Excess of drawings over profits for partnerships, <i>limited liability partnerships</i> and <i>sole traders</i>	GENPRU 2.2.100 R; there is no related text for <i>sole traders</i>	
Net losses on equities held in the available-for-sale financial asset category	GENPRU 2.2.185 R	
(For certain limited purposes only certain additional deductions are made here)	GENPRU 2.2.239R (2) to GENPRU 2.2.239R (4)	
Total tier one capital after deductions = D-E		(F)
Upper tier two capital		(G)
Perpetual cumulative <i>preference shares</i>	GENPRU 2.2.159 R to GENPRU 2.2.181 R	
Perpetual subordinated debt	See previous entry	

The capital resources calculation for an investment firm deducting material holdings		
Type of capital	Related text	Stage
Perpetual subordinated securities	See previous entry	
Revaluation reserves	GENPRU 2.2.185 R	
General/collective provisions	GENPRU 2.2.187 R to GENPRU 2.2.189 R	
Surplus provisions	GENPRU 2.2.190 R to GENPRU 2.2.193 R	
Lower tier two capital		(H)
Fixed term <i>preference shares</i>	GENPRU 2.2.159 R to GENPRU 2.2.174 R; GENPRU 2.2.194 R to GENPRU 2.2.196 R	
Long term subordinated debt	See previous entry	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Deductions from tier two capital		(J)
(For certain limited purposes only certain additional deductions are made here)	GENPRU 2.2.239R (2) to GENPRU 2.2.239R (4)	
Total tier two capital after deductions = I - J		(K)
Total tier one capital plus tier two capital = F+K		(L)
Deductions from the totals of tier one and two		(M)
<i>Material holdings</i>	GENPRU 2.2.208 R to GENPRU 2.2.215 R	
<i>Expected loss amounts and other negative amounts</i>	GENPRU 2.2.236 R	(Part 1 of stage M)
<i>Securitisation positions</i>	GENPRU 2.2.237 R	
<i>Reciprocal cross-holdings</i>	GENPRU 2.2.217 R to GENPRU 2.2.220 R	(Part 2 of stage M)
Total tier one capital plus tier two capital after deductions = L-M		(N)
In calculating whether a firm's capital resources exceed its capital resources requirement: (1)the <i>credit risk capital component</i> and the <i>counterparty risk capital component</i> ; or (2)the <i>base capital resources requirement</i> ; as the case may be, must be deducted here.		
Upper tier three		(O)
Short term subordinated debt	GENPRU 2.2.241 R to GENPRU 2.2.245 R	
Lower tier three		(P)
Net interim <i>trading book</i> profit and loss	GENPRU 2.2.246 R to GENPRU 2.2.249 R	
Total tier three capital=O+P		(Q)
Total capital before deductions = N+Q		(R)
Deductions from total capital		(S)

The capital resources calculation for an investment firm deducting material holdings		
Type of capital	Related text	Stage
<i>Free deliveries</i>	BIPRU 14.4	
Total capital after deductions (R – S)		(T)
<p>In calculating whether a <i>firm's capital resources</i> exceed its <i>capital resources requirement</i>, the <i>market risk capital requirement</i> and the <i>fixed overheads requirement</i> must be deducted here.</p>		

Note (1): Where the table refers to related text, it is necessary to refer to that text in order to understand fully what is included in the descriptions of capital items and deductions set out in the table.

Note (2): If the amount calculated at:

- (a) stage N less the deductions in respect of the *capital resources requirement* made immediately following stage N; or
- (b) stage T less the deductions in respect of the *capital resources requirement* made immediately following stages N and T;

is a negative number the *firm's capital resources* are less than its *capital resources requirement*.

Capital resources table for a BIPRU firm deducting illiquid assets

The capital resources calculation for an investment firm that deducts illiquid assets		
Type of capital	Related text	Stage
Core tier one capital		(A)
<i>Permanent share capital</i>	GENPRU 2.2.83 R	
Profit and loss account and other reserves (taking into account material interim net losses)	GENPRU 2.2.85 R to GENPRU 2.2.90 R	
<i>Eligible partnership capital</i>	GENPRU 2.2.93 R; GENPRU 2.2.95 R	
<i>Eligible LLP members' capital</i>	GENPRU 2.2.94 R; GENPRU 2.2.95 R	
<i>Sole trader capital</i>	None	
<i>Share premium account</i>	GENPRU 2.2.101 R	
Externally verified interim net profits	GENPRU 2.2.102 R	
Hybrid capital		
Stage B1	GENPRU 2.2.115A R to GENPRU 2.2.117B R	(B1)
Stage B2	GENPRU 2.2.115D R to GENPRU 2.2.117B R	(B2)
Stage C	GENPRU 2.2.115F R to GENPRU 2.2.117B R	(C)
Total tier one capital before deductions = A + B1 + B2 + C		(D)
Deductions from tier one capital		(E)
Investments in own <i>shares</i>	None	
Intangible assets	GENPRU 2.2.155 R	
Excess of drawings over profits for partnerships, <i>limited liability partnerships</i> and <i>sole traders</i>	GENPRU 2.2.100 R; there is no related text for <i>sole traders</i>	
Net losses on equities held in the available-for-sale financial asset category	GENPRU 2.2.185 R	
(For certain limited purposes only certain additional deductions are made here)	GENPRU 2.2.239R (2) to GENPRU 2.2.239R (4)	
Total tier one capital after deductions = D-E		(F)
Upper tier two capital		(G)
Perpetual cumulative <i>preference shares</i>	GENPRU 2.2.159 R to GENPRU 2.2.181 R	
Perpetual subordinated debt	See previous entry	

The capital resources calculation for an investment firm that deducts illiquid assets		
Type of capital	Related text	Stage
Perpetual subordinated securities	See previous entry	
Revaluation reserves	GENPRU 2.2.185 R	
General/collective provisions	GENPRU 2.2.187 R to GENPRU 2.2.189 R	
Surplus provisions	GENPRU 2.2.190 R to GENPRU 2.2.193 R	
Lower tier two capital		(H)
Fixed term <i>preference shares</i>	GENPRU 2.2.159 R to GENPRU 2.2.174 R; GENPRU 2.2.194 R to GENPRU 2.2.196 R	
Long term subordinated debt	See previous entry	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Deductions from tier two capital		(J)
(For certain limited purposes only certain additional deductions are made here)	GENPRU 2.2.239R (2) to GENPRU 2.2.239R (4)	
Total tier two capital after deductions = I - J		(K)
Total tier one capital plus tier two capital = F+K		(L)
Deductions from the totals of tier one and two		(M)
<i>Expected loss</i> amounts and other negative amounts	GENPRU 2.2.236 R	(Part 1 of stage M)
<i>Securitisation positions</i>	GENPRU 2.2.237 R	
<i>Reciprocal cross-holdings</i>	GENPRU 2.2.217 R to GENPRU 2.2.220 R	(Part 2 of stage M)
Total tier one capital plus tier two capital after deductions = L-M		(N)
In calculating whether a <i>firm's capital resources</i> exceed its <i>capital resources requirement</i> : (1)the <i>credit risk capital component</i> and the <i>counterparty risk capital component</i> ; or (2)the <i>base capital resources requirement</i> ; as the case may be, must be deducted here.		
Upper tier three		(O)
Short term subordinated debt	GENPRU 2.2.241 R to GENPRU 2.2.245 R	
Lower tier three		(P)
Net interim <i>trading book</i> profit and loss	GENPRU 2.2.246 R to GENPRU 2.2.249 R	
Total tier three capital=O+P		(Q)
Total capital before deductions = N+Q		(R)
Deductions from total capital		(S)

The capital resources calculation for an investment firm that deducts illiquid assets		
Type of capital	Related text	Stage
<i>Illiquid assets</i>	GENPRU 2.2.259 R to GENPRU 2.2.260 R	
<i>Free deliveries</i>	BIPRU 14.4	
Total capital after deductions = R-S		(T)
<p>In calculating whether a <i>firm's capital resources</i> exceed its <i>capital resources requirement</i>, the <i>market risk capital requirement</i> and the <i>fixed overheads requirement</i> must be deducted here.</p>		

Note (1): Where the table refers to related text, it is necessary to refer to that text in order to understand fully what is included in the descriptions of capital items and deductions set out in the table.

Note (2): If the amount calculated at:

(a) stage N less the deductions in respect of the *capital resources requirement* made immediately following stage N; or

(b) stage T less the deductions in respect of the *capital resources requirement* made immediately following stages N and T;

is a negative number the *firm's capital resources* are less than its *capital resources requirement*.

Capital resources table for a BIPRU firm with a waiver from consolidated supervision

Part 1 of the capital resources calculation for an investment firm with a waiver from consolidated supervision		
Type of capital	Related text	Stage
Core tier one capital		(A)
<i>Permanent share capital</i>	GENPRU 2.2.83 R	
Profit and loss account and other reserves (taking into account material interim net losses)	GENPRU 2.2.85 R to 2.2.90	
<i>Eligible partnership capital</i>	GENPRU 2.2.93 R; GENPRU 2.2.95 R	
<i>Eligible LLP members' capital</i>	GENPRU 2.2.94 R; GENPRU 2.2.95 R	
<i>Sole trader capital</i>	None	
<i>share premium account</i>	GENPRU 2.2.101 R	
Externally verified interim net profits	GENPRU 2.2.102 R	
Hybrid capital		
Stage B1	GENPRU 2.2.115A R to GENPRU 2.2.117B R	(B1)
Stage B2	GENPRU 2.2.115D R to GENPRU 2.2.117B R	(B2)
Stage C	GENPRU 2.2.115F R to GENPRU 2.2.117B R	(C)
Total tier one capital before deductions = A + B1 + B2 + C		(D)
Deductions from tier one capital		(E)
Investments in own <i>shares</i>	None	(Part 1 of stage E)
Intangible assets	GENPRU 2.2.155 R	
Excess of drawings over profits for partnerships, <i>limited liability partnerships</i> and <i>sole traders</i>	GENPRU 2.2.100 R; there is no related text for <i>sole traders</i>	
Net losses on equities held in the available-for-sale financial asset category	GENPRU 2.2.185 R	(Part 1 of stage E)
(For certain limited purposes only certain additional deductions are made here. This line does not include <i>material holdings</i> .)	GENPRU 2.2.239R (2) to GENPRU 2.2.239R (4)	
<i>Material holdings</i> falling into Note (4)	Note (4) of Part 2 of this table; GENPRU 2.2.208 R to GENPRU 2.2.215 R	(Part 2 of stage E)

Part 1 of the capital resources calculation for an investment firm with a waiver from consolidated supervision		
Type of capital	Related text	Stage
(For certain limited purposes only certain additional deductions of <i>material holdings</i> are made here)	Note (5) of Part 2 of this table; GENPRU 2.2.239R (2) to GENPRU 2.2.239R (4)	(Part 3 of stage E)
Total tier one capital after deductions = D-E		(F)
Upper tier two capital		(G)
Perpetual cumulative <i>preference shares</i>	GENPRU 2.2.159 R to GENPRU 2.2.181 R	
Perpetual subordinated debt	See previous entry	
Perpetual subordinated securities	See previous entry	
Revaluation reserves	GENPRU 2.2.185 R	
General/collective provisions	GENPRU 2.2.187 R to GENPRU 2.2.189 R	
Surplus provisions	GENPRU 2.2.190 R to GENPRU 2.2.193 R	
Lower tier two capital		(H)
Fixed term <i>preference shares</i>	GENPRU 2.2.159 R to GENPRU 2.2.174 R; GENPRU 2.2.194 R to GENPRU 2.2.196 R	
Long term subordinated debt	See previous entry	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Deductions from tier two capital		(J)
(For certain limited purposes only certain additional deductions are made here)	Note (5) of Part 2 of this table; GENPRU 2.2.239R (2) to GENPRU 2.2.239R (4)	
Total tier two capital after deductions = I - J		(K)
Total tier one capital plus tier two capital = F+K		(L)
Deductions from the totals of tier one and two		(M)
<i>Material holdings</i> falling into Note (5)	Note (5) of Part 2 of this table; GENPRU 2.2.208 R to GENPRU 2.2.215 R	(Part 1 of stage M)
Contingent liabilities	Note (6) of Part 2 of this table	
<i>Expected loss</i> amounts and other negative amounts	GENPRU 2.2.236 R	
<i>Securitisation positions</i>	GENPRU 2.2.237 R	
<i>Reciprocal cross-holdings</i>	GENPRU 2.2.217 R to GENPRU 2.2.220 R	(Part 2 of stage M)
Total tier one capital plus tier two capital after deductions = L-M		(N)
In calculating whether a <i>firm's capital resources</i> exceed its <i>capital resources requirement</i> :		
(1)the <i>credit risk capital component</i> and the <i>counterparty risk capital component</i> ; or		

Part 1 of the capital resources calculation for an investment firm with a waiver from consolidated supervision

Type of capital	Related text	Stage
(2)the <i>base capital resources requirement</i> ; as the case may be, must be deducted here.		
Upper tier three		(O)
Short term subordinated debt	GENPRU 2.2.241 R to GENPRU 2.2.245 R	
Lower tier three		(P)
Net interim <i>trading book</i> profit and loss	GENPRU 2.2.246 R to GENPRU 2.2.249 R	
Total tier three capital=O+P		(Q)
Total capital before deductions = N+Q		(R)
Deductions from total capital		(S)
<i>Illiquid assets</i>	GENPRU 2.2.259 R to GENPRU 2.2.260 R	
<i>Free deliveries</i>	BIPRU 14.4	
Total capital after deductions = R-S		(T)
In calculating whether a <i>firm's capital resources</i> exceed its <i>capital resources requirement</i> , the <i>market risk capital requirement</i> , and the <i>fixed overheads requirement</i> must be deducted here.		

Part 2 of the capital resources calculation for an investment firm with a waiver from consolidated supervision

Note (1): Where the table refers to related text, it is necessary to refer to that text in order to understand fully what is included in the descriptions of capital items and deductions set out in the table.

Note (2): If the amount calculated at:
 (a)stage N less the deductions in respect of the *capital resources requirement* made immediately following stage N; or
 (b)stage T less the deductions in respect of the *capital resources requirement* made immediately following stages N and T;
 is a negative number the *firm's capital resources* are less than its *capital resources requirement*.

Note (4): The *material holdings* that must be deducted at part 2 of stage E are *material holdings* issued by *undertakings* which would have been members of the *firm's UK consolidation group* or *non-EEA sub-group* if the *firm* did not have an *investment firm consolidation waiver* if:

- (1) in relation to a *BIPRU firm*, the holding forms part of the *undertaking's tier one capital resources*; or
- (2) (subject to (3)) in relation to any other *undertaking*, the holding would form part of the *undertaking's tier one capital resources* if:
 - (a) that *undertaking* were a *BIPRU firm* with a *Part 4A permission*; and
 - (b) it had carried on all its business in the *United Kingdom* and had obtained whatever *permissions* for doing so are required under the *Act*; or
- (3) in relation to any *undertaking* not falling within (1) and for which the methodology in (2) does not give an answer, the holding would form part of its *tier one capital resources* if the *undertak-*

Part 2 of the capital resources calculation for an investment firm with a waiver from consolidated supervision

ing were a *BIPRU firm* of the same category as the *firm* carrying out the calculation under this Annex.

Note (5): The *material holdings* that must be deducted by a *firm* at part 3 of stage E and at stage J or at Part 1 of stage M are *material holdings* issued by *undertakings* which would have been members of that *firm's UK consolidation group* or *non-EEA sub-group* if the *firm* did not have an *investment firm consolidation waiver* and which do not fall into Note (4).

Note (6): The contingent liabilities that must be deducted by a *firm* at Part 1 of stage M are any contingent liabilities which the *firm* has in favour of *BIPRU firms, financial institutions, asset management companies* and *ancillary services undertakings* which would have been members of the *firm's UK consolidation group* or *non-EEA sub-group* if the *firm* did not have an *investment firm consolidation waiver*.

Admissible assets in insurance

Guidance on applications for waivers relating to Implicit items

Chapter 3

Cross sector groups

3.1 Application

3.1.1

R

(1) Unless otherwise stated, ■ GENPRU 3.1 applies to every *firm* that is a member of a *financial conglomerate* other than:

- (a) an *incoming EEA firm*;
- (b) an *incoming Treaty firm*;
- (c) a *UCITS qualifier*;
- (d) an *ICVC*;
- (e) a *bank*;
- (f) a *designated investment firm*; and
- (g) an *insurer*.

(1A) ■ GENPRU 3.1 (except ■ GENPRU 3.1.5R to ■ GENPRU 3.1.13G) applies to each of the following *firms* that is a member of a *financial conglomerate*:

- (a) a *bank*;
- (b) a *designated investment firm*; and
- (c) an *insurer* that is a "UK Solvency II firm" as defined in the PRA Rulebook: Glossary.

(2) ■ GENPRU 3.1 does not apply to a *firm* with respect to a *financial conglomerate* of which it is a member if the interest of the *financial conglomerate* in that *firm* is no more than a *participation*.

(3) ■ GENPRU 3.1.25 R (Capital adequacy requirements: high level requirement), and ■ GENPRU 3.1.35 R (Risk concentration and intra group transactions: the main rule) do not apply with respect to a *third-country financial conglomerate*.

Purpose

3.1.2

G

■ GENPRU 3.1 implements the *Financial Groups Directive*. However, material on the following topics is to be found elsewhere in the *Handbook* as follows:

- (1) further material on *third-country financial conglomerates* can be found in ■ GENPRU 3.2;
- (2) ■ SUP 15.9 contains notification *rules* for members of *financial conglomerates*;

- (3) material on reporting obligations can be found in ■ SUP 16.12.32 R and ■ SUP 16.12.33 R; and
- (4) material on systems and controls in *financial conglomerates* can be found in ■ SYSC 12.

Introduction: identifying a financial conglomerate

3.1.3

G

- (1) In general the process in (2) to (8) applies for identifying *financial conglomerates*.
- (2) *Competent authorities* that have authorised *regulated entities* should try to identify any *consolidation group* that is a *financial conglomerate*. If a *competent authority* is of the opinion that a *regulated entity* authorised by that *competent authority* is a member of a *consolidation group* which may be a *financial conglomerate* it should communicate its view to the other *competent authorities* concerned.
- (3) A *competent authority* may start (as described in (2)) the process of deciding whether a group is a *financial conglomerate* even if it would not be the *coordinator*.
- (4) A member of a group may also start that process by notifying one of the *competent authorities* that have authorised group members that its group may be a *financial conglomerate*, for example by notification under ■ SUP 15.9.
- (5) If a group member gives a notification in accordance with (4), that does not automatically mean that the group should be treated as a *financial conglomerate*. The process described in (6) to (9) still applies.
- (6) The *competent authority* that would be *coordinator* will take the lead in establishing whether a group is a *financial conglomerate* once the process has been started as described in (2) and (3).
- (7) The process of establishing whether a group is a *financial conglomerate* will normally involve discussions between the *financial conglomerate* and the *competent authorities* concerned.
- (8) A *financial conglomerate* should be notified by its *coordinator* that it has been identified as a *financial conglomerate* and of the appointment of the *coordinator*. The notification should be given to the *parent undertaking* at the head of the group or, in the absence of a *parent undertaking*, the *regulated entity* with the largest balance sheet total in the *most important financial sector*. That notification does not of itself make a group into a *financial conglomerate*; whether or not a group is a *financial conglomerate* is governed by the definition of *financial conglomerate* as set out in ■ GENPRU 3.1.
- (9) ■ GENPRU 3 Annex 3 is a questionnaire (together with its explanatory notes) that the *FCA* asks groups that may be *financial conglomerates* to fill out in order to decide whether or not they are.
- (10) If a *mixed financial holding company* is subject to equivalent provisions under the *EEA prudential sectoral legislation* in relation to

the *banking and investment services sector* and under ■ GENPRU 3 (Cross sector groups) and the FCA is the *coordinator*, the FCA may, on application by a *firm* and after consulting other *competent authorities* responsible for the supervision of subsidiaries, disapply such provisions of the *EEA prudential sectoral legislation* in relation to the *banking and investment services sector* with regard to the *mixed financial holding company* and apply only the relevant provisions of ■ GENPRU 3 to the *mixed financial holding company*.

3.1.3A **G** If a *mixed financial holding company* is subject to equivalent provisions under this Chapter and under *EEA prudential sectoral legislation* in relation to the *insurance sector* as implemented in the *United Kingdom* and the FCA is the *coordinator*, the FCA may, on application by the *firm* and after consulting other *relevant competent authorities*, disapply such provisions of the *EEA prudential sectoral legislation* as implemented in the *United Kingdom* with regard to that undertaking which are considered by the FCA as equivalent to those applying to the *firm* under ■ GENPRU 3.1.

[Note: article 120(2) of CRD]

Introduction: The role of other competent authorities

3.1.4 **G** A lead supervisor (called the *coordinator*) is appointed for each *financial conglomerate*. Article 10 of the *Financial Groups Directive* describes the criteria for deciding which *competent authority* is appointed as *coordinator*. Article 11 of the *Financial Groups Directive* sets out the tasks of the *coordinator*.

Definition of financial conglomerate: basic definition

3.1.5 **R** A *financial conglomerate* means a *consolidation group* that is identified as a *financial conglomerate* in accordance with the decision tree in ■ GENPRU 3 Annex 4.

Definition of financial conglomerate: sub-groups

3.1.6 **R** A *consolidation group* is not prevented from being a *financial conglomerate* because it is part of a wider:

- (1) *consolidation group*; or
- (2) *financial conglomerate*; or
- (3) group of persons linked in some other way.

Definition of financial conglomerate: the financial sectors: general

3.1.7 **R** For the purpose of the definition of *financial conglomerate*, there are two *financial sectors* as follows:

- (1) the *banking sector* and the *investment services sector*, taken together; and
- (2) the *insurance sector*.

3.1.8

R

- (1) This *rule* applies for the purpose of the definition of *financial conglomerate* and the *financial conglomerate definition decision tree*.
- (1A) In determining the *investment services sector* for the purpose of identifying a *financial conglomerate* in the boxes entitled Threshold Test 1, Threshold Test 2 and Threshold Test 3 in the *financial conglomerate definition decision tree*, any *investment firm* that does not fall within the definition of article 4(1)(2) of the *EU CRR* is excluded.
- (2) Any *mixed financial holding company* is considered to be outside the *overall financial sector* for the purpose of the tests set out in the boxes titled Threshold Test 1, Threshold Test 2 and Threshold Test 3 in the *financial conglomerate definition decision tree*.
- (3) Determining whether the tests set out in the boxes titled Threshold Test 2 and Threshold Test 3 in the *financial conglomerate definition decision tree* are passed is based on considering the consolidated and/or aggregated activities of the members of the *consolidation group* within the *insurance sector* and the consolidated and/or aggregated activities of the members of the *consolidation group* within the *banking sector* and the *investment services sector*.

Definition of financial conglomerate: adjustment of the percentages

3.1.9

R

Once a *financial conglomerate* has become a *financial conglomerate* and subject to supervision in accordance with the *Financial Groups Directive*, the figures in the *financial conglomerate definition decision tree* are altered as follows:

- (1) the figure of 40% in the box titled Threshold Test 1 is replaced by 35%;
- (2) the figure of 10% in the box titled Threshold Test 2 is replaced by 8%; and
- (3) the figure of six billion Euro in the box titled Threshold Test 3 is replaced by five billion Euro.

3.1.10

R

The alteration in ■ GENPRU 3.1.9 R only applies to a *financial conglomerate* during the period that:

- (1) begins when the *financial conglomerate* would otherwise have stopped being a *financial conglomerate* because it does not meet one of the unaltered thresholds referred to in ■ GENPRU 3.1.9 R; and
- (2) covers the three years following that date.

Definition of financial conglomerate: balance sheet totals

3.1.11

R

The calculations referred to in the *financial conglomerate definition decision tree* regarding the balance sheet must be made on the basis of the aggregated balance sheet total of the members of the *consolidation group*, according to their annual accounts. For the purposes of this calculation, *undertakings* in which a *participation* is held must be taken into account as

regards the amount of their balance sheet total corresponding to the aggregated proportional share held by the *consolidation group*. However, where consolidated accounts are available, they must be used instead of aggregated accounts.

Definition of financial conglomerate: solvency requirement

3.1.12 **R** The solvency and capital adequacy requirements referred to in the *financial conglomerate definition decision tree* must be calculated in accordance with the provisions of the relevant *sectoral rules*.

Definition of financial conglomerate: discretionary changes to the definition

3.1.13 **G** Articles 3(3) to 3(6), Article 5(4) and Article 6(5) of the *Financial Groups Directive* allow *competent authorities*, on a case by case basis, to:

- (1) change the definition of *financial conglomerate* and the obligations applying with respect to a *financial conglomerate* (which would include, where the *appropriate regulator* would be the *coordinator* under ■ GENPRU 3.1.3G (6), permitting *firms* to apply, on an annual basis and subject to publication and notification to the *relevant competent authorities*, for a group of which it is a member not to be regarded as a *financial conglomerate* on the basis of Article 3(3) of the *Financial Groups Directive* (for a group that, in terms of the tests in ■ GENPRU 3 Annex 4, does not meet Threshold Test 2 but meets Threshold Test 3) or Article 3(3a) of the *Financial Groups Directive* (for a group that, in terms of the tests in ■ GENPRU 3 Annex 4, meets Threshold Test 2 but not Threshold Test 3);
- (2) apply the scheme in the *Financial Groups Directive* to *EEA regulated entities* in specified kinds of group structures that do not come within the definition of *financial conglomerate*; and
- (3) exclude a particular entity in the scope of capital adequacy requirements that apply with respect to a *financial conglomerate*.

Capital adequacy requirements: introduction

3.1.14 **G** The capital adequacy provisions of ■ GENPRU 3.1 are designed to be applied to *EEA-based financial conglomerates*.

3.1.15 **G** ■ GENPRU 3.1.25 R is a high level capital adequacy *rule*. It applies whether or not the *FCA* is the *coordinator* of the *financial conglomerate* concerned.

3.1.16 **G** ■ GENPRU 3.1.29 R to ■ GENPRU 3.1.31 R and ■ GENPRU 3 Annex 1 implement the detailed capital adequacy requirements of the *Financial Groups Directive*. They only deal with a *financial conglomerate* for which the *FCA* is the *coordinator*. If another *competent authority* is *coordinator* of a *financial conglomerate*, those *rules* do not apply with respect to that *financial conglomerate* and instead that *coordinator* will be responsible for implementing those detailed requirements.

- 3.1.17** **G** Annex I of the *Financial Groups Directive* lays down three methods for calculating capital adequacy at the level of a *financial conglomerate*. Those three methods are implemented as follows:
- (1) Method 1 calculates capital adequacy using accounting consolidation. It is implemented by ■ GENPRU 3.1.29 R to ■ GENPRU 3.1.31 R and Part 1 of ■ GENPRU 3 Annex 1.
 - (2) Method 2 calculates capital adequacy using a deduction and aggregation approach. It is implemented by ■ GENPRU 3.1.29 R to ■ GENPRU 3.1.31 R and Part 2 of ■ GENPRU 3 Annex 1.
 - (3) [deleted]
 - (4) Method 3 consists of a combination of Methods 1 and 2 from Annex I of the *Financial Groups Directive* and would be implemented by means of a *requirement*.
- 3.1.18** **G** [deleted]
- 3.1.19** **G** Paragraph 5.7 of ■ GENPRU 3 Annex 1 (Capital adequacy calculations for financial conglomerates) deals with a case in which there are no capital ties between entities in a *financial conglomerate*. In particular, the *FCA* , after consultation with the other *relevant competent authorities* and in accordance with Annex I of the *Financial Groups Directive*, will determine which proportional share of a solvency deficit in such an entity will have to be taken into account, bearing in mind the liability to which the existing relationship gives rise.
- 3.1.20** **G** (1) [deleted]
(2) [deleted]
- 3.1.21** **G** The Annex I method to be applied may be decided by the *coordinator* after consultation with the *relevant competent authorities* and the *financial conglomerate* itself. Where the *FCA* acts as *coordinator*, the *financial conglomerate* itself may choose which of Method 1 or Method 2 from Annex I it will apply, unless the *firm* is subject to a *requirement* obliging the *firm* to apply a particular method.
- 3.1.22** **G** [deleted]
- 3.1.23** **G** [deleted]
- 3.1.24** **G** [deleted]
- 3.1.25** **R** **Capital adequacy requirements: high level requirement**
.....
(1) A *firm* that is a member of a *financial conglomerate* must at all times have capital resources of such an amount and type that results in the

capital resources of the *financial conglomerate* taken as a whole being adequate.

(2) This *rule* does not apply with respect to any *financial conglomerate* until notification has been made that it has been identified as a *financial conglomerate* as contemplated by Article 4(2) of the *Financial Groups Directive*.

3.1.26 **R** [deleted]

3.1.27 **R** [deleted]

3.1.28 **R** (1) [deleted]
(2) [deleted]

Capital adequacy requirements: application of Method 1 or 2 from Annex I of the Financial Groups Directive

3.1.29 **R** If, with respect to a *firm* and a *financial conglomerate* of which it is a member, this *rule* applies under **■ GENPRU 3.1.29A R** to the *firm* with respect to that *financial conglomerate* as described in **■ GENPRU 3.1.30 R**, the *firm* must at all times have capital resources of an amount and type that ensures that the *conglomerate capital resources* of that *financial conglomerate* at all times equal or exceed its *conglomerate capital resources requirement*.

3.1.29A **R** **■ GENPRU 3.1.29 R** applies to a *firm* with respect to the *financial conglomerate* of which it is a member if notification has been made in accordance with regulation 2 of the *Financial Groups Directive Regulations* that the *financial conglomerate* is a *financial conglomerate* and that the *FCA* is coordinator of that *financial conglomerate*.

Capital adequacy requirements: use of requirement to apply Annex I of the Financial Groups Directive

3.1.30 **R** If **■ GENPRU 3.1.29 R** (application of Method 1 or 2 from Annex I of the *Financial Groups Directive*) applies to a *firm* with respect to the *financial conglomerate* of which it is a member, then with respect to the *firm* and the *financial conglomerate*:

- (1) the definitions of *conglomerate capital resources* and *conglomerate capital resources requirement* that apply for the purposes of that *rule* are the ones from whichever of Part 1 or Part 2 of **■ GENPRU 3 Annex 1** the *firm* has indicated to the *FCA* it will apply, unless the *firm* is subject to a *requirement* obliging the *firm* to apply a specific part of **■ GENPRU 3 Annex 1**, in which case **■ GENPRU 3.1.31 R** will apply; and
- (2) the *firm* must indicate to the *FCA* in advance which Part of **■ GENPRU 3 Annex 1** the *firm* intends to apply.

3.1.31 **R** If **■ GENPRU 3.1.29 R** (application of Method 1 or 2 from Annex I of the *Financial Groups Directive*) applies to a *firm* with respect to a *financial conglomerate* of which it is a member, and the *firm* is subject to a *requirement* obliging the *firm* to apply a specific part of **■ GENPRU 3 Annex 1**, the definitions of *conglomerate capital resources* and *conglomerate capital resources requirement* that apply for the purposes of that *rule* are the ones from whichever of Part 1 or Part 2 of **■ GENPRU 3 Annex 1** is specified in the *requirement*.

Risk concentration and intra-group transactions: introduction

3.1.32 **G** **■ GENPRU 3.1.35 R** implements Article 7(4) and Article 8(4) of the *Financial Groups Directive*, which provide that where a *financial conglomerate* is headed by a *mixed financial holding company*, the *sectoral rules* regarding *risk concentration* and *intra-group transactions* of the *most important financial sector* in the *financial conglomerate*, if any, shall apply to that sector as a whole, including the *mixed financial holding company*.

3.1.33 **G** Articles 7(3) (Risk concentration) and 8(3) (Intra-group transactions) and Annex II (Technical application of the provisions on intra-group transactions and risk concentration) of the *Financial Groups Directive* say that Member States may apply at the level of the *financial conglomerate* the provisions of the *sectoral rules on risk concentrations and intra-group transactions*. **■ GENPRU 3.1** does not take up that option, although the *FCA* may impose such obligations on a case by case basis.

Risk concentration and intra-group transactions: application

3.1.34 **R** **■ GENPRU 3.1.35 R** applies to a *firm* with respect to a *financial conglomerate* of which it is a member if:

- (1) the condition in Articles 7(4) and 8(4) of the *Financial Groups Directive* is satisfied (the *financial conglomerate* is headed by a *mixed financial holding company*); and
- (2) that *financial conglomerate* is a *UK regulated EEA financial conglomerate*.

Risk concentration and intra group transactions: the main rule

3.1.35 **R** A *firm* must ensure that the *sectoral rules* regarding *risk concentration* and *intra-group transactions* of the *most important financial sector* in the *financial conglomerate* referred to in **■ GENPRU 3.1.34 R** are complied with with respect to that *financial sector* as a whole, including the *mixed financial holding company*. The *sectoral rules* for these purposes are those identified in the table in **■ GENPRU 3.1.36 R**.

Risk concentration and intra-group transactions: Table of applicable sectoral rules

3.1.36 **R** Table: application of sectoral rules
This table belongs to **■ GENPRU 3.1.35 R**

The most important financial sector	Applicable sectoral rules	
	Risk concentration	Intra-group transactions
<i>Banking and investment services sector</i>	the <i>EU CRR</i>	Part Four of the <i>EU CRR</i>
<i>Insurance sector</i>	<i>PRA Rulebook: Solvency II Firms Group Supervision 16.1</i>	<i>PRA Rulebook: Solvency II Firms: Groups: 16.2</i>
Note	Any <i>waiver</i> , approval or permission granted to a member of the <i>financial conglomerate</i> , on a solo (or individual for the purposes of the <i>EU CRR</i>) or consolidated basis, shall not apply in respect of the <i>financial conglomerate</i> for the purposes of GENPRU 3.1.36 R. For this purpose, "permission" refers to a consent, approval or agreement conferred on the <i>appropriate regulator as competent authority</i> under the <i>EU CRR</i> .	

3.1.37 R [deleted]

- 3.1.38 R
- (1) [deleted]
 - (2) [deleted]
 - (3) [deleted]
 - (4) [deleted]

The financial sectors: asset management companies and alternative investment fund managers

- 3.1.39 R
- (1) In accordance with Articles 30 and 30a of the *Financial Groups Directive* (Asset management companies and Alternative investment fund managers), this *rule* deals with the inclusion of an *asset management company* or an *alternative investment fund manager* that is a member of a *financial conglomerate* in the scope of regulation of *financial conglomerates*.
 - (2) An *asset management company* or an *alternative investment fund manager* is in the overall *financial sector* and is a *regulated entity* for the purpose of:
 - (a) ■ GENPRU 3.1.29 R to ■ GENPRU 3.1.36 R;
 - (b) ■ GENPRU 3 Annex 1 (Capital adequacy calculations for financial conglomerates) and ■ GENPRU 3 Annex 2 (Prudential rules for third country groups); and
 - (c) any other provision of the *Handbook* relating to the supervision of *financial conglomerates*.
 - (3) In the case of a *financial conglomerate* for which the *FCA* is the *coordinator*, all *asset management companies* and all *alternative investment fund managers* must be allocated to one *financial sector* to which they belong for the purposes in (2), being either the *investment services sector* or the *insurance sector*. But if that choice

has not been made in accordance with (4) and notified to the *FCA* in accordance with (4)(d), an *asset management company* or an *alternative investment fund manager* must be allocated to the smallest *financial sector*.

(4) The choice in (3):

- (a) must be made by the *undertaking* in the *financial conglomerate* holding the position referred to in Article 4(2) of the *Financial Groups Directive* (group member to whom notice must be given that the group has been found to be a *financial conglomerate*);
- (b) applies to all *asset management companies* and all *alternative investment fund managers* that are members of the *financial conglomerate* from time to time;
- (c) cannot be changed; and
- (d) must be notified to the *FCA* as soon as reasonably practicable after the notification in (4)(a).

(5) This *rule* applies even if:

- (a) a *UCITS management company* is an *IFPRU investment firm*; or
- (b) an *asset management company* or *alternative investment fund manager* is an *investment firm*.

3.2 Third-country groups

Application

3.2.1 **R** ■ GENPRU 3.2 applies to every *firm* that is a member of a *third-country group*. But it does not apply to:

- (1) an *incoming EEA firm*; or
- (2) an *incoming Treaty firm*; or
- (3) a *UCITS qualifier*; or
- (4) an *ICVC*; or
- (5) a *bank*; or
- (6) a *designated investment firm*; or
- (7) an *insurer*.

3.2.1A **R** ■ GENPRU 3.2.9R (Supervision by analogy: rules for third-country banking and investment groups) applies in relation to the following:

- (1) a *CAD investment firm*; and
- (2) an *investment firm* that falls within the definition of “investment firm” in article 4(1)(2) of the *EU CRR*.

Purpose

3.2.2 **G** ■ GENPRU 3.2 implements in part article 18 of the *Financial Groups Directive*, article 127 of the *CRD* and (in relation to *BIPRU firms*) article 143 of the *BCD*.

Equivalence

3.2.3 **G** The first question that must be asked about a *third-country financial group* is whether the *EEA regulated entities* in that *third-country group* are subject to supervision by a *third-country competent authority*, which is equivalent to that provided for by the *Financial Groups Directive* (in the case of a *financial conglomerate*) or the *EEA prudential sectoral legislation* for the *banking sector* or the *investment services sector* (in the case of a *banking and investment group*). Article 18(1) of the *Financial Groups Directive* sets out the process for establishing equivalence with respect to *third-country financial conglomerates* and article 127(1) and (2) of the *CRD* does so with respect to

third-country banking and investment groups, except where the investment firms in the group are CAD investment firms only, in which case article 143 of the BCD applies.

Other methods: General

- 3.2.4 **G** If the supervision of a *third-country group* by a *third-country competent authority* does not meet the equivalence test referred to in ■ GENPRU 3.2.3 G, the methods set out in the *CRD* and *EU CRR* will apply or *competent authorities* may apply other methods that ensure appropriate supervision of the *EEA regulated entities* in that *third-country group* in accordance with the aims of supplementary supervision under the *Financial Groups Directive* or consolidated supervision under the applicable *EEA prudential sectoral legislation*.

Supervision by analogy: introduction

- 3.2.5 **G** If the supervision of a *third-country group* by a *third-country competent authority* does not meet the equivalence test referred to in ■ GENPRU 3.2.3 G, a *competent authority* may, rather than take the measures described in ■ GENPRU 3.2.4 G, apply, by analogy, the provisions concerning supplementary supervision under the *Financial Groups Directive* or, as applicable, consolidated supervision under the applicable *EEA prudential sectoral legislation*, to the *EEA regulated entities* in the *banking sector*, *investment services sector* and (in the case of a *financial conglomerate*) *insurance sector*.

- 3.2.6 **G** The *FCA* believes that it will only be right to adopt the option in ■ GENPRU 3.2.5 G in response to very unusual group structures.

- 3.2.7 **G** ■ GENPRU 3.2.8 R and ■ GENPRU 3.2.9 R and ■ GENPRU 3 Annex 2 set out *rules* to deal with the situation covered in ■ GENPRU 3.2.5 G. Those *rules* do not apply automatically. Instead, they can only be applied with respect to a particular *third-country group* through the *Part 4A permission* of a in that *third-country group*.

Supervision by analogy: rules for third-country conglomerates

- 3.2.8 **R** If the *Part 4A permission* of a *firm* contains a *requirement* obliging it to comply with this *rule* with respect to a *third-country financial conglomerate* of which it is a member, it must comply, with respect to that *third-country financial conglomerate*, with the *rules* in Part 1 of ■ GENPRU 3 Annex 2, as adjusted by Part 3 of that annex.

Supervision by analogy: rules for third-country banking and investment groups

- 3.2.9 **R** If the *Part 4A permission* of a *firm* contains a *requirement* obliging it to comply with this *rule* with respect to a *third-country banking and investment group* of which it is a member, it must comply, with respect to that *third-country banking and investment group*, with the *rules* in Part 2 of ■ GENPRU 3 Annex 2, as adjusted by Part 3 of that annex.

Capital adequacy calculations for financial conglomerates (GENPRU 3.1.26R and GENPRU 3.1.29R)

1 Table: PART 1: Method of Annex I of the Financial Groups Directive (Accounting Consolidation Method)

Capital resources	1.1	The <i>conglomerate capital resources</i> of a <i>financial conglomerate</i> calculated in accordance with this Part are the capital of that <i>financial conglomerate</i> , calculated on an accounting consolidation basis, that qualifies under paragraph 1.2.
	1.2	The elements of capital that qualify for the purposes of paragraph 1.1 are those that qualify in accordance with the <i>applicable sectoral rules</i> , in accordance with the following: <ol style="list-style-type: none"> (1) the <i>conglomerate capital resources requirement</i> is divided up in accordance with the contribution of each <i>financial sector</i> to it; and (2) the portion of the <i>conglomerate capital resources requirement</i> attributable to a particular <i>financial sector</i> must be met by capital resources that are eligible in accordance with the <i>applicable sectoral rules</i> for that <i>financial sector</i>.
Capital resources requirement	1.3	The <i>conglomerate capital resources requirement</i> of a <i>financial conglomerate</i> calculated in accordance with this Part is equal to the sum of the capital adequacy and solvency requirements for each <i>financial sector</i> calculated in accordance with the <i>applicable sectoral rules</i> for that <i>financial sector</i> .
Consolidation	1.4	The information required for the purpose of establishing whether or not a <i>firm</i> is complying with GENPRU 3.1.29 R (insofar as the definitions in this Part are applied for the purpose of that <i>rule</i>) must be based on the consolidated accounts of the <i>financial conglomerate</i> , together with such other sources of information as appropriate.
	1.5	The <i>applicable sectoral rules</i> that are applied under this Part are the <i>applicable sectoral consolidation rules</i> . Other <i>applicable sectoral rules</i> must be applied if required.

2 Table: PART 2: Method 2 of Annex I of the Financial Groups Directive(Deduction and aggregation Method)

Capital resources	2.1	The <i>conglomerate capital resources</i> of a <i>financial conglomerate</i> calculated in accordance with this Part are equal to the sum of the following amounts (so far as they qualify under paragraph 2.3) for each member of the <i>overall financial sector</i> : <ol style="list-style-type: none"> (1) (for the <i>person</i> at the head of the <i>financial conglomerate</i>) its <i>solo capital resources</i>; (2) (for any other member): <ol style="list-style-type: none"> (a) its <i>solo capital resources</i>; less
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		<p>(b) the book value of the <i>financial conglomerate's</i> investment in that member, to the extent not already deducted in the calculation of the <i>solo capital resources</i> for:</p> <p>(i) the <i>person</i> at the head of the <i>financial conglomerate</i>; or</p> <p>(ii) any other member.</p>
	2.2	The deduction in paragraph 2.1(2) must be carried out separately for each type of capital represented by the <i>financial conglomerate's</i> investment in the member concerned.
	2.3	The elements of capital that qualify for the purposes of paragraph 2.1 are those that qualify in accordance with the <i>applicable sectoral rules</i> . In particular, the portion of the <i>conglomerate capital resources requirement</i> attributable to a particular member of a <i>financial sector</i> must be met by capital resources that would be eligible under the <i>sectoral rules</i> that apply to the calculation of its <i>solo capital resources</i> .
Capital resources requirement	2.4	The <i>conglomerate capital resources requirement</i> of a <i>financial conglomerate</i> calculated in accordance with this Part is equal to the sum of the <i>solo capital resources requirement</i> for each member of the <i>financial conglomerate</i> that is in the <i>overall financial sector</i> .
Partial inclusion	2.5	The capital resources and capital resources requirements of a member of the <i>financial conglomerate</i> in the <i>overall financial sector</i> must be included proportionally. If however the member is a <i>subsidiary undertaking</i> and it has a <i>solvency deficit</i> , they must be included in full.
Accounts	2.6	The information required for the purpose of establishing whether or not a <i>firm</i> is complying with GENPRU 3.1.29 R (insofar as the definitions in this Part are applied for the purpose of that <i>rule</i>) must be based on the individual accounts of members of the <i>financial conglomerate</i> , together with such other sources of information as appropriate.

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6 Table

Types of financial conglomerate	4.3	<p>(1) This paragraph sets out how to determine the category of <i>financial conglomerate</i>.</p> <p>(2) If there is an <i>EEA regulated entity</i> at the head of the <i>financial conglomerate</i>, then:</p> <p>(a) if that entity is in the <i>banking sector</i> or the <i>investment services sector</i>, the <i>financial conglomerate</i> is a <i>banking and investment services conglomerate</i>; or</p> <p>(b) if that entity is in the <i>insurance sector</i>, the <i>financial conglomerate</i> is an <i>insurance conglomerate</i>.</p> <p>(3) If (2) does not apply and the <i>most important financial sector</i> is the <i>banking and investment services sector</i>, it is a <i>banking and investment services conglomerate</i>.</p> <p>(4) If (2) and (3) does not apply, it is an <i>insurance conglomerate</i>.</p>
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7 Table

A mixed financial holding company	4.4	<p>A <i>mixed financial holding company</i> must be treated in the same way as:</p> <p>(1) a <i>financial holding company</i> (if Part One, Title II, Chapter 2 of the <i>EU CRR</i> and the <i>PRA Rulebook : Groups Part</i>) are applied; or</p> <p>(2) an <i>insurance holding company</i> (if the <i>rules</i> in <i>PRA Rulebook: Solvency II Firms: Group Supervision</i> are applied).</p>
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8 Table: PART 5: Principles applicable to all methods

Transfer-ability of capital	5.1	<p>Capital may not be included in</p> <p>(1) a <i>firm's conglomerate capital resources</i> under GENPRU 3.1.29 R</p> <p>if the effectiveness of the transferability and availability of the capital across the different members of the <i>financial conglomerate</i> is insufficient, given the objectives (as referred to in the third unnumbered sub-paragraph of paragraph 2(ii) of Annex I of the <i>Financial Groups Directive</i> (Technical principles)) of the capital adequacy rules for <i>financial conglomerates</i>.</p>
Double counting	5.2	<p>Capital must not be included in a <i>firm's conglomerate capital resources</i> under GENPRU 3.1.29 R</p> <p>if:</p> <p>(1) it would involve double counting or multiple use of the same capital; or</p> <p>(2) it results from any inappropriate intra-group creation of capital.</p>
Cross sectoral capital	5.3	<p>In accordance with the second sub-paragraph of paragraph 2(ii) of Section I of Annex I of the <i>Financial Groups Directive</i> (Other technical principles and insofar as not already required in Parts 1-2):</p> <p>(1) the solvency requirements for each different <i>financial sector</i> represented in a <i>financial conglomerate</i> required by GENPRU 3.1.29 R must be covered by own funds elements in accordance with the corresponding <i>applicable sectoral rules</i>; and</p> <p>(2) if there is a deficit of own funds at the <i>financial conglomerate</i> level, only cross sectoral capital (as referred to in that sub-paragraph) shall qualify for verification of compliance with the additional solvency requirement required by GENPRU 3.1.29 R.</p>
Application of sectoral rules: General	5.4	<p>The following adjustments apply to the <i>applicable sectoral rules</i> as they are applied by the <i>rules</i> in this annex.</p> <p>(1) [deleted]</p> <p>(2) If any of those <i>rules</i> would otherwise not apply to a situation in which they are applied by GENPRU 3 Annex 1, those <i>rules</i> nevertheless still apply (and in particular, any of those <i>rules</i> that would otherwise have the effect of disapplying consolidated supervision do not apply).</p> <p>(3) (If it would not otherwise have been included) an <i>ancillary insurance services undertaking</i> is included in the <i>insurance sector</i>.</p> <p>(4) The scope of those <i>rules</i> is amended so as to remove restrictions relating to where members of the <i>financial conglomerate</i> are incorporated or have their head office, so</p>

<p>Application of sectoral rules: Insurance sector</p>	<p>5.5</p>	<p>that the scope covers every member of the <i>financial conglomerate</i> that would have been included in the scope of those <i>rules</i> if those members had their head offices in an <i>EEA State</i>.</p> <p>(5) (For the purposes of Parts 1 and 2) those <i>rules</i> must be adjusted, if necessary, when calculating the capital resources, capital resources requirements or solvency requirements for a particular <i>financial sector</i> to exclude those for a member of another <i>financial sector</i>.</p> <p>(6) Any <i>waiver</i>, approval or permission granted to a member of the <i>financial conglomerate</i> under those <i>rules</i> does not apply for the purposes of this annex.</p> <p>[deleted]</p>
<p>Application of sectoral rules: Banking sector and investment services sector</p>	<p>5.6</p>	<p>In relation to a <i>BIPRU firm</i> that is a member of a <i>financial conglomerate</i> where there are no <i>credit institutions</i> or <i>investment firms</i>, the following adjustments apply to the applicable sectoral rules for the <i>banking sector</i> and the <i>investment services sector</i> as they are applied by the <i>rules</i> in this annex.</p> <p>(1) References in those <i>rules</i> to <i>non-EEA sub-groups</i> do not apply.</p> <p>[deleted]</p> <p>(3) Any <i>investment firm consolidation waivers</i> granted to members of the <i>financial conglomerate</i> do not apply.</p> <p>(4) (For the purposes of Parts 1 and 2), without prejudice to the application of requirements in BIPRU 8 preventing the use of an <i>advanced prudential calculation approach</i> on a consolidated basis, any <i>advanced prudential calculation approach permission</i> that applies for the purpose of BIPRU 8 does not apply.</p> <p>(5) (For the purposes of Parts 1 and 2), BIPRU 8.5.9 R and BIPRU 8.5.10 R do not apply.</p> <p>(6) (For the purposes of Part 3), where the <i>financial conglomerate</i> does not include a <i>credit institution</i>, the method in GENPRU 2 Annex 4 must be used for calculating the capital resources and BIPRU 8.6.8 R does not apply.</p>

<p>No capital ties</p>	<p>5.7</p>	<p>(Other than as above) the <i>CRD</i> and <i>EU CRR</i> apply for the <i>banking sector</i> and the <i>investment services sector</i>.</p> <p>(1) This <i>rule</i> deals with a <i>financial conglomerate</i> in which some of the members are not linked by capital ties at the time of the notification referred to in GENPRU 3.1.29A R (Capital adequacy requirements: Application of Method 1 or 2 from Annex I of the Financial Groups Directive).</p> <p>[deleted]</p> <p>[deleted]</p> <p>(4) If:</p> <p>[deleted]</p> <p>(b) GENPRU 3.1.29 R (Capital adequacy requirements: Application of Method 1 or 2 from Annex I of the Financial Groups Directive) applies with respect to a <i>financial conglomerate</i> falling into (1);</p> <p>then:</p> <p>(c) the treatment of the links in (1) (including the treatment of any <i>solvency deficit</i>) is as provided for in whichever of Part 1 or Part 2 of GENPRU 3 Annex 1 the <i>firm</i> has, under GENPRU 3.1.30 R, indicated to the <i>FCA</i> it will apply or, if applicable, in the <i>requirement</i> referred to in GENPRU 3.1.31 R; and</p> <p>(d) GENPRU 3.1.29 R applies even if the <i>applicable sectoral rules</i> do not deal with how <i>undertakings</i> not linked by capital ties are to be dealt with for the purposes of consolidated supervision .</p> <p>[deleted]</p>
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9 Table: PART 6: Definitions used in this Annex

<p>Defining the financial sectors</p>	<p>6.1</p>	<p>For the purposes of Parts 1 and 2 of this annex:</p> <p>(1) an <i>asset management company</i> is allocated in accordance with GENPRU 3.1.39 R; an <i>alternative investment fund manager</i> is allocated in accordance with GENPRU 3.1.39 R; and</p> <p>(3) a <i>mixed financial holding company</i> must be treated as being a member of the <i>most important financial sector</i>.</p>
<p>Solo capital resources requirement: Banking sector and investment service sector</p>	<p>6.2</p>	<p>(1) The <i>solo capital resources requirement</i> of an <i>undertaking</i> in the <i>banking sector</i> or the <i>investment services sector</i> must be calculated in accordance with this <i>rule</i>, subject to paragraphs 6.5 and 6.6.</p> <p>(2) The <i>solo capital resources requirement</i> of a <i>building society</i> is its <i>own funds requirements</i>.</p> <p>(3) The <i>solo capital resources requirement</i> of an <i>electronic money institution</i> is the capital resources requirement that applies to it under the <i>Electronic Money Regulations</i>.</p> <p>(4) If there is a <i>credit institution</i> in the <i>financial conglomerate</i>, the <i>solo capital resources requirement</i> for any <i>undertaking</i> in the <i>banking sector</i> or the <i>investment services sector</i> is, subject to (2) and (3), calculated in accordance with the <i>EU CRR</i> for calculating the <i>own funds requirements</i> of a <i>bank</i>.</p> <p>(5) If:</p> <p>(a) the <i>financial conglomerate</i> does not include a <i>credit institution</i>;</p>

(b) there is at least one *investment firm* in the *financial conglomerate*; and(c) all the *investment firms* in the *financial conglomerate* are *limited licence firms* or *limited activity firms*;

the *solo capital resources requirement* for any *undertaking* in the *banking sector* or the *investment services sector* is calculated in accordance with the *EU CRR* for calculating the *own funds requirements* of:

(i) (if there is a *limited activity firm* in the *financial conglomerate*), an *IFPRU limited activity firm*; or

(ii) (in any other case),an *IFPRU limited licence firm*.

(6) If:

(a) the *financial conglomerate* does not include a *credit institution*; and

(b) (5) does not apply;

the *solo capital resources requirement* for any *undertaking* in the *banking sector* or the *investment services sector* is calculated in accordance with the *EU CRR* for calculating the *own funds requirements* of a *full-scope IFPRU investment firm*.

(7) In relation to a *BIPRU firm* that is a member of a *financial conglomerate* where there are no *credit institutions* or *investment firms*, any *capital resources requirements* calculated under a *BIPRU TP* may be used for the purposes of the *solo capital resources requirement* in this rule in the same way that the *capital resources requirements* can be used under *BIPRU 8*.

Solo capital resources requirement: application of rules 6.3

Any exemption that would otherwise apply under any *rules* applied by paragraph 6.2 do not apply for the purposes of this Annex.

Solo capital resources requirement: Insurance sector 6.4

(1) The *solo capital resources requirement* of an *undertaking* in the *insurance sector* must be calculated in accordance with this rule.The *solo capital resources requirement* of an *undertaking* in the *insurance sector* is:

(a) in respect of a UK Solvency II firm, the *SCR*;

(b) in respect of a Solvency II undertaking other than a UK Solvency II firm, the equivalent *SCR* as calculated in accordance with the Solvency II EEA implementing measures in the *EEA State* in which it has received authorisation in accordance with article 14 of the *Solvency II Directive*;

(c) in respect of a third country insurance undertaking or third country reinsurance undertaking to which the PRA Rulebook: Solvency II Firms: Group Supervision, 10.4(2) applies, the equivalent of the *SCR* as calculated in accordance with the applicable requirements in that *third country*; and

(d) in respect of any *undertaking* which is not within (a) to (c), the capital resources requirement calculated according to the rules for the calculation of the solo capital resources requirement applicable to that *undertaking* for the purposes of the calculation referred to in the PRA Rulebook: Solvency II Firms: Group Supervision and Chapter 1 of Title II of the delegated acts, or if no rules are applicable for that calculation under Group Supervision and Chapter 1 of Title II of the delegated acts, in accordance with the *SCR Rules*.

		<p>For the purpose of this Part as it applies in relation to GENPRU 3.1, the following expressions bear the same meaning as defined in the PRA Rulebook: Glossary:</p> <ul style="list-style-type: none"> (i) "UK Solvency II firm"; (ii) "Solvency II undertaking"; (iii) "delegated acts"; (iv) "third country insurance undertaking"; (v) "third country reinsurance undertaking"; and (vi) "SCR Rules".
Solo capital resources requirement: EEA firms in the banking sector or investment services sector	6.5	<p>The <i>solo capital resources requirement</i> for an EEA regulated entity (other than a bank, building society, designated investment firm, IFPRU investment firm, BIPRU firm, an insurer or an EEA insurer) that is subject to the solo capital adequacy sectoral rules for its financial sector of the competent authority that authorised it is equal to the amount of capital it is obliged to hold under those sectoral rules provided that the following conditions are satisfied:</p> <ul style="list-style-type: none"> (1) (for the purposes of the banking sector and the investment services sector) those sectoral rules must correspond to the FCA's sectoral rules identified in paragraph 6.2 as applying to that financial sector; (2) the entity must be subject to those sectoral rules in (1); and (3) paragraph 6.3 applies to the entity and those sectoral rules.
Solo capital resources requirement: non-EEA firms subject to equivalent regimes in the banking sector or investment services sector	6.6	<p>The <i>solo capital resources requirement</i> for a recognised third country credit institution or a recognised third country investment firm is the amount of capital resources that it is obliged to hold under the sectoral rules for its financial sector that apply to it in the state or territory in which it has its head office provided that:</p> <ul style="list-style-type: none"> (1) there is no reason for the firm applying the rules in this annex to believe that the use of those sectoral rules would produce a lower figure than would be produced under paragraph 6.2; and (2) paragraph 6.3 applies to the entity and those sectoral rules.
Solo capital resources requirement: mixed financial holding company	6.7	<p>The <i>solo capital resources requirement</i> of a mixed financial holding company is a notional capital requirement. It is the capital adequacy requirement that applies to regulated entities in the most important financial sector under the table in paragraph 6.10.</p>
Reference to "rules"	6.7A	<p>A reference to "rules" in this annex includes any directly applicable Community regulation that is relevant to the purpose of which "rules" as used refers to.</p>

10 Table

Solo capital resources requirement: the insurance sector	6.8	<p>References to capital requirements in the provisions of GENPRU 3 Annex 1 defining <i>solo capital resources requirement</i> must be interpreted in accordance with paragraph 5.4.</p>
Applicable sectoral consolidation rules	6.9	<p>The <i>applicable sectoral consolidation rules</i> for a financial sector are the sectoral rules about capital adequacy and solvency on a consolidated basis that are applied in the table in paragraph 6.10.</p>

11 Table: Paragraph 6.10: Application of sectoral consolidation rules

Financial sector	Sectoral rules
<i>Banking sector</i>	Part One, Title II, Chapter 2 of the <i>EU CRR</i> and <i>IFPRU 8.1</i> .
<i>Insurance sector</i>	PRA Rulebook: Solvency II Firms: Group Supervision.
<i>Investment services sector</i>	<p>(in relation to an <i>IFPRU investment firm</i> which is a member of a <i>financial conglomerate</i> for which the <i>PRA</i> is the <i>coordinator</i>) Part One, Title II, Chapter 2 of the <i>EU CRR</i> and the <i>PRA</i> Rulebook;</p> <p>(in relation to a <i>designated investment firm</i> or an <i>IFPRU investment firm</i> which is a member of a <i>financial conglomerate</i> for which the <i>FCA</i> is the <i>coordinator</i>) Part One, Title II, Chapter 2 of the <i>EU CRR</i> and <i>IFPRU 8.1</i>;</p> <p>(in relation to a <i>BIPRU firm</i> that is a member of a <i>financial conglomerate</i> where there are no <i>credit institutions</i> or <i>investment firms</i> for which the <i>FCA</i> is the <i>coordinator</i>) <i>BIPRU 8</i> and <i>BIPRU TP</i></p>

12 Table:

Part 5	1	This Part 6 is subject to Part 5 of this Annex.
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Prudential rules for third country groups (GENPRU 3.2.8R to GENPRU 3.2.9R)

1 Table: PART 1: Third-country financial conglomerates

1.1	This Part of this annex sets out the <i>rules</i> with which a <i>firm</i> must comply under GENPRU 3.2.8 R with respect to a <i>financial conglomerate</i> of which it is a member.
1.2	A <i>firm</i> must comply, with respect to the <i>financial conglomerate</i> referred to in paragraph 1.1, with GENPRU 3.1.29 R as applied under paragraph 1.3.
1.3	For the purposes of paragraph 1.2: <ol style="list-style-type: none"> (1) [deleted] (2) the definitions of <i>conglomerate capital resources</i> and <i>conglomerate capital resources requirement</i> that apply for the purposes of that <i>rule</i> are the ones from whichever of Part 1 or Part 2 of GENPRU 3 Annex 1 is specified in the <i>requirement</i> referred to in GENPRU 3.2.8 R; and (3) the <i>rules</i> so applied (including those in GENPRU 3 Annex 1) are adjusted in accordance with paragraph 3.1.
1.4	If the condition in Articles 7(4) and 8(4) of the <i>Financial Groups Directive</i> is satisfied (the <i>financial conglomerate</i> is headed by a <i>mixed financial holding company</i>) with respect to the <i>financial conglomerate</i> referred to in paragraph 1.1 the <i>firm</i> must also comply with GENPRU 3.1.35 R (as adjusted in accordance with paragraph 3.1) with respect to that <i>financial conglomerate</i> .
1.5	A <i>firm</i> must comply with the following with respect to the <i>financial conglomerate</i> referred to in paragraph 1.1: <ol style="list-style-type: none"> (1) SYSC 12 (as it applies to <i>financial conglomerates</i> and as adjusted under paragraph 3.1); and (2) GENPRU 3.1.25 R.

2 Table: PART 2: Third-country banking and investment groups

2.1	This Part of this annex sets out the <i>rules</i> with which a <i>firm</i> must comply under GENPRU 3.2.9 R with respect to a <i>third-country banking and investment group</i> of which it is a member.
2.2	A <i>firm</i> must comply with one of the sets of <i>rules</i> specified in paragraph 2.3 as adjusted under paragraph 3.1 with respect to the <i>third-country banking and investment group</i> referred to in paragraph 2.1.
2.3	The <i>rules</i> referred to in paragraph 2.2 are : <ol style="list-style-type: none"> (1) the <i>applicable sectoral consolidation rules</i> in paragraph 6.10 of GENPRU 3 Annex 1.
2.4	The set of <i>rules</i> from paragraph 2.3 that apply with respect to a particular <i>third-country banking and investment group</i> (as referred to in paragraph 2.1) are those that would apply if they were adjusted in accordance with paragraph 3.1.

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| 2.5 | The <i>sectoral rules</i> applied by Part 2 of this annex cover all prudential <i>rules</i> applying on a consolidated basis including those relating to large exposures. |
| 2.6 | A <i>firm</i> must comply with SYSC 12 (as it applies to <i>banking and investment groups</i> and as adjusted under paragraph 3.1) with respect to the <i>third-country banking and investment group</i> referred to in paragraph 2.1. |

3 Table: PART 3: Adjustment of scope

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| 3.1 | <p>The adjustments that must be carried out under this paragraph are that the scope of the <i>rules</i> referred in Part 1 or Part 2 of this annex, as the case may be, are amended:</p> <p>(1) so as to remove any provisions disapplying those <i>rules</i> for <i>third-country groups</i>;</p> <p>(2) so as to remove all limitations relating to where a member of the <i>third-country group</i> is incorporated or has its head office; and</p> <p>(3) so that the scope covers every member of the <i>third-country group</i> that would have been included in the scope of those <i>rules</i> if those members had their head offices in, and were incorporated in, an <i>EEA State</i>.</p> |
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4Table: PART 4: Definition used in this Annex

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| 4.1 | This Part sets out the definition which a <i>firm</i> must apply for the purposes of this annex as it applies in relation to GENPRU 3.2. |
| 4.2 | A reference to " <i>rules</i> " in this annex includes any directly applicable Community regulation that is relevant to the purpose of which " <i>rules</i> " as used refers to. |

Guidance Notes for Classification of Groups

Classification of Groups (GENPRU 3.1.3 G) - This annex consists only of one or more forms. Forms are to be found through the following address. [genpru_ch3_annex3G.pdf](#)

Purpose and scope

The form is designed to identify groups and sub-groups that are likely to be financial conglomerates under the Financial Groups Directive. A group may be a financial conglomerate if it contains both insurance and banking/investment businesses and meets certain threshold tests. The FCA needs to identify conglomerates with their head offices in the EEA and those with their head offices outside the EEA, although this does not necessarily mean that the latter will be subject to EEA conglomerate supervision.

This form's purpose is to enable the FCA to obtain sufficient information so as to be able to determine how likely a group/sub-group is to be a financial conglomerate. In certain cases this can only be determined after consultation with the other EU relevant competent authorities. A second purpose of the form is therefore to identify any groups and sub-groups that may need such consultation so that this can be made as soon as possible. This should allow firms time to prepare to comply.

The third purpose of the form is to gain information from firms on the most efficient way to implement the threshold calculations in detail (consistently with the directive). We have, therefore, asked for some additional information in part 4 of the form.

A copy of this form can be found on the FCA's Financial Groups Website with current contact details.

Please include workings showing the method employed to determine the percentages in part 2 (for the threshold conditions) and giving details of all important assumptions / approximations made in doing the calculations.

The definition of financial conglomerate includes not only conventional groups made up of parent-subsidiary relationships but groups linked by control and "consolidation Article 12(1) relationships". If this is the case for your group, please submit along with this form a statement that this is the case. Please include in that statement an explanation of how you have included group members not linked by capital ties in the questionnaire calculations.

A consolidation Article 12(1) relationship arises between undertakings in the circumstances set out in Article 12(1) of the Seventh Company Law Directive. These are set out in the Handbook Glossary (in the definition of consolidation Article 12(1) relationship). Broadly speaking, undertakings come within this definition if they do not form a conventional group but:

- (a) are managed on a unified basis; or
- (b) have common management.

General guidance

We would like this to be completed based on the most senior parent in the group, and, if applicable, for the company heading the most senior conglomerate group in the EEA. If appropriate, please also attach a list of all other likely conglomerate sub-groups.

Please use the most recent accounts for the top level company in the group together with the corresponding accounts for all subsidiaries and participations that are included in the consolidated accounts. Please indicate the names of any significant subsidiaries with a different year-end from the group's year-end.

Please note the following:

- (a) Branches should be included as part of the parent entity.

- (b) Include in the calculations overseas entities owned by the relevant group or sub-group.
- (c) There are only two sectors for this purpose: banking/investment and insurance.
- (d) You will need to assign non-regulated financial entities to one of these sectors:
 - **banking/investment** activities are listed in – Annex 1 to the Capital Requirements Directive 2013/36/EU
 - **insurance** activities are listed in - schedule 1 to, and *contracts of insurance* defined in article 3(1) of, the *Regulated Activities Order* .
 - Any **operator of a UCITS scheme, insurance intermediary, mortgage broker and mixed financial holding company** does not fall into the directive definitions of either financial sector or insurance sector and should be treated for these purposes as being outside the financial sector. They should therefore be ignored for the purposes of these calculations.

Threshold tests

For the purpose of completing section 2 of the form relating to the threshold tests, the following guidance should be used. However, if you consider that for your group there is a more appropriate calculation then you may use this calculation so long as the method of computation is submitted with the form.

Calculating balance sheet totals

Generally, use total (gross) assets for the balance sheet total of a group/entity. However, investments in other entities that are part of the group will need to be deducted from the sector that has made the investment and the balance sheet total of the entity is added to the sector in which it operates.

Our expectation of how this may be achieved efficiently is as follows:

- (i) Off-balance-sheet items should be excluded.
- (ii) Where off-balance sheet treatment of **funds under management** and on-balance sheet treatment of **policy holders' funds** may distort the threshold calculation, groups should consult the *FCA* on the appropriateness of using other measures under article 3.5 of the Financial Groups Directive.
- (iii) If consolidated accounts exist for a sub-group consisting of financial entities from only one of the two sectors, these consolidated accounts should be used to measure the balance-sheet total of the sub-group (i.e. total assets less investments in entities in the other sector). If consolidated accounts do not exist, intra-group balances should be netted out when calculating the balance sheet total of a single sector (but cross-sector intra-group balances should not be netted out).
- (iv) Where consolidated accounts are used, minority interests should be excluded and goodwill should be included.
- (v) Where accounting standards differ between entities, groups should consult the *FCA* if they believe this is likely materially to affect the threshold calculation.
- (vi) Where there is a subsidiary or participation in the opposite sector from its parent (i.e. insurance sector for a banking/investment firm parent and vice versa), the balance sheet amount of the subsidiary or participation should be allocated to its sector using its individual accounts.
- (vii) The balance-sheet total of the parent entity/sub-group is measured as total assets of the parent/sub-group less the book value of its subsidiaries or participations in the other sector (i.e. the value of the subsidiary or participation in the parent's consolidated accounts is deducted from the parent's consolidated assets).
- (viii) The cross-sector subsidiaries or participations referred to above, valued according to their own accounts, are allocated pro-rata, according to the aggregated share owned by the parent/sub-group, to their own sector.
- (ix) If the cross-sector entities above themselves own group entities in the first sector (i.e. that of the top parent/sub-group) these should (in accordance with the methods above) be excluded from the second sector and added to the first sector using individual accounts.

Solvency (capital adequacy) requirements

Generally, the solvency requirements should be according to sectoral rules of the *FCA* that would apply to the type of entity. However, you can use EEA rules or local rules in the circumstances set out in Part 6 of ■ GENPRU 3 Annex 1. But if this choice makes a significant difference,

either with respect to whether the group is a financial conglomerate or with respect to which sector is the biggest, you should consult with the *FCA*. Non-regulated financial entities should have proxy requirements calculated on the basis of the most appropriate sector. If sub-groups submit single sector consolidated returns then the solvency requirement may be taken from those returns.

Our expectation of how this may be achieved efficiently is as follows:

- (i) If you complete a solvency return for a sub-group consisting of financial entities from only one of the two sectors, the total solvency requirement for the sub-group should be used.
- (ii) Solvency requirements taken must include any deductions from available capital so as to allow the appropriate aggregation of requirements.
- (iii) Where there is a regulated subsidiary or participation in the opposite sector from its parent/sub-group, the solvency requirement of the subsidiary or participation should be from its individual regulatory return. If there is an identifiable contribution to the parent's solvency requirement in respect of the cross-sector subsidiary or participation, the parent's solvency requirement may be adjusted to exclude this.
- (iv) Where there is an unregulated financial undertaking in the opposite sector from its parent/sub-group, the solvency requirement of the subsidiary or participation should be one of the following:
 - (a) as if the entity were regulated by the *FCA* under the appropriate sectoral rules;
 - (b) using EU minimum requirements for the appropriate sector; or
 - (c) using non-EU local requirements* for the appropriate sector.
 Please note on the form which of these options you have used, according to the country and sector, and whether this is the same treatment as in your latest overall group solvency calculation.
- (v) For banking/investment requirements, use the total amount of capital required.
- (vi) For insurance requirements, use the total amount of capital required.

Market share measures

These are not defined by the directive. The aim is to identify any standard industry approaches to measuring market share in individual EU countries by sector, or any data sources which are commonly used as a proxy.

Article I.

Article II. Threshold tests

Test F2

B/S of banking/investment + insurance sector = result %

B/S total

Test F3/F4/F5

B/S of insurance sector

B/S of banking/investment sector + insurance sector = A%

B/S of banking/investment sector

B/S of banking/investment sector + insurance sector = B%

Solvency requirement of insurance sector

Solvency requirement of banking/investment sector + insurance sector = C%

Solvency requirement of banking/investment sector

Solvency requirement of banking/investment sector + insurance sector = D%

The relevant percentage for the insurance sector is:

$$(A\% + C\%)/2 = I\%$$

The relevant percentage for the banking/investment sector is:

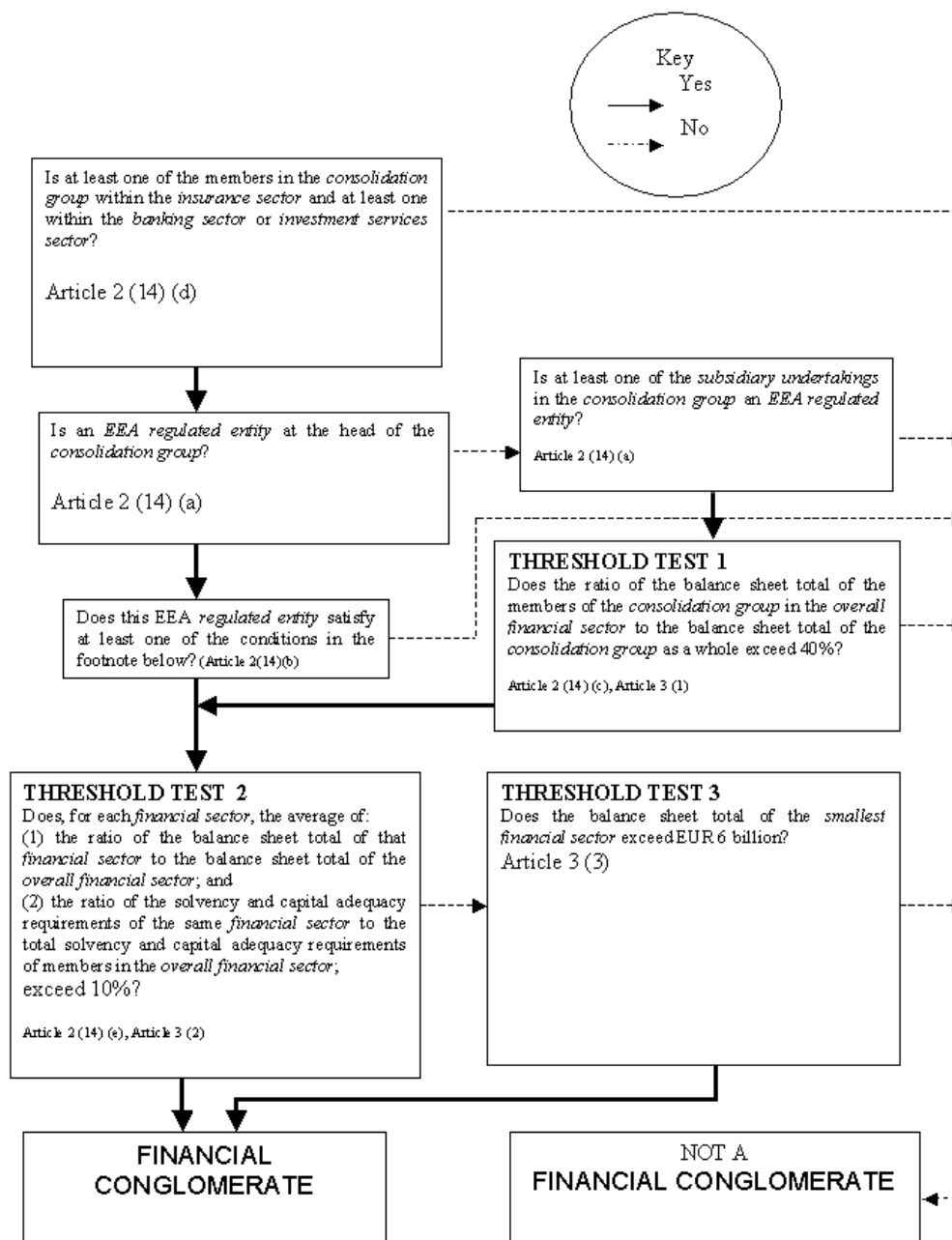
$$(B\% + D\%)/2 = BI\%$$

The smallest sector is the sector with the smallest relevant percentage.

Article III. If $I\% < BI\%$ then F3 is insurance, F4 = A%, and F5 = C%

Article IV. If $BI\% < I\%$ then F3 is banking/investment, F4 = B% and F5 = D%

(see GENPRU 3.1.5R)



Footnote: The conditions are that the *EEA regulated entity* at the head of the *consolidation group*:
 (1) is a *parent undertaking* of a member of the *consolidation group* in the *overall financial sector*;
 (2) has a *participation* in a member of the *consolidation group* that is in the *overall financial sector*; or
 (3) has a *consolidation Article 12(1) relationship* with a member of the *consolidation group* that is in the *overall financial sector*.

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GENPRU TP 1

Application of GENPRU TP 1 to GENPRU TP 6 and other general provisions for insurers

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GENPRU TP 2 IPRU(INS) waivers

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GENPRU TP 3

Table: IPRU(INS) waivers

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GENPRU TP 4 Capital instruments

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GENPRU TP 5 Calls for supplementary contributions

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GENPRU TP 6 Implicit items waivers

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GENPRU TP 7
[deleted]

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GENPRU TP 8

Miscellaneous capital resources definitions for BIPRU firms

			Application
8.1	R		This section applies to a <i>BIPRU firm</i> .
[FCA]			
8.2	R		Any provision of this section that applies on a consolidated basis under <i>GENPRU TP 8.3R</i> applies to any <i>firm</i> to which <i>BIPRU 8 (Group risk - consolidation)</i> applies.
[FCA]			
			Consolidation
8.3	R		A provision of this section applies on a consolidated basis for the purpose of <i>BIPRU 8 (Group risk -consolidation)</i> to the extent that, and in the same way that, the provision in <i>BIPRU</i> to which it relates applies on a consolidated basis.
[FCA]			
			(2) the <i>building society</i> issued it before 18 November 2004; and
			Preference shares
8.7	R		A <i>BIPRU firm</i> may treat a <i>preference share</i> as eligible for inclusion within stage B of the <i>capital resources table</i> (Perpetual non-cumulative preference shares) if it would not otherwise be eligible if:
[FCA]			
		(1)	on 31 December 2006 the <i>firm</i> was subject to <i>IPRU(INV)</i> ;
		(2)	the <i>firm</i> issued it on or before 31 December 2006;
		(3)	as at 31 December 2006 the <i>firm</i> included it, and was entitled to include it, in the calculation of its capital resources under <i>IPRU(INV)</i> as capital of a type that corresponded to <i>tier one capital resources</i> ;
		(4)	it would have been eligible for inclusion within stage B of the <i>capital resources table</i> except for the fact that it does not meet <i>GENPRU 2.2.64 R (4)(b)</i> (Restrictions on mandatory <i>coupons</i> for <i>tier one capital</i>) or <i>GENPRU 2.2.109 R (1)</i> (Restrictions on mandatory <i>coupons</i> for perpetual non-cumulative <i>preference shares</i>) or both of those rules;
		(5)	the only reason that it does not meet <i>GENPRU 2.2.64 R (4)(b)</i> or <i>GENPRU 2.2.109 R (1)</i> is because a mandatory cash <i>coupon</i> is payable;
		(6)	the <i>firm</i> has the right not to pay the cash <i>coupon</i> if it is in breach of any of the <i>main BIPRU firm Pillar 1 rules</i> or to the extent that paying such <i>coupon</i>

8.9 [FCA]	R	<p>would result in a breach of any of those <i>rules</i>; and</p> <p>(7) any amount not paid under (6) does not accumulate.</p> <p>Upper tier 2 instruments: Deferral of interest</p> <p>A BIPRU firm may treat a <i>capital instrument</i> as eligible for inclusion within stage G of the <i>capital resources table</i> (Upper tier two capital) if it would not otherwise be eligible if:</p> <p>(1) on 31 December 2006 the <i>firm</i> was subject to IPRU(INV);</p> <p>(2) the <i>firm</i> issued it on or before 31 December 2006;</p> <p>(3) as at 31 December 2006 the <i>firm</i> included it, and was entitled to include it, in the calculation of its capital resources under IPRU(INV) as capital of a type that corresponded to <i>upper tier two capital resources</i>;</p> <p>(4) it would have been eligible for inclusion within stage G of the <i>capital resources table</i> except for the fact that it does not meet GENPRU 2.2.177 R (2);</p> <p>(5) the only reason that it does not meet GENPRU 2.2.177 R (2) is because a mandatory <i>cash coupon</i> is payable; and</p> <p>(6) the <i>firm</i> has the right not to pay the <i>cash coupon</i> if it is in breach of any of the <i>main BIPRU firm Pillar 1 rules</i> or to the extent that paying such <i>coupon</i> would result in a breach of any of those <i>rules</i>.</p>
8.11 [FCA]	R	<p>Conversion ratio</p> <p>GENPRU 2.2.138 R (2) (Tier one capital: Conversion ratio) does not apply to a <i>capital instrument</i> issued by a <i>firm</i> if:</p> <p>(1) on 31 December 2006 the <i>firm</i> was subject to IPRU(INV);</p> <p>(2) the <i>firm</i> issued it on or before 31 December 2006; and</p> <p>(3) as at 31 December 2006 the <i>firm</i> included it, and was entitled to include it, in the calculation of its capital resources under:</p> <p>(a) [deleted]</p> <p>(b) IPRU(INV) as capital of a type that corresponded to <i>tier one capital</i>.</p>
8.12 [FCA]	R	<p>Legal opinions</p> <p>GENPRU 2.2.118 R (Legal opinions for <i>innovative tier one capital</i>) does not apply to a <i>capital instrument</i> issued by a <i>firm</i> if:</p> <p>(1) on 31 December 2006 the <i>firm</i> was subject to IPRU(INV);</p>

		(2)	the <i>firm</i> issued the <i>capital instrument</i> on or before 31 December 2006; and
		(3)	[deleted]
		(4)	the <i>firm</i> included the <i>capital instrument</i> , and was entitled to include it, in the calculation of its capital resources under <i>IPRU(INV)</i> as capital of a type that corresponded to <i>tier one capital</i> .
8.13	R	The following <i>rules</i> :	
[FCA]		(1)	GENPRU 2.2.159 R (12) (Legal opinions for <i>tier two capital</i>);
		(2)	GENPRU 2.2.163 R (Legal opinions for <i>tier two capital</i> governed by a foreign law);
		(3)	GENPRU 2.2.181 R (Legal opinions for <i>upper tier two capital</i>); and
		(4)	GENPRU 2.2.244 R (Application of certain <i>rules</i> about <i>tier two capital</i> to <i>tier three capital</i>) so far as it applies the <i>rules</i> in (1) to (3);
		do not apply to a <i>capital instrument</i> issued by a <i>firm</i> if:	
		(5)	on 31 December 2006 the <i>firm</i> was subject to <i>IPRU(INV)</i> ;
		(6)	the <i>firm</i> issued the <i>capital instrument</i> on or before 31 December 2006; and
		(7)	as at 31 December 2006 the <i>firm</i> included the <i>capital instrument</i> , and was entitled to include it, in the calculation of its capital resources under <i>IPRU(INV)</i> as capital of the type that corresponds to:
		(a)	(where the <i>firm</i> disappplies the <i>rule</i> in (1) or (2)) <i>tier two capital</i> ; or
		(b)	(where the <i>firm</i> disappplies the <i>rule</i> in (3)) <i>upper tier two capital</i> ; or
		(c)	(where the <i>firm</i> disappplies the <i>rule</i> in (4)) <i>tier three capital</i> .
		Version of IPRU	
8.14	R	Any reference in this section to a type of capital in <i>IPRU</i> is to a type of capital in <i>IPRU</i> in the form <i>IPRU</i> was in on 31 December 2006.	
[FCA]		Eligibility	
8.15	G	If this section says that an item of capital is eligible for inclusion within a particular stage of the <i>capital resources table</i> this is still subject to the application of the <i>capital resources gearing rules</i> .	
[FCA]		Waivers and concessions	

8.16 [FCA]	G	<p>A reference to a <i>firm</i> being entitled to include <i>capital instruments</i> in the calculation of its capital resources under <i>IP-RU(INV)</i> at a particular level includes the <i>firm</i> being able to do this under a <i>waiver</i>.</p> <p>Combinations of provisions</p>
8.17 [FCA]	G	<p>A <i>firm</i> may combine the use of two or more of the provisions in this section.</p>

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GENPRU TP 8A

Further miscellaneous capital resources definitions for BIPRU firms

Application and interpretation

8A.1 R This section applies to a *BIPRU firm*. In this section a reference to 30 December 2010 means 23.59 on 30 December 2010.

Tier one capital

8A.2 R Until 31 December 2040 a *BIPRU firm* may treat a *capital instrument* as eligible for inclusion as *hybrid capital*, if it would not otherwise be eligible, if:

- (1) on 30 December 2010 the *BIPRU firm* was subject to *GENPRU*; and
- (2) as at 30 December 2010 the *BIPRU firm* included it, and was entitled to include it, at stage B or C of the calculation in the *capital resources table*.

8A.3 If a *BIPRU firm* treats a *capital instrument* as eligible for inclusion as *hybrid capital* under *GENPRU TP8A.2R*, then the *firm*:

- (1) if it included the *capital instrument* as *innovative tier one capital* as at 30 December 2010, must treat the *capital instrument* as *hybrid capital* included at stage C of the calculation in the *capital resources table*;
- (2) must apply the limit in *GENPRU 2.2.30AR (3)* to the aggregate of the *capital instruments* treated under (1) and the *hybrid capital* that is eligible under *GENPRU 2.2* for inclusion at stage C of the calculation in the *capital resources table*;
- (3) [deleted]
- (4) [deleted]
- (5) must not include *hybrid capital* at stage B2 of the calculation in the *capital resources table* under *GENPRU 2.2*, except as provided by *GENPRU TP8A.4R*, if and to the extent that the aggregate of the following exceeds the limit in *GENPRU 2.2.30AR (2)*
 - (a)
 - (b) *capital instruments* included at stage B of the calculation in the *capital resources table* as at 30 December 2010 and treated under *GENPRU TP8A.2R*;
- (6) if it includes *hybrid capital* at stage B2 of the calculation in the *capital resources table* under *GENPRU 2.2*, except as provided by *GENPRU TP8A.4R*, must include *capital instruments* treated under *GENPRU TP8A.2R* in the calculation of the limit in *GENPRU 2.2.30AR (2)*;
- (7) must not include *hybrid capital* at stage B1 of the calculation in the *capital resources table* under *GENPRU 2.2*, except as provided by *GENPRU TP8A.5R*, if and to the extent that the aggregate of the following exceeds the limit in *GENPRU 2.2.30AR (1)*:

		(a)	<i>capital instruments</i> included at stage C in the <i>capital resources table</i> under (1) and GENPRU 2.2; and
		(b)	
	(8)		if it includes <i>hybrid capital</i> at stage B1 of the calculation in the <i>capital resources table</i> under GENPRU 2.2, except as provided by GENPRU TP8A.5R, must include <i>capital instruments</i> treated under GENPRU TP8A.2R in the calculation of the limit in GENPRU 2.2.30AR (1).
8A.4	R		A BIPRU firm may include <i>hybrid capital</i> at stage B2 of the calculation in the <i>capital resources table</i> , notwithstanding GENPRU TP8A.3R(5), if the firm issued it after 30 December 2010 and:
		(1)	the <i>capital instrument</i> would otherwise be eligible for inclusion as <i>hybrid capital</i> at stage B2 of the calculation in the <i>capital resources table</i> under GENPRU 2.2; and
		(2)	the firm issued it in order to replace another <i>capital instrument</i> that the firm treated as <i>hybrid capital</i> under GENPRU TP8A.2R.
8A.5	R		A BIPRU firm may include <i>hybrid capital</i> at stage B1 of the calculation in the <i>capital resources table</i> , notwithstanding GENPRU TP8A.3R(7), if the firm issued it after 30 December 2010 and:
		(1)	the <i>capital instrument</i> would otherwise be eligible for inclusion as <i>hybrid capital</i> at stage B1 of the calculation in the <i>capital resources table</i> under GENPRU 2.2; and
		(2)	the firm issued it in order to replace another <i>capital instrument</i> that the firm treated as <i>hybrid capital</i> under GENPRU TP8A.2R.
8A.6	R		In relation to the <i>tier one capital resources</i> of a BIPRU firm, calculated at stage F of the calculation in the <i>capital resources table</i> (Total tier one capital after deductions):
		(1)	from 31 December 2020 until 30 December 2030:
		(a)	no more than 20% may be accounted for by items treated under GENPRU TP8A.2R as <i>tier one capital</i> ; and
		(b)	[deleted]
		(2)	from 31 December 2030 until 30 December 2040, no more than 10% may be accounted for by items treated under GENPRU TP8A.2R as <i>tier one capital</i> .
8A.7	R		BIPRU firms which do not comply by 31 December 2010 with the limits set out in GENPRU 2.2.29 R to GENPRU 2.2.30AR (3) must develop strategies and processes on the necessary measures to resolve this situation before the dates set out in GENPRU TP8A.6R.

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GENPRU TP 8B

Miscellaneous capital resources definitions for BIPRU firms: Core tier one capital

Application

8B.1 R This section applies to a *BIPRU firm*.

Core tier one capital

8B.2 R A provision in this section applies on a consolidated basis for the purposes of BIPRU 8 (Group risk - consolidation) to a *UK consolidation group* to the extent that, and in the same manner that, the provision in *GENPRU* to which it relates applies on a consolidated basis.

8B.5 R A *BIPRU firm* may treat an ordinary *share* that has different voting rights to other ordinary *shares* issued by the *firm* as eligible for inclusion within stage A of the *capital resources table* (Core tier one capital) without making a notification of issue or change in voting rights to the *appropriate regulator* under GENPRU 2.2.83B R if:

- (1) on 30 December 2010 the *firm* was subject to *GENPRU*;
- (2) the *firm* issued the ordinary *share* on or before 30 December 2010 and the shareholders were bound by the differences in voting rights on or before 30 December 2010; and
- (3) as at 30 December 2010 the *firm* included the ordinary *share*, and was entitled to include it, in the calculation of *capital resources* under *GENPRU* as *permanent share capital*;

provided that by 30 June 2011 the *firm* provides the *appropriate regulator* with full details of the ordinary *shares*, their terms of issue and the differences in voting rights applicable to those ordinary *shares*.

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GENPRU TP 9
[deleted]

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GENPRU TP 10 Assets of former underwriting members

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GENPRU TP 11 PRU waivers

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GENPRU TP 12 Table: PRU waivers

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GENPRU TP 13 EEA pure reinsurers

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GENPRU TP 14
[deleted]

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GENPRU TP 16
[deleted]

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Schedule 1 Record keeping requirements

Sch 1 G

1 The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant record keeping requirements.

2 It is not a complete statement of those requirements and should not be relied on as if it were.

3 Table

Handbook reference	Subject of Record	Contents of record	When record must be made	Retention Period
GENPRU 1.2.60 R - GENPRU 1.2.61 R	<i>Firm's</i> assessment of its financial resources	(1) The major sources of risk the <i>firm</i> has identified (2) How the <i>firm</i> intends to deal with those risks (3) Details of the stress and scenario analyses carried out and the resulting financial resources estimated to be required	Not specified	At least three years
GENPRU 1.3.22 R	Valuation models for marking to model	Secure copy of <i>firm's</i> own valuation model	When model is in use	Not specified

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Schedule 2 Notification and reporting requirements

Sch 2 G

1 The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant notification requirements.

2 It is not a complete statement of those requirements and should not be relied on as if it were.

3 Table

Handbook reference	Matter to be notified	Contents of notification	Trigger events	Time allowed
GENPRU 1.5.19 R [PRA]	Intention to change maximum amount of <i>callable contribution</i>	Fact of intention and details of the change	Intention to change the maximum amount	Adequate advance notice, normally not less than 6 months
GENPRU 2.1.11 R [FCA] [PRA]	Breach or expected breach of GENPRU 2.1.13 R or <i>main BIPRU firm Pillar 1 rules</i>	Fact of breach or expectation of breach	Breach or expectation of breach	Immediately
[deleted]				
GENPRU 2.2.61B R [FCA] [PRA]	Intention to issue a <i>capital instrument</i> for inclusion in <i>capital resources</i>	Fact of intention and details of intended amount, issue date, type of investor, stage of capital, features of instrument and confirmation of compliance with <i>rules</i>	Intention to issue	One <i>month</i> prior to issue, unless exceptional circumstances prevent a <i>firm</i> adhering to a one- <i>month</i> period
GENPRU 2.2.61C R [FCA] [PRA]	Proposed changes to details of the issue of a <i>capital instrument</i> notified under GENPRU 2.2.61B R	Proposed change and all information required under GENPRU 2.2.61B R (1) to GENPRU 2.2.61B R (4)	Intention to change any details of the issue previously notified to the <i>appropriate regulator</i>	As soon as the changes are proposed
GENPRU 2.2.61D R [FCA] [PRA]	Proposed establishment of a debt securities program	All information required under GENPRU 2.2.61B R (1) to GENPRU 2.2.61B R (4)	Intention to establish	One month prior to first drawdown

Handbook reference	Matter to be notified	Contents of notification	Trigger events	Time allowed
GENPRU 2.2.61F R [FCA] [PRA]	Issue of <i>capital instruments</i> for inclusion in <i>capital resources</i> where instrument or facility previously notified to the appropriate regulator	All information required under GENPRU 2.2.61B R (1) to GENPRU 2.2.61B R (3) and confirmation no changes have been made to the terms of the instrument since a previous similar issue	Intention to issue	No later than date of issue
GENPRU 2.2.74 R [FCA] [PRA]	Intention to redeem <i>tier one instrument</i> included in <i>tier one capital resources</i>	Fact of intention and details of the <i>firm's</i> position after such redemption in order to show how it will meet the <i>capital resources requirement</i> , how it will have sufficient financial resources to meet the <i>overall financial adequacy rule</i> and, in the case of a <i>BIPRU firm</i> , how it will not otherwise suffer any undue effects to its financial or solvency conditions	Intention to redeem	At least one month prior to becoming committed to redeem
[deleted]				
[deleted]				
[deleted]				
[deleted]				
GENPRU 2.2.171 R [FCA] [PRA]	Proposal to amend a tier two instrument	Details of the proposed amendment	Proposal to amend	One month before amendment is due to take effect
GENPRU 2.2.174 R [FCA] [PRA]	Intention to repay (other than on contractual repayment date) <i>tier two instrument</i>	Fact of intention and details of the <i>firm's</i> position after such repayment in order to show how it will meet the <i>capital resources requirement</i> and how it will have sufficient financial resources	Intention to repay	Six <i>Months</i> (in the case of an <i>insurer</i>) or one <i>Month</i> (in the case of a <i>BIPRU firm</i>) prior to becoming committed to repayment

Handbook reference	Matter to be notified	Contents of notification	Trigger events	Time allowed
[deleted] [deleted]		to meet the <i>overall financial adequacy rule</i>		

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Schedule 3 Fees and other requirement payments

Sch 3 G

There are no requirements for fees or other payments in *GENPRU*.

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Schedule 4 Powers exercised

Sch 4.1 G
[deleted]

Sch 4.2 G
[deleted]

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Schedule 5 Rights of action for damages

Sch 5 G

1. The table below sets out the rules in *GENPRU* contravention of which by an *authorised person* may be actionable under section 138D of the Act (Actions for damages) by a person who suffers loss as a result of the contravention.

2. If a "Yes" appears in the column headed "For private person", the rule may be actionable by a private person under section 138D (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001/2256)). A "Yes" in the column headed "Removed" indicates that the FCA has removed the right of action under section 138D(3) of the Act. If so, a reference to the rule in which it is removed is also given.

3. The column headed "For other person" indicates whether the rule may be actionable by a person other than a private person (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of person by whom the rule may be actionable is given.

Chapter/ Appendix	Section/Annex	Right of action under section 138D		
		For private person	Removed	For other person
All rules in <i>GENPRU</i>		No	Yes - <i>GENPRU</i> 1.4.1 R	No

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Schedule 6 Rules that can be waived

Sch 6 G

The rules in *GENPRU* may be waived by the *appropriate regulator* under section 138A of the *Act* (Modification or waiver of rules). However, if the *rules* incorporate requirements laid down in European directives, it will not be possible for the *appropriate regulator* to grant a *waiver* that would be incompatible with the *United Kingdom's* responsibilities under those directives. It therefore follows that if a *rule* in *GENPRU* contains provisions which derive partly from a directive, and partly not, the *appropriate regulator* will be able to consider a *waiver* of the latter requirements only, unless the directive provisions are optional rather than mandatory.

