

Chapter 10

Capital buffers

10.1 Application

10.1.1 **R** ■ IFPRU 10 applies to an *IFPRU investment firm*, unless it is one of the following:

- (1) an *IFPRU limited licence firm*; or
- (2) an *exempt IFPRU commodities firm*.

Purpose

10.1.2 **G** This chapter implements articles 129 (part), 130 (part), 140 (part), 141, 142 (part) of *CRD*.



10.2 Capital conservation buffer

10.2.1

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A firm must calculate a capital conservation buffer of common equity tier 1 capital equal to 2.5% of its total risk exposure amount.

[Note: article 129(1) (part) of CRD]

10.3 Countercyclical capital buffer

Main requirement

- 10.3.1 **R** A firm must calculate a *countercyclical capital buffer* of common equity tier 1 capital equal to its *total risk exposure amount* multiplied by the weighted average of the *countercyclical buffer rates* that apply to exposures in the jurisdictions where the *firm's relevant credit exposures* are located.

[Note: article 130(1) (part) of CRD]

Calculation of countercyclical capital buffer rates

- 10.3.2 **R**
- (1) To calculate the weighted average in **IFPRU 10.3.1 R**, a firm must apply to each applicable *countercyclical buffer rate* its total *own funds requirements* for credit risk, specific risk, incremental default and migration risk that relates to the *relevant credit exposures* in the jurisdiction in question, divided by its total *own funds requirements* for credit risk that relates to all of its *relevant credit exposures*.
 - (2) For the purposes of (1), a firm must calculate its total *own funds requirement* for credit risk, specific risk, incremental default and migration risk in accordance with Part Three, Titles II (Capital requirements for credit risk) and IV (Own funds requirements for market risk) of the *EU CRR*.
 - (3) The *countercyclical buffer rate* for an exposure located in the *UK* is the rate set by the *UK countercyclical buffer authority* for the *UK*.
 - (4) The *countercyclical buffer rate* for an exposure located in an *EEA State* other than the *UK* is:
 - (a) the rate set by the *EEA countercyclical buffer authority* for that jurisdiction; or
 - (b) if that rate exceeds 2.5% of *total risk exposure amount* and has not been recognised by the *UK countercyclical buffer authority*, 2.5%
 - (5) The *countercyclical buffer rate* for an exposure located in a *third country* is the rate set by the *UK countercyclical buffer authority* for that jurisdiction.
 - (6) If the *UK countercyclical buffer authority* has not set a rate for a *third country*, the *countercyclical buffer rate* for an exposure located in that jurisdiction is:

- (a) the rate set by the *third country countercyclical buffer authority* for that jurisdiction; or
 - (b) if that rate exceeds 2.5% and has not been recognised by the *UK countercyclical buffer authority*, 2.5%.
- (7) If the *UK countercyclical buffer authority* has not set a rate for a *third country* and either there is no *third-country countercyclical buffer authority* for that country or the authority has not set a rate for that jurisdiction, the *countercyclical buffer rate* for an exposure located in that jurisdiction is zero.
- (8) If the *countercyclical buffer rate* for the *UK* is increased, that increase takes effect from the date specified by the *UK countercyclical buffer authority*.
- (9) If the *countercyclical buffer rate* for an *EEA State* other than the *UK* is increased, subject to (4)(b), that increase takes effect from:
- (a) the date specified by the *EEA countercyclical buffer authority* for that jurisdiction, if the rate applied under this chapter does not exceed 2.5%; or
 - (b) the date specified by the *UK countercyclical buffer authority* if the rate applied under this chapter exceeds 2.5%.
- (10) If the *countercyclical buffer rate* for a *third country* is increased by the *UK countercyclical buffer authority*, that increase takes effect from the date specified by the *UK countercyclical buffer authority*.
- (11) If the *UK countercyclical buffer authority* does not set a *countercyclical buffer rate* for a *third country* and that rate is increased by the *third-country countercyclical buffer authority* for that jurisdiction, subject to 6(b), that increase takes effect from:
- (a) the date 12 months after the date on which the increase was published by the *third-country countercyclical buffer authority* in accordance with the relevant law of the *third country*, if the rate applied under this chapter does not exceed 2.5%; or
 - (b) the date specified by the *UK countercyclical buffer authority* if the rate applied under this chapter exceeds 2.5%.
- (12) If a *countercyclical buffer rate* is reduced, that reduction takes effect immediately.

[Note: articles 136(4) (part) , 139(2) to (5) (part) and 140(1) to (4) and (6) (part) of *CRD*]

Location of exposures

10.3.3

G

A *firm* must identify the geographical location of a *relevant credit exposure* in accordance with the regulatory technical standards adopted under article 140(7) of *CRD*.

[Note: article 140(5) of *CRD*]

10.4 Capital conservation measures

Combined buffer

- 10.4.1 **R** A firm does not meet the *combined buffer* if the *common equity tier 1 capital* maintained by the firm which is not used to meet the *own funds requirement* under article 92(1)(c) of the *EU CRR* (Total capital ratio) does not meet the *combined buffer*.

[Note: articles 129(1) (part) and 130(5) (part) of *CRD*]

Restrictions on distributions

- 10.4.2 **R** A firm that meets the *combined buffer* must not make a *distribution in connection with common equity tier 1 capital* to an extent that would decrease its *common equity tier 1 capital* to a level where the *combined buffer* is no longer met.

[Note: article 141(1) of *CRD*]

- 10.4.3 **R**
- (1) A firm that does not meet the *combined buffer* must:
 - (a) calculate the *MDA* in accordance with (4); and
 - (b) report the *MDA* to the *FCA* in writing no later than five *business days* after the firm identified that it did not meet the *combined buffer*.
 - (2) A firm that does not meet the *combined buffer* must not undertake any of the following actions before it has calculated the *MDA*:
 - (a) make a *distribution in connection with common equity tier 1 capital*;
 - (b) create an obligation to pay variable remuneration or *discretionary pension benefits* or pay variable remuneration or *discretionary pension benefits* if the obligation to pay was created at a time when the firm did not meet the *combined buffer*; and
 - (c) make payments on *additional tier 1 instruments*.
 - (3) If a firm does not meet the *combined buffer*, it must not distribute more than the *MDA*, calculated in (4), through any action in (2)(a) to (c).

- (4) (a) A *firm* must calculate the *MDA* by multiplying the sum calculated in (5) by the factor determined in (6).
- (b) Any of the actions in (2)(a), (b) or (c) shall have the effect of reducing the *MDA*.
- (5) The sum to be multiplied in (4) shall consist of:
- (a) interim profits not included in *common equity tier 1 capital* under article 26(2) of the *EU CRR* (Common equity tier 1 items) that have been generated since the most recent decision on the distribution of profits or any of the actions in 2(a), (b) or (c);
- Plus
- (b) year-end profits not included in *common equity tier 1 capital* under article 26(2) of the *EU CRR* that have been generated since the most recent decision on the distribution of profits or any of the actions in (2) (a), (b) or (c);
- Minus
- (c) amounts which would be payable by tax if the items specified in (a) and (b) were to be retained.
- (6) The factor in (4) shall be determined as follows:
- (a) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds requirement* under article 92(1)(c) of the *EU CRR* expressed as a percentage of the *firm's total risk exposure amount* is within the first (ie, the lowest) quartile of the *combined buffer*, the factor shall be 0;
- (b) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds requirement* under article 92(1)(c) of the *EU CRR*, expressed as a percentage of the *firm's total risk exposure amount* is within the second quartile of the *combined buffer*, the factor shall be 0.2;
- (c) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds requirement* under article 92(1)(c) of the *EU CRR* expressed as a percentage of the *firm's total risk exposure amount* is within the third quartile of the *combined buffer*, the factor shall be 0.4;
- (d) if the *common equity tier 1 capital* maintained by the *firm* which is not used to meet the *own funds requirement* under article 92(1)(c) of the *EU CRR* expressed as a percentage of the *firm's total risk exposure amount* is within the fourth (ie, the highest) quartile of the *combined buffer*, the factor shall be 0.6.

- (7) A *firm* must calculate the lower and upper bounds of each quartile of the *combined buffer* as follows:

$$\text{lower bound of quartile} = \frac{\text{Combined buffer}}{4} \times (Q_n - 1)$$

$$\text{upper bound of quartile} = \frac{\text{Combined buffer}}{4} \times Q_n$$

"Q_n" indicates the ordinal number of the quartile concerned.

- (8) The restrictions imposed by this *rule* only apply to payments that result in a reduction of *common equity tier 1 capital* or in a reduction of profits, and where a suspension of payment or failure to pay does not constitute an event of default or a condition for the commencement of proceedings for an order for the appointment of a liquidator or administrator of the *firm*.
- (9) If a *firm* does not meet the *combined buffer* and intends to distribute any of its distributable profits or undertake an action in (2)(a), (b) and (c), it must give the *FCA* not less than one *month's* notice before the intended date of distribution or action. When giving notice a *firm* must provide the following information:
- (a) the amount of *own funds* maintained by the *firm*, subdivided as follows:
 - (i) *common equity tier 1 capital*;
 - (ii) *additional tier 1 capital*; and
 - (iii) *tier 2 capital*;
 - (b) the amount of its interim and year-end profits;
 - (c) the *MDA* calculated in (4);
 - (d) the amount of distributable profits it intends to allocate between the following:
 - (i) dividend payments;
 - (ii) share buybacks;
 - (iii) payments on *additional tier 1 instruments*; and
 - (iv) the payment of variable remuneration or *discretionary pension benefits*, whether by creation of a new obligation to pay, or payment pursuant to an obligation to pay created at a time when the *firm* did not meet its *combined buffer*.

[Note: article 141(2) to (9) of *CRD*]



10.5 Capital conservation plan

10.5.1 **R** When a *firm* does not meet the *combined buffer*, it must prepare a capital conservation plan and submit it to *FCA* no later than five *business days* after the *firm* identified that it did not meet the *combined buffer*.

[**Note:** article 142(1) of *CRD*]

10.5.2 **R** The capital conservation plan must include the following

- (1) the *MDA*;
- (2) estimates of income and expenditure and a forecast balance sheet;
- (3) measures to increase the capital ratios of the *firm*; and
- (4) a plan and timeframe for the increase of *own funds* with the objective of meeting the *combined buffer*.

[**Note:** article 142(2) of *CRD*]

10.6 Application on an individual and consolidated basis

Application on an individual basis

- 10.6.1 **R** This chapter applies to a *firm* on an individual basis, whether or not it also applies to the *firm* on a *consolidated basis* or *sub-consolidated basis*.

Application on a consolidated basis

- 10.6.2 **R** A *firm* that is a *parent institution in a Member State* must comply with this chapter on the basis of its *consolidated situation*.
- 10.6.3 **R** A *firm* controlled by a *parent financial holding company in a Member State* or a *parent mixed financial holding company in a Member State* must comply with this chapter on the basis of the *consolidated situation* of that holding company in the *FCA consolidation group*.

Sub-consolidation of entities in third countries

- 10.6.4 **R** A *firm* that is a *subsidiary* must apply this chapter on a *sub-consolidated basis* if the *firm*, or the *parent undertaking* where it is a *financial holding company* or *mixed financial holding company*, have an *institution or financial institution* as a *subsidiary* in a *third country* or hold a *participation* in such an *institution or financial institution*.


[Note: articles 129(1) (part) and 130(1) (part) of CRD]

Extent and manner of prudential consolidation

- 10.6.5 **G** If this chapter applies to a *firm* on a *consolidated basis* on a *sub-consolidated basis*, the *firm* must carry out consolidation to the extent and in the manner prescribed in Part One, Title II, Chapter 2, Section 2 (Methods for prudential consolidation) and Section 3 (Scope of prudential consolidation) of the *EU CRR* and **IFPRU 8.1** (Prudential consolidation).




10.7 Exemption

10.7.1 **R** This chapter does not apply to a *firm* that meets the condition in  IFPRU 10.7.2 R.

[**Note:** articles 129(2) (part) and 130(2) (part) of *CRD*]

10.7.2 **R**

- (1) The condition referred to in  IFPRU 10.7.1 R is that the *firm* is a small and medium-sized *investment firm*.
- (2) For this purpose, a *firm* is categorised as small and medium-sized in accordance with the European Commission Recommendation 2003/361/EC concerning the definition of micro, small and medium-sized enterprises.

[**Note:** articles 129(4) and 130(4) of *CRD*]

