Consultation Paper

10/17***

Financial Services Authority

Strengthening Capital Standards 3 –

feedback to CP09/29, final rules for CRD2, and further consultation

July 2010

FSA®

Financial Services Authority

Contents

	List of acronyms used in this Consultation Paper	
1	Overview	7
	Part I – response to CP09/29	
2	Response to CP09/29	13
3	Summary of changes to our CP proposals	14
4	Hybrid capital	17
5	Large exposures	30
6	Securitisation	43
7	Trading book	56
8	Other feedback	66
9	Technical amendments	70
	Part II – further consultation	
10	Further consultation	75
11	Core tier one capital	76
12	Operational risk	86
13	Large exposures	88
14	Credit risk amendments – 0% risk weight for intra-group exposures under the standardised approach	89

Annex 1: Compatibility with our objectives and principles of good regulation
Annex 2: Areas of super-equivalence
Annex 3: List of national discretions
Annex 4: List of questions in this Consultation Paper
Annex 5: List of non-confidential respondents to the questions in CP09/29

Appendix 1: Final Handbook text
Appendix 2: 'Near final' Handbook text – Large exposures

Draft Handbook text
Appendix 3: CEBS guidance – Core tier one capital
Appendix 4: CEBS guidance – Operational risk
Appendix 5: CEBS guidance – Large exposures
Appendix 6: Credit risk amendments

The Financial Services Authority (the FSA) invites comments on this Consultation Paper (CP).
Comments should reach us:

- for CEBS guidance (Chapters 11 – 13) by 23 October 2010; and
- for credit risk amendments (Chapter 14) by 23 August 2010.

Comments may be sent by electronic submission using the form on the FSA's website at: www.fsa.gov.uk/Pages/Library/Policy/CP/2010/cp10_17_response.shtml

Alternatively, please send comments in writing to:

Wayne Riley
Prudential Policy Division
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS
Telephone: 020 7066 4552
Fax: 020 7066 4553
Email: cp10_17@fsa.gov.uk

It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure.

A confidential response may be requested from us under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.

Copies of this Consultation Paper are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

List of acronyms used in this Consultation Paper

ABCP	Asset Backed Commercial Paper
AGCC	Additional Going Concern Capital
AGM	Annual General Meeting
AMA	Advanced Measurement Approach
BBA	British Bankers' Association
BCBS	Basel Committee on Banking Supervision
BCD	Banking Consolidation Directive
BIPRU	Prudential sourcebook for Banks, Building Societies and Investment Firms
BSA	Building Societies Association
CAD	Capital Adequacy Directive
CBA	Cost-Benefit Analysis
CCR	Counterparty Credit Risk
CEBS	Committee of European Banking Supervisors
COREP	Common Reporting Framework
CP	Consultation Paper
CQS	Credit Quality Steps
CRD	Capital Requirements Directive
CRM	Credit Risk Mitigation
ECAI	External Credit Assessment Institution
EU	European Union

FSA	The Financial Services Authority
FSMA	Financial Services and Markets Act 2000
GENPRU	General Prudential sourcebook
IAA	Initial Assessment Approach
IFRS	The International Financial Reporting Standards
IRC	Incremental Risk Charge
IRB	Internal Ratings Based approach to credit risk
LGD	Losses Given Default
LLP	Limited Liability Partnership
NJS	Non-Joint Stock
ORTM	Other Risk Transfer Mechanism
PD	Probabilities of Default
PIBS	Permanent Interest Bearing Shares
PRA	Position Risk Adjustment
PS	Policy Statement
PWCE	Programme Wide Credit Enhancements
QIS	Quantitative Impact Study
RTC	Regulatory Transactions Committee
RWEA	Risk Weighted Exposure Amounts
SPV	Special Purpose Vehicle
SRT	Significant Risk Transfer
TP	Transitional Provision
TSA	The Standardised Approach to credit risk
UKIG	UK Integrated Group
VaR	Value-at-Risk

1 Overview

Introduction

1.1 In this Paper we provide feedback on the responses to Consultation Paper (CP) 09/29, changes to our rules for elements of CRD2[1] that were included in that consultation, and we consult further on additional CRD2-related credit risk material not included in CP09/29. We also consult on implementing the Committee of European Banking Supervisors (CEBS) guidance on core tier one capital, large exposures and operational risk, which were issued after CP09/29 was published.

Background

1.2 Various packages of changes were proposed to the Capital Requirements Directive (CRD[2]) quite close together, which the European Commission (the Commission) 'numbered' to avoid confusion and for ease of reference. CP09/29 dealt with two of these packages:

- 'CRD2' – This package was discussed during 2008, with all final agreements concluded by July 2009 under the relevant European legislative processes, and published in the Official Journal of the European Union on 17 November 2009. The necessary national laws, regulations and administrative provisions required for compliance must be made by 31 October 2010, to be applied from 31 December 2010.

1 'Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management'. In addition , the Commission has also adopted technical changes to the CRD in accordance with the comitology procedure. The technical changes to Directive 2006/49/ EC were adopted by the Commission on 7 April 2009 (Commission Directive 2009/27/EC amending certain Annexes to Directive 2006/49/EC of the European Parliament and of the Council as regards technical provisions concerning risk management). The technical changes to Directive 2006/48/EC were adopted by the Commission on 27 July 2009 (Commission Directive 2009/83/EC amending certain Annexes to Directive 2006/48/EC of the European Parliament and of the Council as regards technical provisions concerning risk management).

2 The CRD comprises two (amended) directives, the recast Banking Consolidation Directive 2006/48/EC (BCD) and the recast Capital Adequacy Directive 2006/49/EC (CAD). It was adopted by Council and European Parliament on 14 June 2006.

- 'CRD3[3]' – This package was the subject of consultation by the Commission during spring 2009 and its proposal began the legislative process in July 2009. Under its original timetable, as reflected in CP09/29, the relevant national laws, regulations and administrative provisions were to come into force by 1 January 2011. However, as a result of changes during this process, the CRD3 amendments are now required to be implemented by 31 December 2011 at the latest.

1.3 On 10 December 2009 we published CP09/29 on '*Strengthening Capital Standards 3*', which included our proposals for implementing the CRD2 and most of the CRD3 amendments to the CRD. The consultation's aim was to reflect strengthening of the European prudential regime in the CRD, address several lessons learned from the credit market turmoil and to follow up aspects of *The Turner Review* publications.

1.4 The consultation period closed on 10 March 2010.

1.5 In CP09/29 we said that we would consult in a different CP on CRD2 proposals to improve liquidity risk management, to the extent that further modifications were required to fully implement the new requirements. This was because we had already consulted on a new liquidity risk regime in CP08/22[4], and set out our final policy in Policy Statement (PS) 09/16[5] in October 2009. We have now considered our proposals against the CRD2 liquidity risk requirements, and in CP10/15[6] consulted on amendments to BIPRU[7] 12.3 and 12.4. The consultation closes on 13 August 2010.

1.6 We consulted on the CRD3 changes in CP09/29 although the EU Parliament had not yet voted on the final text, because we felt that including the CRD3 proposals in CP09/29 was the most efficient course of action and would prove useful in highlighting potential changes to industry. The legislative process has taken longer to conclude than originally expected. Therefore, although we provide feedback, we do not include the CRD3 final rules in this PS. We will clarify our plans for implementing the final CRD3 outcome, including any further consultation, as soon as practicable.

1.7 The CRD3 changes also include rules to tackle perverse pay incentives by requiring firms to have sound remuneration policies and practices that do not encourage or reward excessive risk-taking. We committed in PS09/15[8] to keep our domestic code on remuneration (Remuneration Code) under close review, to take account of future market developments and also of progress on international implementation. We will therefore be publishing a CP in 2010, to be followed by a PS which will lay out the amendments to the Remuneration Code so that it is in line with the new CRD3 remuneration requirements. The CRD3 rules on remuneration will come into effect from 1 January 2011.

3 'Directive amending Directives 2006/48/EC and 2009/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies'.

4 CP08/22: *Strengthening liquidity standards* – www.fsa.gov.uk/pubs/cp/cp08_22.pdf

5 PS09/16: *Strengthening liquidity standards including feedback on CP08/22, CP09/13, CP09/14* – www.fsa.gov.uk/pubs/policy/ps09_16.pdf

6 CP10/15: *Quarterly consultation no. 25* – www.fsa.gov.uk/pages/Library/Policy/CP/2010/10_15.shtml

7 Prudential sourcebook for Banks, Building Societies and Investment Firms.

8 PS09/15: *Reforming remuneration practices in financial services – Feedback on CP09/10 and final Rules* – www.fsa.gov.uk/pubs/policy/ps09_15.pdf

Who should read this Policy Statement and consultation?

1.8 This Paper starts with a short explanation of its context and purpose. The introduction sets out who should read this Paper, a summary of the policy and reporting changes and how these proposals will have an impact on small firms and consumers.

1.9 The Paper then comprises two main Parts. Part I focuses on comments made by firms on the proposals in CP09/29 and our responses to them.

1.10 Part II contains further consultation in relation to CRD2-related amendments – CEBS guidance concerning aspects of core tier one capital, large exposures and operational risk produced after the publication of CP09/29. We are also consulting on an amendment to the criteria for assigning a 0% risk weight under The Standardised Approach (TSA) to credit risk to certain intra-group exposures in the UK, which is being aligned to the definition of the large exposure's core UK group consulted on in CP09/29.

1.11 The contents of this paper apply principally to banks, building societies and certain investment firms caught by the CRD (see Chapter 2 of CP09/29, scope of application), and will be of particular interest to such firms and their advisers. There is also a particular change for firms who benefit from the capital requirements exemption for specialist commodity derivatives firms (see paragraph 1.70 of CP09/29).

Implementation date

1.12 In CP09/29 we suggested the CRD2 requirement that '[Member States] shall apply [the laws, regulations, etc] from 31 December may allow for our rules to come into force at the end of 31 December 2010, i.e. in effect they would apply from the beginning of 1 January 2011. This would have been consistent with the then proposed effective date for CRD3. However, after our consultation period had closed, the Commission advised Member States that it wished to see harmonised implementation and that the Directive should be interpreted as taking effect at the start of 31 December 2010. Having discussed this with the Treasury and taken soundings from other EU regulators and trade bodies, we have decided to follow the Commission's interpretation, and so we will make the final rules to commence with effect from the beginning of 31 December 2010. The soundings we have taken from the industry suggest that, although unwelcome, this change of implementation date will not create overriding operational difficulties for firms. We comment on the implications for firms in the cost-benefit analysis (CBA) section of each policy chapter.

Effects on reporting requirements

1.13 We have made several changes to the reporting requirement proposals consulted on in CP09/29 that are worth noting. These are as follows:

- Items related to CRD3 (for which we are not making the rules in this PS) have been removed from the versions of FSA005 and FSA046 we consulted on in

CP09/29, pending the finalisation of the Directive text and clarification of the implementation date.

- We have retained FSA058 (even though it was mostly relevant only to CRD3), as we are using it to capture information on retention. We considered removing the new form completely, but as we were making several other changes at the same time, it was more efficient to include it with the CRD2 changes.
- In FSA008 we have removed the requirement to report trading book concentration risk excesses (Part 3, Data Element 8). This information is less relevant now we have removed the concession that allowed third party trading book exposures to exceed the 25% large exposure limit.

1.14 Firms should note that the effect of the change for the CRD2 implementation date means that reporting on the amended forms will take effect for reporting period end dates on or after 31 December 2010.

1.15 The costs to firms of the proposed changes to the reporting rules were considered in CP09/29. An upper bound for these costs was estimated to be around £25,000 per firm. Most of the costs are expected to arise from production of the new FSA058 (the cost of amending forms FSA003, FSA005, FSA008 and FSA046 is expected to be around £25,000 across all firms affected for each of the forms). Some firms will need to bring the implementation of reporting changes forward by a couple of months to comply with the 31 December 2010 implementation date. If these firms have 3 months less to implement the changes, we expect the reporting costs estimated in CP09/29 to increase by around a third, which is by up to around £8,500 per firm affected.

1.16 The changes to the reporting requirements presented in this Paper are based on FSA-style[9] Data Items. However, as required by CRD2 Article 74, CEBS is currently consulting[10] on harmonised EU reporting guidelines so that 'competent authorities shall apply, by 31 December 2012, uniform formats, frequencies and dates of reporting'. So it is possible that we will need to make further changes in the future.

1.17 Firms are encouraged to respond to the CEBS CP by 16 September 2010 if they have views on harmonised capital adequacy reporting. In the meantime we have to implement CRD2 reporting changes by 30 December 2010, so we are doing that on our existing systems.

Smaller firms

1.18 We consider the following areas of this paper to be of particular relevance to smaller businesses:

- We have granted relief to smaller firms in our large exposure regime (interbank exposure limit). After considering the feedback received and reconsidering the costs and benefits of a reduced smaller firm exemption limit set at €100m, we

9 Our Integrated Regulated Reporting system – "GABRIEL".
10 www.c-ebs.org/Publications/Consultation-Papers/All-consultations/CP01-CP10/CP04-Revised-2.aspx

plan to alter our planned implementation and set the limit at €150m. Using the maximum discretion allowed for smaller banks could aid competition and have a positive effect on retail services provided to consumers.

- The CEBS guidelines on core tier one capital outline criteria that instruments should meet in order to be included within core tier one. We propose adopting these into our Handbook where our current rules and guidance do not meet the CEBS guidance provisions. An adjustment for mutuals is that we propose to allow non-joint stock companies to have a cap on the distributions of their instruments where the purpose of the cap is to protect reserves.

Consumers

1.19 This paper primarily focuses on meeting our market confidence objective by reducing the risks that banks and other financial market firms face, and improving stability in the financial sector in general. This improved stability is expected, in turn, to enhance consumer protection.

Next steps

1.20 The rule changes required to transpose CRD2 need to be made by 31 October 2010, and the final version of the bulk of the new Handbook text is set out in Appendix 1 to this statement. However, the rules which relate to the CRD2 changes in the large exposure regime are only presented in 'near final' form. This is because we are undertaking a one-month consultation on the criteria for allowing a 0% risk weight for intra-group exposures under TSA to credit risk. This work was highlighted in CP09/29 and is closely inter-twined with the large exposure intra-group provisions. While the consultation is still in progress, making the final rules for the rest of the large exposures changes now would not give Handbook users a clear view of the overall BIPRU 10 requirements. We give further details in Chapter 5.

1.21 Subject to responses to the credit risk amendments in the one-month consultation, we will put the final CRD2 rules in place in September 2010, along with making the final rules for the changes to the large exposures regime.

1.22 The various CEBS guidance proposals, if adopted, are not required for 31 October 2010. Therefore, we aim to provide feedback on the CEBS guidance proposals, subject to consultation, in Quarter 4 with final rules and guidance made in the FSA Handbook in December 2010.

1.23 The Basel Committee on Banking Supervision (BCBS) decided at its July 2009 meeting to extend beyond 2009 the rules on Basel I capital floors. Consequently, CRD3 also proposed to extend the capital floor rules until the end of 2011. We consulted on extending the transitional floors in Chapter 12 of CP09/20,[11] and will publish our conclusions and final rules with other CRD3 amendments as soon as practicable.

11 CP09/20: *Quarterly consultation (No.21)* – www.fsa.gov.uk/pages/Library/Policy/CP/2009/09_20.shtml

Part I

Response to CP09/29

2 Overview of responses to CP09/29

2.1 We received 27 responses from a mixture of banks, building societies, investment management firms, trade associations and other regulators.

2.2 Overall, respondents generally supported many of the proposals being implemented to the Capital Requirements Directive (CRD) through CP09/29 and stressed their appreciation of the dialogue we conduct with market participants to support our objectives.

2.3 However, many respondents agreed that the timing of implementation has to be aligned with the European timetable, particularly in relation to CRD3. Many would like to see an extended or staggered timetable for implementing the trading book requirements and grandfathering provisions for the new securitisation requirements. Firms would like further guidance regarding the relevance of the grandfathering arrangements for hybrid capital instruments in light of the recent BCBS Basel III and Commission's CRD4 consultations.

2.4 Respondents were also concerned with areas where we have been super-equivalent, for example restricting Special Purpose Vehicle (SPV) issues to the 15% hybrid bucket. Concern was also expressed where we had not applied certain national discretions, and also where we had made use of other national discretions, such as setting the large exposures inter-bank exemption limit at (the lower figure of) €100m for 'smaller' firms, which some felt will disadvantage them over their EU counterparts. The new intra-group large exposures regime, also an area of national discretion under the Directive, raised several queries.

2.5 The extended use of waivers within our large exposures and securitisation provisions was a concern felt by others and the notification process for Significant Risk Transfer (SRT) was opposed by some respondents.

2.6 The rest of Part I of this Paper is structured to follow the policy chapter order of CP09/29.

3 Summary of changes to our CP proposals

Introduction

3.1 We have considered all respondents' comments and made changes, set out below, to proposed policy where we thought prudent.

Hybrid capital

3.2 In response to respondents' feedback we have revised our proposal to require firms to obtain a legal opinion with regard to potential SPV cross-border risks. We have amended our requirement to state that firms will need to conduct an analysis of cross-border legal and operational risks and how they have been mitigated. We have also clarified the scope of the legal opinion on whether instruments meet the requirements for inclusion within hybrid capital and added guidance on how it should cover the requirement that a hybrid capital instrument should not hinder recapitalisation.

Large exposures

3.3 The large exposure rules and guidance are being deferred to the September board for making. This is because, before finalising the rules, we need to consult (in Chapter 14 of this Paper) on amendments to the 0% risk weighting of intra-group exposures under The Standardised Approach (TSA) for credit risk. This area references the same criteria as that used to exempt certain intra-group exposures from the large exposures limit, which we proposed to change in CP09/29. This further consultation will close in August. The feedback will be relevant to informing the final outcome as regards the criteria used for these intra-group provisions. We are therefore publishing 'near final' large exposure rules in Appendix 2 of this Paper; however any changes will be limited to the intra-group criteria only. Further detail is given in Chapter 5.

3.4 Most respondents did not agree with our proposal to set the 'smaller firm inter-bank exemption' limit at €100m. After considering the feedback received and reconsidering the costs and benefits of a reduced smaller firm exemption limit set at €100m, we plan to alter our planned implementation and set the limit at €150m.

3.5 Several respondents raised concerns regarding the new intra-group proposals. We have worked with members of the industry since CP09/29 was published to identify areas where the rules can be clarified. The 'near final' Handbook text has been revised to reflect these discussions. It also now includes an appendix of diagrams to assist users, together with updated large exposure requirements for non-EEA sub groups.

Securitisation

3.6 Several respondents raised concerns with the potential timing of our implementation of the CRD3 securitisation provisions. It was not our intention to implement the CRD3 requirements prior to the Directive being agreed. We have summarised the feedback received on the CRD3 amendments, but have not provided our detailed responses, or included final Handbook text. Now that the Directive is agreed, we will provide further feedback, re-consult as necessary, and make final Handbook text as soon as practicable.

3.7 Several respondents expressed concerns with our proposed notification approach for implementing the new CRD2 provisions in respect of SRT. We still believe that the notification approach is the most appropriate available to us. The new SRT provisions provide for a mechanistic approach to assessing SRT, and while meeting the mechanistic tests may result in firms taking capital relief commensurate with the credit risk transferred to third parties, we continue to believe that it is possible to satisfy the mechanistic tests and subsequently benefit from a disproportionate amount of capital relief relative to the amount of risk transferred. We therefore consider it important that we are notified of securitisation transactions so we can exercise an appropriate level of supervisory oversight over firms' assessment of SRT.

3.8 Respondents were also concerned with how the SRT waivers process would work in practice. We are discussing the operation of the waiver approach with the industry, in particular via the Securitisation Standing Group, to reach a common understanding of how the process will operate. We continue to believe that a waiver based approach is the most appropriate means of implementing the CRD2 provisions that provide for an alternative to the mechanistic approach for assessing SRT. The waiver approach will ensure a formal and consistent process is used to enable us to determine whether firms have appropriate policies and methodologies in place to assess SRT.

Trading book

3.9 Most concerns respondents raised were about the ongoing uncertainty surrounding the final content of the CRD3 amending Directive and ensuring the overall package is consistent with international agreements. We have therefore not included our proposed final CRD3 rules in this Paper and will provide further feedback and make final Handbook text, or re-consult should there be material changes, once we have had an opportunity to consider the final text agreed in Europe.

3.10 Firms have stated they do not require further detailed guidance in implementing a stressed Value-at-Risk (VaR) measure, implementing the Incremental Risk Charge (IRC) and the all price risk measure requirements. However, after reviewing their responses to our CP and CRD3 implementation questionnaire, and after our bilateral and multilateral discussions with firms, we believe firms would benefit from some general guidance. We will supply further detail on the outcome of this exercise in the subsequent CP for CRD3.

Other changes

3.11 Some respondents were concerned about overall proposals to the CRD3 prudent valuation framework. While in many cases valuation for regulatory purposes will be expected to be the same as for financial statement purposes, the prudent valuation requirements have provided a mechanism where additional adjustment to valuations for prudential purposes might also be required. We note that certain respondents appeared unaware of the potential consequence of the existing framework that regulatory valuations may, if required, be more prudent than those used for audited financial statement purposes. Therefore we believe the proposals do not constitute a significant extension or reinterpretation of the existing framework. Final CRD3 rules will be made once we have had opportunity to consider whether the final CRD3 text requires any further changes.

3.12 We intend to continue with our copy-out approach to implementing Pillar 3 requirements.

Technical amendments

3.13 We have made the following changes to the proposals for technical amendments in CP09/29:

- Counterparty Credit Risk (CCR) (CRD2) – minor typographical error corrected;
- CCR (CRD3) – not implementing the CRD3 changes in this PS; and
- the Standardised Approach (TSA) to credit risk – the changes relating to the 'treatment of exposures to regional and local governments', are not being included as final CRD2 rules in this PS as they were inadvertently positioned as CRD2 amendments. We can confirm that they are part of the CRD3 package.

4 Hybrid capital

4.1 We consulted in Chapter 3 of CP09/29 on implementing the CRD2 amendments in respect of 'hybrid' capital and the Committee of European Banking Supervisors (CEBS) associated draft guidance on hybrid capital instruments.[12] We received 16 formal written responses from banks, building societies and trade associations.

4.2 The key issues respondents raised were:

- the grandfathering of instruments following further developments in the definition of capital that formed part of a BCBS Consultation Document[13] published on 17 December 2009;
- the restriction of hybrid capital issued via an SPV to the 15% hybrid tier one bucket; and
- the requirements for legal opinions on cross-border legal risks associated with issuance of hybrid capital via a non-UK SPV and on an instrument's eligibility as hybrid capital.

4.3 Several respondents expressed concern that the BCBS Consultation Document had created uncertainty as to whether instruments would be grandfathered when final BCBS proposals were implemented in the EU as part of the expected CRD4 package of changes. In particular, the statement in the BCBS consultation that only instruments that had been issued 'prior to the implementation of the consultation document' would be eligible for grandfathering appeared to contradict the grandfathering provisions in the CRD2 amendments. One respondent commented, for example, that more guidance was needed to 'unblock the currently frozen issuance market'.

4.4 We note respondents' concerns about the relationship between the grandfathering of instruments under the CRD amendments and the BCBS proposals. This issue was not part of our consultation, as our proposals implement the grandfathering provisions contained in the CRD2 amendments – and we have not amended these

12 CEBS' guidelines were finalised and was published in December 2009. *Implementation Guidelines for Hybrid Capital Instruments*, Committee of European Banking Supervisors, 10 December 2009 – www.c-ebs.org/documents/Publications/Standards---Guidelines/2009/Hybrids/Guidelines.aspx

13 *Strengthening the resilience of the banking sector – consultative document*, Basel Committee on Banking Supervision, December 2009. – www.bis.org/publ/bcbs164.pdf?noframes=

provisions following the responses to this consultation. We cannot comment further at this stage about grandfathering under the BCBS proposals. This is because the BCBS is considering its proposals in light of the responses to its consultation and Quantitative Impact Study (QIS). We are fully engaged in the work of the BCBS and expect its proposals to be finalised by end-2010.[14]

4.5 Most respondents did not agree with our proposal to restrict SPV issuances to the 15% hybrid tier one bucket. This was because they argued that such an approach would have cost implications for firms that would put them at a competitive disadvantage compared with non-UK EEA banks. We have considered the points raised by respondents. However, based upon the results of our cost-benefit analysis (CBA) for CP09/29, which was conducted on the basis of a 15% restriction, and our views set out below, we continue to consider it appropriate to limit SPV issues to the 15% hybrid tier one bucket. We may revisit this decision, if appropriate, dependent on the outcome of the BCBS proposals and CRD4.

4.6 In response to respondents' feedback we have, however, revised our proposal to require firms to obtain a legal opinion with regard to potential SPV cross-border risks. We have amended our requirement to state that firms will need to conduct an analysis of cross-border legal and operational risks and how they have been mitigated. This may or may not be in the form of a legal opinion. We have maintained the requirement for a legal opinion on whether instruments meet the requirements for inclusion within hybrid capital. The purpose of this legal opinion is to ensure that instruments meet the new eligibility requirements for hybrid capital. We have, however, clarified the scope of this legal opinion and added guidance on how it should cover the requirement that a hybrid capital instrument should not hinder recapitalisation.

4.7 We set out below a summary of the written replies that we received to individual questions together with an indication of how we intend to respond to the matters raised. This includes further detail on the SPV issue that is summarised above.

Special purpose vehicles: restriction to 15% hybrid tier one bucket

4.8 In CP09/29, we proposed to restrict hybrid instruments issued by SPVs to the 15% hybrid tier one bucket, which is consistent with the current limit on SPV issuances. We noted that this proposal was super-equivalent to the CRD2 requirements. To address the CEBS guidelines that firms must demonstrate they have mitigated legal risks, we proposed to add a requirement to our rules that firms should obtain a legal opinion on cross-border legal risks.

> Q1: Do you agree it is appropriate to restrict SPV issues to the 15% hybrid tier one bucket?

4.9 None of the respondents to this question agreed that it would be appropriate to restrict SPV issues to the 15% hybrid tier one bucket. The main reason that respondents gave for this was that restricting UK firms to the 15% bucket would put them at a competitive disadvantage versus non-UK EEA firms. This was because

14 The BCBS noted in *Strengthening the resilience of the banking sector* (paragraph 10) that 'the fully calibrated set of standards will be developed by the end of 2010'.

one impact of this policy would be to limit the tax-deductible instruments that firms could include within hybrid capital, thereby increasing costs for firms. In addition, some respondents commented that SPV issuances were not restricted as part of 'additional going concern capital' (i.e. non-core tier one capital) proposed in the December 2009 consultation from the BCBS. A further argument made by one respondent was that, in a crisis, SPV issuances were no less loss-absorbing than direct issues.

4.10 Respondents also commented on the operational and legal risks that led to us proposing a 15% limit on SPV issues. One respondent argued that SPVs should be permitted outside 15% if there is evidence that operational and legal risks are similar to these in a direct issue. A further respondent believed this could be achieved by a firm's supervisors reviewing the risks to ensure there were clear unwind procedures, which could be supported by an independent legal opinion. Another respondent commented that SPVs were widely used and accepted in other financing vehicles that we permitted, including securitisations.

4.11 Several respondents also expressed concerns at the proposed requirement for a legal opinion on how cross-border legal risks had been mitigated where the SPV was based in a non-UK jurisdiction. The concerns were that firms would, in practice, be limited to issuing in the UK, as it would not be possible to obtain a legal opinion on the adequacy of the mitigation of cross-border legal risks. Respondents argued that this would limit the investor base, as English limited partnerships may not be able to be listed, and this may increase costs.

Our response: We considered the issues of cost and the associated potential for a competitive disadvantage from restricting SPV issues to a 15% limit in our consultation. (We estimated an 'upper bound' estimate of £1.1bn relating to the opportunity costs of such a restriction.) We also note that the BCBS proposes to restrict SPV issuances within Additional Going Concern Capital (AGCC) to instruments where the on-loan is in the form of the same or better quality capital. This will effectively remove the benefits of issuing capital instruments via SPVs. And the level of AGCC has yet to be calibrated.

We will continue to restrict SPV issues to the 15% hybrid capital bucket. However, we will review this decision in due course against the European implementation of the BCBS proposals in the proposed CRD4 package.

We note the points made by respondents regarding the potential operational and legal risks that mean that SPV issues may not work in the same way as equivalent direct issues. Our concern is that allowing a higher limit could pose increased potential legal and operational risk. Investors may find themselves able to claim on the SPV's assets, which is often a subordinated loan to the parent company and not a tier one instrument. The SPV's trustees may not act quickly enough, may be bound to act in accordance with local law or regulation that is contrary to expectation, or may frustrate the conversion of the structure in the event of the trigger being breached.

As these potential risks exist, we still believe it is appropriate to limit SPV issues to the 15% hybrid capital bucket.

In terms of cross-border risks, our main concern is to ensure that SPV issues can unwind and become direct issues without any potential legal risks or operational difficulties. However,

the most appropriate way of analysing these risks or difficulties may not be by obtaining a legal opinion. So, we have amended our proposed rule to state that firms will need to conduct and record an analysis of these risks and the ways they have been mitigated, but this does not need to be in the form of a legal opinion. However, it may still be appropriate for firms to obtain their own legal opinion as part of this analysis.

Loss absorbency

Q2: Loss absorbency mechanism – what practical issues do you foresee in structuring securities with conversion or write-down features?

Issuing additional shares

4.12 One method of loss absorbency is for a non-core tier one instrument to be able to convert into a fixed or unlimited number of ordinary shares (or, for mutuals, other core tier one instruments). Several respondents commented on the practical issues of issuing more ordinary shares such as:

- the existence of pre-emption limits;
- the need to obtain Annual General Meeting (AGM) approval for allotting equity shares;
- the dilution effect being unfavourable to existing shareholders; and
- increasing the corporate governance burden on issuance by reducing issuer flexibility around market access.

Our response: As recommended in the CEBS guidelines, the instrument should either convert into core tier one (i.e. equity) or the principal value should be written-down. If the instrument is designed to convert into equity, firms must have the necessary arrangements in place to ensure they have the additional authorised shares available so the conversion can take place.

Subordination issues and loss-sharing between hybrid and equity holders

4.13 A consequence of the fixed conversion mechanism is that the investor suffers the downside risk *pari passu* with ordinary shares between the time of issue and conversion. Some respondents stated this was inconsistent with the principles of subordination, where ordinary shareholders absorb losses ahead of subordinated debt holders. This is because subordinated debt holders do not share in the upside and so require certain limited protection in relation to the common equity holders who participate in the upside.

4.14 One respondent argued that suspending dividend stoppers could lead to a situation where core tier one capital holders receive a coupon payment while hybrid capital holders suffer both non-payment of coupons and write-down of principal. Other respondents stated our proposals were not in line with the CEBS guidelines. They commented that their interpretation of the guidelines was that during the write-down period the coupon should be cancelled and dividend stoppers and

pushers should operate in a way that places the hybrid holders *pari passu* with the shareholders or holders of instruments referred to in Article 57(a).

Our response: If subordinated debt holders receive shares that are of a lower value than the amount they paid in, they would absorb losses alongside ordinary shareholders. This would be because the relative subordination is effectively switched off at the trigger point. The amount of loss absorbed would depend on the conversion rate. Regarding the comment that suspending dividend payments includes suspending dividend stoppers is not in line with CEBS proposals, the CEBS guidelines[15] state that 'during the write-down period, the coupon should be cancelled and dividend stoppers and pushers should operate in a way that places the hybrid holders *pari passu* with the shareholders or holders of instruments referred to in Article 57(a)'. The purpose of not paying a coupon during a write-down period is to ensure that hybrid capital does not hinder recapitalisation by receiving a coupon. Hybrids remain *pari passu* with ordinary shares, as they receive a share of future profits. This means their value is being increased towards par, which is the level at which they would again be eligible for a dividend. This does not preclude dividends being paid on ordinary shares, as such distributions would constitute part of the future profits belonging to ordinary shareholders.

Investor base

4.15 Several respondents commented on the potential investor base for hybrid capital instruments. In particular, some argued there was a need to provide clarity to ensure that investors understand the risks such as the market reaction to conversion and how that might contribute to a further deterioration of a firm's capital position, as a conversion was only likely to occur in an emergency situation. On this theme, a further comment was that hybrid capital instruments may be difficult for investors to price or risk-manage, so it may not be in the interests of orderly financial markets to encourage the development of this investor base.

4.16 A further set of comments noted that fixed-income investors such as pension funds, insurance groups and other real money investors, who are long-term holders of instruments, are the main investors in current hybrid instruments. As such, fixed-income funds may be unable to invest in instruments that could convert into equity and the introduction of equity-linked hybrids could reduce this traditional investor base.

Our response: We note the comments made by respondents about the potential investor base for hybrid capital. However, our proposals incorporate the terms of the CRD2 amendments and related CEBS guidelines into our Handbook and so are not designed to be tailored to the risk appetite of any particular set of investors.

Accounting and tax issues in relation to gains and losses with write-down

4.17 A number of respondents highlighted practical issues relating to accounting and tax, particularly in relation to gains and losses arising from writing-down the capital instrument. For example, they noted that any gain from a debt write-down would flow into extraordinary gains and losses in the profit and loss account on a solo and consolidated basis. This would reduce the efficiency of the loss absorption mechanism for the issuer.

15 Paragraph 114(b)

4.18 Another comment was that temporary write-down (i.e. with the option to write back up) may not be recognised under the International Financial Reporting Standards (IFRS) accounting standards. This is because the contingent nature of the adjustment means the offset for losses that would be provided by writing down the principal of the liability occurs only if the write-down is permanent. However, CEBS' guidance considers write-up from future profits as an appropriate loss-absorbency mechanism. This means that an asymmetry between the regulatory requirement and accounting rules may exist, as IFRS accounting rules would not allow a reduction in the liability when such write-back features are included.

4.19 Respondents also noted that issuers seeking to hedge interest rate risk on issued capital, who choose to fairly value the capital for interest rate movements, are likely to unwind the hedge for interest rate risk if a write-down is triggered. This is because interest would only be paid on the reduced nominal going forward, while the current accounting treatment would require any gain or loss on the hedge to be taken to the profit and loss account, so reducing or increasing the gain on write-down.

Our response: We note this helpful feedback on potential accounting issues. We are undertaking further work in this area and intend to provide additional commentary on this at a later date.

Mutuals

4.20 Respondents from non-joint stock (mutual) organisations commented that formal principal write-down of Permanent Interest Bearing Shares (PIBS) is unnecessary, because of loss-sharing between the instrument and general reserves. They also argued it was not clear what type of core tier one instrument the contingent capital could convert into that would both be marketable and recognised by us as core tier one.

Our response: We consider that PIBS do not have a mechanism to enable the principal amount to absorb losses in a going concern and not hinder recapitalisation. So, traditional PIBS currently in issue will not be eligible under the CRD amendments. However, we note the comments made by mutual organisations and are fully supportive of the mutual industry's efforts to develop a marketable core tier one instrument into which hybrid instruments could convert.

Triggers

4.21 CP09/29 proposed that, for all hybrids, the trigger for the write-down or conversion mechanism should, at the latest, be where a significant deterioration in the firm's financial or solvency situation is reasonably foreseeable or on a breach of capital requirements. For the 50% hybrid bucket, the proposed trigger was an emergency situation or the regulator's discretion.

4.22 It was proposed that the terms of the hybrid instruments give the firm discretion to activate the loss-absorption mechanism. The draft amendments to GENPRU[16] set out the circumstances when a loss-absorption mechanism may or must be operated by the firm:

16 GENPRU: General Prudential sourcebook.

- For the 50% bucket, the mechanism must be operated by the firm during the pre-defined emergency situation, and may in addition be converted by the firm or the holder at any time.
- For all buckets, the terms of the instrument must enable the firm, at and after the trigger points, to operate the mechanism.

Q3: Trigger for activation of loss absorbency mechanism – Do you agree that in order for the mechanism to be effective in supporting the firm's core capital in times of stress the trigger needs to be activated at the discretion of the firm?

4.23 All respondents favoured a trigger that is clearly and transparently defined from the outset, and documented in the terms of the hybrid instrument. Respondents argued that this would widen the investor base for such instruments.

4.24 Some respondents were in support of giving firms discretion not to activate the mechanism after the trigger point. This gives the firm leeway to take other remedial actions to address its problems to the regulator's satisfaction. Nevertheless, the majority of respondents expressed concerns over the degree of discretion given to both firms and the regulator in the trigger process. Stated concerns focused on three areas:

- discretionary trigger activation may prevent the rating of the instruments, complicate their pricing and/or reduce their marketability;
- discretionary activation could introduce a perception of moral hazard; and
- the draft rules require a prudent trigger, which should include the firm's capital resources requirement as the latest trigger point, but without specifying what constitutes prudence in this context.

4.25 One respondent highlighted the risk of the trigger activating a loss of confidence and liquidity freeze. The respondent argued that such a risk may apply even if conversion or write-down is based on a 'reasonably foreseeable' event as stated in the draft rules (GENPRU 2.2.117B R), with the activation of the trigger itself becoming a destabilising event.

Our response: The CEBS guidelines set out the key aspects of the trigger features for loss absorption mechanisms. Paragraph 115 of the guidelines states that 'the issuer or the competent authority shall be able to operate the mechanisms when losses lead to a significant reduction of the retained earnings and other reserves with a consequence of causing a significant deterioration in the solvency level – which does not necessarily mean a breach of the required solvency level – expressed in terms of an original own funds ratio or any other relevant ratio that the issuer must maintain to be viable'. We would note that the rules only require the terms of the instrument to give us the power of conversion in the 50% hybrid bucket. We would need to use our powers under section 45 of the Financial Services and Markets Act 2000 (FSMA) to require conversion for instruments in the 15% and 35% hybrid buckets. In addition, paragraph 116 of the guidelines states that, when the trigger is about to be reached, the issuer and the regulator have discretion to consider what measures to take to restore the issuer's financial situation and whether to activate the loss absorption mechanism as part of those measures.

While the degree of discretion given to both the firm and the regulator in the rules flows directly from the CEBS guidelines, we note the reservations expressed by respondents with regard to the need for clear and transparent trigger mechanisms. This is something that we are currently considering in the context of the ongoing work on contingent capital and the use of conversion/write-down features in BCBS and the CRD4 amendments to follow.

Handbook text

Q4: Is the draft Handbook text for GENPRU 2.2 clear? Is any further guidance needed?

4.26 There were seven responses to this question, which sought clarification on various points in the draft proposed rules. Most of these requests for clarification questioned or challenged the policy decisions upon which the rules are based rather than the clarity of the rule/guidance itself. One respondent submitted suggested changes to several rules; we have considered this carefully and amended the rules where we considered appropriate. Please see below our responses to the key points raised by respondents on particular rules.

Loss absorbency of tier one capital (GENPRU 2.2.9 G)

4.27 We proposed an amendment to this guidance to clarify that tier one capital should be 'available when required', as well as permanent. One respondent sought clarity about the meaning of the phrase '…(or in the case of a BIPRU[17] firm) available when required' in this proposed guidance and whether it covered convertible capital instruments.

Our response: The clarification of 'or in the case of a BIPRU firm' was added to explain the scope of the amendment. This is because, while the CRD2 amendments apply to banking and credit institutions, they do not apply to other types of firms to which the rules and guidance of GENPRU 2 apply (i.e. insurers). The change to the Handbook guidance to add that tier one capital should be 'available when required' reflects the fact that, while under CRD2 hybrid (tier one) capital can be dated, it must also be available to absorb losses. This is a point of introductory guidance to tier one capital in general, and we believe the rules that follow make the treatment of tier one instruments clear.

4.28 Another respondent suggested that the guidance should read 'remains available' rather than 'is available'.

Our response: We have considered this suggested amendment carefully and have determined that 'is available' is appropriate in this case.

Dividend stoppers (GENPRU 2.2.68A R (1))

4.29 We included this proposed new rule to prohibit dividend stoppers, which reflects CEBS guidelines. One respondent suggested that these rules should say 'the capital instrument contains a dividend stopper' rather than 'the capital instrument is affected by a dividend stopper'.

17 BIPRU: Prudential sourcebook for Banks, Building Societies and Investment Firms.

Our response: Dividend stoppers are not always explicit within the terms of an instrument. Indeed, they may not be included within the terms of that instrument at all, but within the terms of other instruments that affect how the hybrid capital instrument operates. Therefore, we believe the word 'affected' deals more precisely with the mischief that this rule aims at preventing.

Payment of coupons (GENPRU 2.2.69D G (2))

4.30 We added proposed guidance to new rules on the payment of coupons to clarify that any coupon payment made in the form of core tier one capital (a 'substituted payment') should be made without delay. One respondent suggested that 'without delay' should be replaced with 'in a timely and reasonable manner'.

Our response: We have considered this suggested amendment carefully but will retain 'without delay' in order to mirror the language of the CEBS guidelines.

Payment of coupons (GENPRU 2.2.69D G (3))

4.31 We also added proposed guidance to our rules on the payment of coupons making it clear that a firm would not be committed to find investors for any coupons payments made in the form of a substituted payment. Two respondents questioned whether this fetters the firm's ability to sell these instruments – one asked whether 'not being committed to finding new investors' precludes a voluntary arrangement to find new investors where the hybrid investors would bear the risk of such new investors not being found.

Our response: The firm should be under no obligation, either express or implied to find new investors. So, for clarity, we have amended to rule to say 'the firm is not obliged'.

Redemption of tier one instruments (GENPRU 2.2.70A G and GENPRU 2.2.114 R)

4.32 We proposed added guidance on incentives to redeem, stating we considered step-ups and principal stock settlement mechanisms, in conjunction with a call, to be incentives to redeem. A respondent argued that the existence of a call option with no interest rate step-ups or principal stock settlement is not an incentive to redeem.

Our response: We note the point made by this respondent, but we do not intend to give further guidance in our Handbook on features that do not appear to be an incentive to redeem. However, we would note that in most circumstances we would not regard a 'pure call', i.e. a call not in conjunction with a feature such as a step-up, as an incentive to redeem.

Dated tier one instruments – lock-in mechanism (GENPRU 2.2.74B R)

4.33 We proposed a rule to confirm that a BIPRU firm that was in breach of its capital resources requirement should suspend the repayment of its dated tier one instruments. A respondent suggested that the word 'suspend' should be replaced with 'defer'.

Our response: We have considered this suggested amendment, but we have decided to continue to use the word 'suspend', as that is the term used in the CEBS guidelines.

Repurchases of tier one capital instruments (GENPRU 2.2.79A R and 2.2.79B G)

4.34 We added proposed rules and guidance on repurchasing tier one instruments. These stated that a firm should not repurchase a tier one capital instrument until on or after the fifth anniversary of its issue, although it may apply for a waiver in exceptional circumstances. Two respondents asked that such buybacks should be allowed prior to the instrument's fifth anniversary without the requirement to submit a waiver application.

Our response: A fundamental requirement of the capital quality for tier one is permanence or availability when needed. Repurchases within five years of the instrument's issue date could undermine that principle and the capital position of the firm. In addition, the CEBS guidelines state that repurchases should not take place before five years and then only subject to obtaining prior supervisory approval. So, we consider that any repurchases before five years must be subject to supervisory scrutiny in the form of a waiver and that it would be imprudent to apply a different approach.

Repurchases of tier one capital instruments – temporary holdings for market making purposes (GENPRU 2.2.79D R (1) and (2))

4.35 We proposed a rule to clarify that temporary holdings for the purpose of market making would not be subject to the repurchase rules in certain circumstances. We also proposed limits within which such holdings would not be regarded as repurchases. One respondent suggested that this rule should be amended to say 'for a temporary period for the purpose of market making'. In addition, another respondent asked why we had proposed a limit of 5% of the relevant issuance to the firm's purchase of its own instruments, while the final CEBS guidelines had proposed a higher limit of 10% of relevant issuance or 3% of the total outstanding.

Our response: There are risks to firms in making markets in their own shares and, as explained in our consultation, firms wishing to do so must have adequate policies in place taking into account market abuse rules and regulations. We have amended the proposed rule to make it clear that this applies to temporary holdings for the purposes of market making. We have also amended the rule to reflect the final CEBS guidelines, which proposed a limit of 10% of the relevant issuance or 3% of the total outstanding on repurchases that would require our approval. Our proposed limit of 5% on repurchases was based on the draft CEBS guidelines, which were amended in the final version.

Repurchase of tier one capital instruments – one month's notice requirement (GENPRU 2.2.79G R)

4.36 We proposed a rule requiring firms to give us one month's notice of any proposed repurchases. Two respondents challenged this proposed rule – one suggested that the one month's notice requirement was super-equivalent, as it is not explicitly required under the CEBS guidelines, while the other sought flexibility in terms of the length of notice.

Our response: The CEBS guidelines state further that 'redemptions should be subject to strict conditions and to prior supervisory approval'. The procedure that we have put in place

of a month's notice will allow us to consider whether we wish to object to a repurchase in line with these guidelines. So, we do not agree that our approach is super-equivalent to the CEBS guidelines.

Loss absorbency – calculation of number of instruments to be issued in conversion (GENPRU 2.2.117A R (5)(c)(i))

4.37 We outlined the requirements for determining the number of instruments into which a hybrid instrument must convert. A respondent suggested that the wording of this rule be amended to 'be determined by the market value of those other instruments at the time of its issue' (rather than 'at the date of its issue') as this would give more flexibility for averaging over a volatile market period.

Our response: We have not changed the text here, as the number of instruments should be determined at a specific date. However, if issuers find in practice that volatile markets at the time of a proposed issue do cause difficulties they should discuss this with us in advance of the issue.

Reporting

Q5: Are the proposed changes to FSA003 clear? Is any further guidance needed?

4.38 All respondents agreed that the proposed changes to reporting in FSA003 were clear and most that no further guidance was required. However, the following points were raised.

4.39 One respondent considered that the guidelines regarding the grandfathering of tier one instruments were not clear. In particular, the respondent asked whether the total tier one number used to compute instruments ineligible for grandfathering was based on a 'static' total tier one limit as at the implementation date or a dynamic limit that may change each year after implementation.

4.40 Another respondent suggested that the proposed reporting changes should be delayed to take into account forthcoming proposals on the definition of capital from the BCBS.

Our response: The maximum amount of instruments that can be grandfathered within tier one capital will be determined at the implementation date based on current limits. The amount of grandfathered instruments eligible for inclusion within tier one capital based on those limits could decline during the grandfathering period. However, if the amount eligible for inclusion within tier one capital subsequently increased during the period, it could not exceed the amount eligible for inclusion in tier one capital on 30 December 2010.

We do not agree that we should delay implementing FSA003 reporting changes resulting from the implementation of CRD2. Changes as a result of the BCBS's forthcoming definition of capital proposals, which are likely to be implemented by the EU as CRD4, and any consequential reporting changes arising from them will be part of any future consultation on the implementation of CRD4.

Cost-benefit analysis

Q6: Has the CBA identified the relevant costs and benefits and have the costs been appropriately estimated?

4.41 We received several responses to our CBA. Following those responses, we do not consider it necessary to amend that CBA. However, we outline below the feedback that we received and our response to the points raised by respondents.

4.42 When constructing the CBA, we provided upper bound/maximum cost estimates due to the current uncertainty in the market with regards to capital. One respondent enquired as to why the CBA assumed that firms would replace instruments with an incentive to redeem within the first ten years (i.e. to 2020) rather than taking advantage of the thirty-year grandfathering provision included in the CP.

Our response: As we intended to capture the theoretical maximum in terms of costs, we assumed that firms would replace all current capital with an incentive to redeem by this date, especially as most of the instruments in issuance include a call date at the latest of ten years from issuance. This assumption was based on the fact that current market practice is for firms to redeem instruments with an incentive to redeem at their first call date, and such an assumption provides an upper bound estimate of the costs. Our statement was not intended to indicate that we would expect firms to call at the step-up date in all circumstances.

4.43 Some respondents questioned the rationale for using historical equity market returns from the past 40 years to calculate an estimated market risk premium. Their concern was that such historical returns would not act as a proxy for future returns due to the potential difference in economic circumstances.

Our response: We note the point made by respondents. However, we consider that the period (40 years) is long enough to form a reasonable assumption about equity market returns.

4.44 Some respondents felt that CBA did not incorporate all the firm-specific costs associated with the proposals, in particular, the costs associated with developing a new compliant instrument and the firm-specific cost of ordinary equity.

Our response: Our cost estimates were calculated for the market as a whole. Our view is that it is reasonable to use a market index to calculate the equity risk premium. Costs associated with the development of a new compliant instrument are non-capital compliance costs that were found to be negligible in the CBA.

4.45 A respondent raised some specific comments with regards to instruments for the mutual sector (PIBS). These included commentary on the limited and smaller market for mutual capital instruments and the resulting higher coupon that would need to be offered.

Our response: The CBA equated loss absorbent PIBS to equities and traditional PIBS to gilts. However, it is unlikely that investors will regard loss absorbent PIBS as being as risky as ordinary shares and, moreover, traditional PIBS are riskier than gilts. It is therefore highly likely that the actual costs incurred will be below the estimate as stated in the CBA.

Change in CRD2 commencement date

4.46 As set out in Chapter 1, CRD2 rules will now apply at the start, not the end, of 31 December 2010. We believe there will be no substantive impact on the definition of capital changes (hybrids, 57a and related CEBS guidance) resulting from this change.

5 Large exposures

5.1 CP09/29 described changes to the large exposures regime. Some of these dealt with amendments made to the mandatory requirements of the CRD, while others described our proposed implementation of various national discretions.

5.2 In addition to the responses received on the specific questions in our consultation exercise, we invited respondents to provide comments and feedback on the revised BIPRU 10 Handbook text on large exposure requirements. We received a range of comments and have taken them into account in our review of the text.

5.3 Where it is practical and compatible with the CRD, we have aligned the implementation date of the new provisions with the beginning of the new calendar year. Provisions which come into force at the start of 31 December 2010 have been highlighted in the relevant sections below.

5.4 The BIPRU 10 Handbook text is presented as 'near final' in Appendix 2. We cannot present final Handbook text while changes to the criteria for 0% risk weighting of intra-group exposures under the BIPRU 3 TSA to credit risk are being consulted on (see Chapter 14). It is important to present final Handbook text for BIPRU 10 only after the consultation has concluded due to BIPRU 10's structure, the interaction between the proposed BIRPU 3 changes and the criteria for the core UK group in BIPRU 10.8, and the consequent benefit in having clear readability of the large exposures rules as a whole. We aim for the final version of BIPRU 10 to be published in September.

5.5 Only the criteria for the core UK group in BIPRU 10.8 is linked to the BIPRU 3 consultation. No other parts of BIPRU 10 could change as a result of that consultation. Where necessary, firms are encouraged to apply early for waivers, as they can be considered based on the 'near final' rules in the BIPRU 10 text in this publication.

Exemption for 'limited licence' and 'limited activity' investment firms

5.6 In CP09/29 we explained that the amendments to the CRD introduced an exemption from the large exposure regime for 'limited licence' and 'limited activity' investment firms.

Q7: Do you agree that we should implement this exemption (if we do not implement this exemption we would be super-equivalent)?

5.7 We received a number of replies to this question indicating broad support for implementing the exemption.

5.8 One respondent sought clarity over any notification process firms needed to go through to make use of the exemption.

Our response: We plan to keep to our proposals and implement this exemption. No notification is needed to make use of the exemption which comes into force at the start of 31 December 2010.

Removal of the 'inter-bank exemption'

5.9 CP09/29 proposed implementing a key change made to the CRD relating to the removal of the current 'inter-bank exemption'. This allows for exposures to institutions with a maturity of one year or less to be exempt from the large exposure limit.

5.10 CP09/29 also discussed the 'smaller firm exemption' which offers some firms a degree of relief in this area. The exemption allows firms to have exposures to other institutions greater than 25% of their capital resources, as long as the exposure is below €150m. We proposed to use a national discretion to set the exemption limit at €100m instead of €150m.

Q8: Do you agree that setting a lower limit for the smaller firm exemption is both prudent and will reduce financial contagion in the banking sector?

5.11 Most respondents to this question did not support the implementation of a lower limit.

5.12 A common reason cited by respondents was the potential increase in credit risk that could result from any further diversification of counterparties as a result of setting a reduced exemption limit. Another frequently cited reason was the possibility that a lower limit would hinder the competiveness of smaller banks.

5.13 Other responses to this question raised issues concerning firms' ability to use the smaller firm exemption to extend individual exposures in excess of 100% of their capital base. Our proposals allow firms to do this after being granted a waiver. Respondents queried why the waiver process was necessary and suggested we were being super-equivalent in our proposals.

5.14 One respondent also questioned if there was a transitional provision in relation to the removal of the inter-bank exemption.

Our response: After considering the feedback received and reconsidering the costs and benefits of a reduced smaller firm exemption limit set at €100m, we plan to alter our proposed implementation and set the limit at €150m.

We plan to allow firms using the smaller firm exemption to extend exposures in excess of 100% of their capital base only after a waiver has been granted to that firm. The

CRD text says that competent authorities may allow the 100% limit to be exceeded 'on a case-by-case basis'. In light of this, we have decided to rely on the waiver process. Such waivers will generally apply to all relevant exposures of that firm. Each waiver granted will be subject to an expiration date and may also include conditions particular to that individual firm taking into account all relevant circumstances.

It is important for interested parties to understand the regime a regulated firm operates under and the waiver process allows for this transparency. In addition, we may not believe it is appropriate to allow certain firms to extend large exposures in excess of their entire capital base. The waiver process will allow firms to present their case and enable us to consider each firm's application on its merits. Firms are encouraged to make early applications for any waivers they may require.

The removal of the inter-bank exemption stems from a change in the CRD that is required to be implemented at the start of 31 December 2010. We have therefore not introduced any transitional arrangements or aligned the implementation date with the calendar year.

National discretions

5.15 The Directive allows for Member States to decide on the implementation of various national discretions in Article 113 (4). The national discretions allow Member States to fully or partially exempt certain exposures from the large exposure limits. We detailed our planned implementation approach in CP09/29.

Q9: Is our approach to the implementation of the national discretions clear?

5.16 Most respondents found the proposals to be clear, although a number of respondents raised particular points on various discretions available to Member States.

5.17 One respondent said exposures to regional governments and local authorities that are risk weighted at 20% and that are currently not exempt should now become exempt. The respondent argued that the proposals could have an adverse impact on the number of counterparties available to it.

5.18 Some respondents said we should continue allowing the exemption for exposures to covered bonds. Some respondents suggested that the structure and regulation of covered bonds meant that they were low risk exposures. Other respondents suggested the relative immaturity of the UK covered bond market was reason enough to allow for their exemption.

5.19 Some respondents said that exposures in the form of documentary credits should be exempted as they deemed them low risk.

5.20 A few respondents asked for clarity on the position for exposures to central counterparties, in particular how BIPRU 10 interacts with the provisions for calculating exposure values in relation to central counterparties in BIPRU 13.3.

5.21 Some respondents questioned why a waiver process was necessary for exempting certain exposures to overseas governments and central banks.

5.22 More general comments were raised by some respondents on the competiveness position of UK firms when compared to firms in Member States that have implemented the national discretions in a different manner.

Our response: When implementing the national discretions in this area, we based our general approach on the policy rationale that the large exposure regime is designed as a non-risk sensitive regulatory backstop to a firm's exposures. As such, the probability of default of an exposure is generally not a relevant consideration in the application of the regime. Based on this rationale, we have not considered as relevant the relative riskiness of covered bonds, documentary credits or exposures to regional governments and local authorities that are risk weighted at 20%, in how we have exercised the national discretions. We therefore do not plan to change our implementation option on these points.

In addition, by providing an exemption from the large exposure limit for covered bonds there is the risk that this will increase interconnectivity and contagion within the banking system. The development of more mature covered bond market in the UK could be aided by the presence of external, non-bank, investors in covered bonds, rather than adopting a regime that could in effect encourage banks to hold other banks' covered bonds.

We can clarify that exposures to central counterparties which firms are able to attribute a zero exposure value under BIPRU 13.3.12R and BIPRU 13.3.13R do not contribute as exposures for the purpose the large exposures limit. Guidance has been added to the BIPRU 10 Handbook text to make this clearer.

As mentioned previously, the waiver process allows interested parties to understand the prudential regime a regulated firm operates under. The waiver process also allows individual firms to present their case and for us to then consider if it is appropriate for that firm to extend a particular type of exposure in excess of the basic large exposure limit and that the extent of the exposure does not pose undue risk to consumers. We therefore plan to keep the waiver requirement for those firms wishing to exempt exposures in the form of certain statutory liquidity requirements held in government securities that are denominated and funded in the national currency of the government issuing the security. The waiver process will also be used for claims in the form of required minimum reserves to be held at central banks that are denominated in the national currency of the central bank at which the deposit is made. We do not expect this to impact on many firms.

The competiveness position of UK firms is our consideration. As we mentioned in our CBA, we believe that most of these national discretions will not impose material costs on firms. Therefore, they are unlikely to affect the competitiveness of UK firms. In addition, a prudent approach to implementing certain national discretions could lead to a greater degree of consumer protection and market confidence. These in turn can improve the competitive position of UK firms when compared to firms operating under other regimes.

Collateral

5.23 The changes to the BIPRU 10 Handbook text detailed in CP09/29 included guidance to clarify how the treatment of collateral relates to the identification of counterparties for the purposes of the application of the large exposure limit.

Q10: Are the provisions for the recognition of collateral and exemptions for residential and commercial property clear?

5.24 We received mixed responses to this question with some respondents asking for greater clarity in the Handbook text.

5.25 One respondent also asked for clarity that collateral with a longer maturity than the exposure could be used as an effective Credit Risk Mitigation (CRM) technique.

Our response: We have made changes to the relevant BIPRU 10 text to make the provisions clearer. These include improved cross referencing to other relevant parts of the Handbook, including to BIPRU 5.8 to make the provisions around maturity mismatch clear.

Exposures to groups of connected clients

5.26 Please refer to Chapter 13.

Exposures to schemes with underlying assets

5.27 Please refer to Chapter 13.

Third party trading book exposures

5.28 CP09/29 proposed to integrate the large exposure limit for trading book exposures to third parties with the large exposure limit for non-trading book exposures to third parties.

Q11: Do you agree that there is no clear rationale within a backstop regime designed to limit the impact of unforeseen event risk to treat trading book and non-trading book exposures differently?

5.29 We received mixed views on this, but of the few firms that did respond to the question, most thought there was a rationale to have different limits for trading book and non-trading book exposures to the same counterparty.

5.30 Respondents suggested that the nature of the trading book meant that active risk management could be used to reduce concentration risk where necessary. They also suggested the current regime, of incremental capital charges held against exposures above the basic 25% limit, worked well and adequately deals with concentration in the trading book.

5.31 Of concerns about the ability to trade out of exposures due to the increasing blur between trading book and non-trading book exposures, many respondents suggested we should do more to police the boundary between the trading book and non-trading book, as opposed to integrating the large exposure limit for both.

5.32 One respondent suggested that the proposals may restrict firms' underwriting activities. While some suggested that the proposals may lead to capacity issues when trading with other firms, which may have an impact on market liquidity.

Our response: As the current provisions allow a firm to extend an exposure that represents many multiples of its own capital resources, we do not think the provisions offer an appropriate degree of protection to UK consumers/markets in the event of such an exposure defaulting.

We believe that within a back stop regime there is no rationale to distinguish between trading and non-trading book exposures to third parties. As trading book exposures are meant to be short term, no transitional period will be granted as firms will have the ability to manage their positions down. We expect firms to comply with the large exposure limits at the date of implementation on 1 January 2011.

It should be noted that the concessions for underwriting exposures remain, as detailed in BIPRU 7.

Intra-group exposures

5.33 In CP09/29 we outlined proposed changes to the regime for intra-group large exposures. We noted that the crisis had highlighted the need to understand the issues and risks arising from group corporate structures, their internal exposures and relationships.

5.34 The CP outlined the key market failures in the area of large intra-group exposures.

Q12: Are there other market failures or risk issues that we should consider?

5.35 Some respondents said we should consider the risk of the proposals to the UK's economic growth.

5.36 One respondent remained unconvinced that there was any evidence of the market failures relating to intra-group exposures. This respondent thought the proposals would provide disincentives to manage risk across firms' group structures and that the focus should be on risk management rather than legal structures. The respondent also believed the proposals would lead to a loss of capital from the UK to ensure overseas subsidiaries could operate on a standalone basis.

5.37 Some respondents said the proposals risked creating incentives for certain types of group structures that conflicted with incentives provided by other parts of the Handbook.

Our response: There is strong evidence to support the market failures that exist for intra-group exposures. As explained in CP09/29, the market failures are especially clear for those exposures that cross national boundaries. Had government support been less forthcoming during the crisis, recoveries for many creditors of insolvent firms would have been directly dependent on the recoveries of intra-group exposures. This would have had a very real impact on many of the respondents to the consultation and their stakeholders.

The wider economic impact of the policy proposals for large exposures was considered as part of the CBA we conducted.

Although we recognised that the intra-group proposals would lead to costs for firms, the proposals do not aim to provide incentives towards a particular business model. Rather, they help achieve certain outcomes including managing interconnectivity risk and improving the chances of resolution and recovery.

We do not expect the proposals to have any significant impact on economic growth. Besides, as firms are likely to hold more capital to comply with other changes in the prudential framework, their large exposure limits will increase as well. This effect, combined with the transitional period, should reduce the impact of the changes to the intra-group large exposures regime.

Intra-group exposures within the UK

5.38 In CP09/29 we proposed to continue allowing for the full exemption of certain intra-group exposures within the UK by way of a 'core UK group'. We proposed to strengthen the current UK integrated group (UKIG) provisions in light of concerns over information asymmetries and fungibility of capital between members of the UKIG.

Q13: Are the criteria for the core UK group clear?

5.39 Firms generally supported the continuation of the provisions to allow for the full exemption of certain intra-group exposures in the UK, although there was some uncertainty around particular aspects of the proposals.

5.40 Several firms were unsure of the meaning behind requiring the unregulated entities in the core UK group to commit support to the regulated members in the core UK group. Some respondents thought that such a requirement was unnecessary given the general requirement to ensure capital is transferable among group members. Other respondents thought the requirement posed issues concerning the fiduciary duties of the directors of the unregulated entities in the core UK group.

5.41 Some respondents questioned why we proposed members of the core UK group to be fully owned, as opposed to the 75% ownership threshold used for solo consolidation purposes, or the majority ownership test as generally applied to subsidiaries.

5.42 Some respondents raised questions over using the waiver process. Others raised more general issues about the clarity of the complete intra-group proposals and thought including diagrams would be useful in explaining the proposed limits structure. One respondent also asked for greater clarity on the proposed large exposure limits for non-EEA sub-groups.

Our response: We have worked with industry members since CP09/29 was published to identify areas where the rules can be clarified. The Handbook text has been revised to reflect these discussions. BIPRU 10 now includes an annex with diagrammatic representation of the intra-group regime with various examples of firms' exposures profiles to assist users and updated large exposure requirements for non-EEA sub-groups.

The imposition of legally binding commitments of support from the unregulated members of the core UK group to the regulated members is designed to ensure capital is transferable among members of the core UK group. The requirement also ensures excess capital is not kept in an unregulated entity when a regulated member of the core UK group needs capital. The Handbook provisions have been updated in this area to make the requirements clearer.

Although individual directors must consider their fiduciary responsibilities, the benefit derived by unregulated subsidiaries in a core UK group from a loan or funding from regulated firms (this is how the firm's intra-group exposure arises) may be considered as a reason for providing a legally binding undertaking to make good the regulated firms' capital resources.

To minimise the chances of any delays in the process of transferring capital around members of the core UK group, the proposed rules excluded any entities from the core UK group that have any minority holdings. We do not propose to change our requirements in this area.

As mentioned above, the waiver process allows a suitable degree of transparency to the regulatory regime. The proposed intra-group provisions are designed to include less subjective requirements compared to some of the current intra-group provisions that have occasionally led to a drawn-out waiver application process. We therefore plan to keep using waivers for the various intra-group provisions.

Exposures outside the core UK group

5.43 CP09/29 proposed a basic limit for the total of a firm's non-core UK group exposures. It proposed to set this limit at 100% of a firm's (or its core UK group's) capital base.

Q14: Do you support the application of a basic limit for all non-core UK group intra-group exposures?

Q15: Do you think the benefits of applying a limit lower than 100% will outweigh the costs?

5.44 We received mixed views on the first question, with some respondents favouring a basic limit, while others did not. We did not receive any responses in favour of applying a limit lower than 100%.

5.45 Those respondents that did not favour a basic limit mainly asked for clarity over the proposals or raised concerns over the impact of the proposed 100% limit.

5.46 The main costs raised by firms related to foreign subsidiaries relying less on their UK parent company for funding. Firms also stated that further costs could arise due to inefficiencies because of their inability to centralise risk management activity across a group. Additional costs mentioned by firms related to senior management oversight, legal and documentation fees and external consultancy fees.

Our response: As mentioned above, BIPRU 10 now includes an annex with diagrammatic representation of the intra-group regime with various examples of firms' exposures profiles to aid clarity.

The benefit of this proposal derives especially from reducing losses to UK creditors in the event of the failure of a cross-border firm in a UK group.

CP09/29 discussed the main drivers of costs together with quantification where possible. In their feedback, firms acknowledged the difficulty of quantification and generally reconfirmed the costs we originally identified through the CBA.

As mentioned in the CP, the competitiveness of some UK firms abroad could potentially be affected. Overseas subsidiaries of UK firms may suffer competitive disadvantages from higher costs of funding as they may have to rely on more local funding, which could be costlier. However, since firms will react differently in adapting to tighter intra-group limits, the final impact on competiveness is difficult to establish. Respondents did not provide further evidence that would allow us to provide a better estimation of the effects on competition or lead us to believe that the competitiveness of UK firms is likely to be significantly impacted.

Further examination of the impact of the proposals on some firms also did not suggest that changes to our planned implementation in this area were required.

Applying a limit lower than 100% would probably lead to higher recoveries for UK creditors in the event of the failure of a cross-border firm in a UK group, as there would be less capital lost upon default. Given this, we will keep this area of the rules under review, as the levels of capital held by firms following changes in other parts of the prudential regime become clearer.

Other intra-group exposures concessions

5.47 CP09/29 proposed to remove several intra-group concessions in BIPRU 10 because they could not be justified given the rationale for the large exposure regime, or that they were effectively redundant given other provisions in the Handbook.

> Q16: Do you agree that the simplification of these proposals will enhance the clarity of the large exposures provisions?

5.48 Most respondents agreed that removing the provisions would enhance clarity.

5.49 Some respondents asked for greater clarity in the Handbook provisions. One respondent suggested that the provisions should be kept as they allowed for flexibility within the rules.

Our response: Where firms are not able to rely upon other intra-group provisions or normal credit risk mitigation techniques to reduce their exposures, there does not appear to be a policy reason to offer additional flexibility in this area.

Given the general response, we do not propose to change our planned implementation in this area, although we have redrafted the relevant Handbook provisions to aid clarity.

Intra-group exposures within the trading book

5.50 CP09/29 discussed our concerns in allowing firms to extend intra-group trading book exposures that represented many multiples of their capital resources.

5.51 CP09/29 mentioned further work we were doing in this area and asked two questions:

> Q17: What limits do you think are appropriate for intra-group trading book exposures?
>
> Q18: Do you think that aligning the treatment of intra-group exposures within the trading book to the treatment of intra-group exposures within the non-trading book will strengthen the protection offered to consumers and markets?

5.52 Of the few responses received to these questions, respondents generally thought the current regime was appropriate and that aligning the intra-group trading and non-trading book limits would not necessarily strengthen the protection offered to consumers and markets.

5.53 Firms thought that any changes to the intra-group trading book exposures limit would reduce the ability for firms to manage risk centrally, increase operational risk and reduce market liquidity.

Our response: As the market failures for intra-group exposures exists for both trading book and non-trading book exposures, there are strong reasons to align the treatment of intra-group exposures within the trading book to the treatment of intra-group exposures within the non-trading book.

Our work in this area (which is subject to a national discretion under the Directive) is still ongoing, so we do not plan to make any proposed changes to the regime at present. However, it is important to note that, as mentioned above, had government support been less forthcoming during the crisis, recoveries for many creditors of insolvent firms would have been directly dependent on the recoveries of intra-group exposures. This would have perhaps made clearer the importance of a meaningful limit structure in this area.

Transitional option

5.54 CP09/29 proposed to allow firms to continue with the existing BIPRU 10 intra-group provisions until 31 December 2012 after notifying us.

> Q19: Is the proposed transitional option for intra-group provisions clear?

5.55 Respondents found the transitional provisions to be clear.

5.56 One respondent asked if there were any conditions underlying the ability to use the transitionals. Some other respondents suggested the duration of the transitional provisions should be longer.

Our response: There are relatively few firms that make use of the limits allowed under the current wider integrated group provisions in BIPRU 10. After reconsidering the impact of the proposals on these firms in particular, we do not intend to extend the expiry date of the transitional provisions.

The new intra-group provisions will come into force on 1 January 2011. To make use of the transitional provisions, firms should notify us before 31 December 2010 and include details of their preliminary plans to move onto the revised BIPRU 10 intra-group provisions.

Reporting

5.57 CP09/29 included updates to the current large exposure reporting form (FSA008) following the amendments to the CRD.

Q20: Are the changes to FSA008 clear?

5.58 Most respondents found the changes to be clear.

5.59 One respondent questioned the level of detail required for funded and unfunded credit protection.

Our response: Following a review of the proposed reporting form and associated guidance, we have further simplified the reporting form and clarified the guidance.

Changes made to the CRD now require details of funded and unfunded credit protection to form part of the large exposure information submitted to competent authorities.

The CRD also now requires a unified reporting to be used by Member States from 31 December 2012. CEBS has designed a form to be submitted to Common Reporting Framework (COREP)[18] for implementation by this date. This form includes the same level of detail with respect to funded and unfunded credit protection as required by the revisions to FSA008.

Cost-benefit analysis

5.60 CP09/29 included a CBA that assessed the costs of the large exposure proposals. The cost estimates presented were based on a survey, and some follow-up discussions, with affected firms.

5.61 The CP also outlined the general benefits from the proposed regime.

Q21: Are there any costs or benefits mentioned above that you believe would not materialise or would be of a different value?

Q22: Are there any other costs or benefits we should consider?

5.62 Some respondents, highlighting the proposals for a reduced limit for the smaller firm exemption, said that the proposals could reduce concentration risk although they could create credit risk.

18 www.c-ebs.org/Publications/Consultation-Papers/All-consultations/CP01-CP10/CP04-Revised-2.aspx

5.63 One respondent also thought that the proposed reduced limit for the smaller firm exemption would affect certain firms disproportionally and this was not reflected accurately in the analysis.

5.64 Some respondents thought that the costs were generally underestimated. Another believed the analysis had identified some of the potential costs and benefits, but noted that the financial impact of the changes was difficult to gauge against a dynamic backdrop in several other areas.

5.65 One firm thought the wider impact on banks and the economy had not been considered fully.

5.66 The impact of the CEBS guidelines on large exposures was identified as an area where further costs would arise.

Our response: As mentioned above, after reconsidering the costs and benefits of a reduced smaller firm exemption limit, we plan to alter our planned implementation and set the exemption limit at €150m, the maximum permitted under the Directive.

The revision to the exemption limit to €150m should reduce the possibility of a disproportionate impact on smaller firms. More generally, we have carefully considered the effects of these proposals on the competitive position of UK firms. Given the responses received, we remain convinced that proposals in this area are not likely to significantly affect the competitiveness of UK firms.

The costs in the CBA were based on discussion and information provided by a range of affected firms. We did not receive further evidence in the responses that allows us to provide revised estimates nor lead us to believe that original costs were underestimated.

As outlined in Chapter 13, we plan to conduct an analysis of the costs and benefits of the CEBS guidelines in due course.

Change in CRD2 commencement date

5.67 As set out in Chapter 1, the commencement date for the CRD2 rules will change from that shown in CP09/29 (1 January 2011) to the start of 31 December 2010. The main impact of the commencement date change on large exposures is expected to be with removing the exemption for inter-bank exposures with a maturity of one year or less from the large exposure limit (BIPRU 10.6.3R (3)). Firms may have been expecting deposits to roll over on 31 December 2010, and could now be in breach of the new rule on that one day. However, there is still time for some firms to change deposit maturities, otherwise manage exposures, or if other mitigating actions are not possible, notify supervisors of a potential breach that would be corrected the very next day.

5.68 We are unable to delay implementing the removal of the exemption, nor provide a transitional to disapply the removal as this would be incompatible with the CRD. However, our response to a breach will consider whether it stemmed solely from the late notice of the change in commencement date.

5.69 Other key large exposure points relating to removing concessions for third party trading book exposures and the changes to the intra-group exposures provisions are based on national discretions retained in CRD2. We have the flexibility to use that discretion to retain the existing treatments for one day until the end of 31 December 2010 through a transitional provision so the new large exposure regime applies from 1 January 2011.

5.70 The exemption of limited licence and limited activity firms from the large exposure regime, together with the changes made to the reporting forms, will take effect on 31 December 2010.

6 Securitisation

6.1 Chapter 5 of CP09/29 set out our proposals to implement changes to the CRD that relate to securitisation in the non-trading book. These changes can be grouped into three categories:

- CRD2 technical amendments;
- CRD2 Article 122a; and
- CRD3 re-securitisation.

6.2 We received eight responses to Chapter 5 of CP09/29 from trade associations and individual firms. We are grateful for all responses received. This chapter is divided into two sections. The first section covers issues raised in feedback that were not covered by any of the specific questions raised in Chapter 5 of CP09/29. Section Two covers feedback received on the CP09/29 questions.

Specific issues raised by firms

Timetable for implementation

6.3 Several respondents acknowledged that the implementation timetable for the CRD changes was tight and recognised that this necessitated early consultation from us. But they raised concerns that we were planning to implement CRD3 before the final Directive text was agreed. The respondents believed this could potentially disadvantage the UK financial sector.

Our response: The amendments to the CRD resulting from CRD3 were consulted on in CP09/29, although the final CRD3 text had not completed its passage through the EU legislative process when CP09/29 was published. We explained that, despite the potential for the text to change, and the uncertainty this created, we believed that consulting on the CRD3 amendments was the most efficient course of action at that time, particularly if the implementation date was to remain unchanged at 1 January 2011. It would prove useful in highlighting potential changes to industry. We acknowledged that we would consult further, should this be necessary in light of any material amendments to the Directive text.

The final CRD3 text has now been agreed and we will need to evaluate it and consider what further consultation is needed. As a consequence, we have not yet been able to finalise our proposals for implementing the new CRD3 amendments and the final Handbook text is not included. We have, however, summarised the feedback received on the CRD3 securitisation provisions. We will provide further feedback, re-consult as necessary, and make the final Handbook text as soon as practicable.

Feedback on proposed CRD3 amendments

6.4 Several respondents suggested that the increased capital requirements introduced in CRD3 should not be applied to existing transactions, or if they were, that grandfathering arrangements should be put in place. This was based on the view that it is not possible to change behaviours or transaction structures retrospectively.

Our response: We accept that new requirements cannot influence market participants' behaviour retrospectively. However, as well as potentially influencing behaviours in the future, the CRD3 proposals concerning re-securitisation risk weights and own unfunded support are important in ensuring firms hold appropriate levels of capital against the risks to which they are exposed. Therefore, we are not persuaded that we should differentiate between existing and new exposures when determining securitisation and re-securitisation risk weights. To do so, would, in our view, result in the undercapitalisation of certain legacy exposures that the crisis demonstrated to be more risky than their current risk weights indicate.

6.5 The European Commission draft of CRD3 included requirements in respect of highly complex re-securitisations in the proposed Article 122b. These requirements were not included in the European Council draft of CRD3, and as Chapter 5 of CP09/29 was based on the European Council draft, we did not consult on the highly complex re-securitisation proposals. Despite this, several respondents commented on the proposed Article 122b. Respondents were concerned that Article 122b was disproportionate, as the issues it was designed to address were already addressed by the due diligence and associated investor penalties in Article 122a of CRD2. They argued that the potential for an automatic capital deduction in respect of highly complex re-securitisations would be an unnecessary drag on the potential recovery of the securitisation market.

Our response: We do not consider it appropriate to provide a detailed response to these comments until we have reviewed the agreed CRD 3 text. We note that the text in relation to Article 122b has been subject to considerable uncertainty as it has progressed through the EU legislative process.

6.6 Several respondents raised concerns about the proposed CRD3 requirement to limit a firm's use of a credit assessment from an eligible External Credit Assessment Institution (ECAI) where that assessment is based, or partly based, on unfunded support provided by the firm. In such a case, the firm would need to treat the position as unrated. Respondents were concerned that while the requirement may be appropriate where the unfunded support drove the credit assessment, it would also capture support such as interest rate and currency derivatives. They argued these could influence a credit assessment but would not materially determine the

assessment meaning a potential capital deduction would be disproportionate to the risk being addressed. One respondent suggested the impact would be particularly significant for multi-seller conduits.

Our response: We do not consider it appropriate to provide a detailed response to these comments until we have reviewed the final CRD3 text. We acknowledge that the industry has concerns about the own unfunded support provisions and we will estimate the impact of these provisions in due course. We also note that the recent BCBS QIS assessed the impact of the changes to the BCBS securitisation framework set out in the *'Enhancements to the Basel II framework'* document published in July 2009, including the changes on which the CRD3 proposals on own unfunded support are based. Analysis of the QIS data may therefore be useful in quantifying any impacts from the own unfunded support proposals.

Scope of the securitisation framework

6.7 Several respondents raised questions concerning the scope of CRD definitions of securitisation and re-securitisation. One respondent requested guidance on the structures captured by the definitions, although it was recognised that it may not be possible or desirable to give definitive guidance.

6.8 One respondent believed that A/B loan structures in commercial real estate transactions should be excluded from the definition of securitisation. Concerning the definition of re-securitisation, one respondent commented that it would capture the commercial paper issued by multi-seller conduits and Programme Wide Credit Enhancements (PWCE) that sponsors provide to multi-seller conduits. They felt the consequent increase in capital requirements resulting from the increased re-securitisation risk weights would be disproportionate in such cases. Another respondent expressed a view that internally restructured transactions should not be captured within the re-securitisation definition.

Our response: We do not consider it appropriate to provide a detailed response to these comments until we have reviewed the final CRD3 text. At a general level, we consider it desirable that any defined terms in the CRD, including the securitisation and re-securitisation definitions, are interpreted consistently across firms in both the UK and the EEA.

We note that these issues have been subject to discussion in our Securitisation Standing Group and we intend to continue these discussions in the future.

Responses to questions in CP09/29

Q23: Would you find additional guidance useful? Please detail the specific areas and suggested text in your response.

6.9 Several respondents questioned why provisions in BIPRU 9.3.15 to BIPRU 9.3.20 that implement Article 122a were only applied to credit institutions and were not applied to investment firms. Several argued that limiting the scope to credit institutions would result in these firms being at a comparative disadvantage.

Our response: The scope of firms to which we are applying the Article 122a provisions is not a policy decision but based on the scope of the Banking Consolidation Directive (BCD). The application of Article 122a provisions is determined by the positioning of the provisions in the BCD, and the section of the Directive in which Article 122a is located only covers credit institutions. We are implementing the new CRD amendments on an intelligent copy-out basis and are therefore following the scope of the Directive and are only applying the requirements to credit institutions.

Any comparative advantage should be lessened by the fact that, as originators or sponsors, investment firms would still have to hold a retained economic interest in the securitisation if they wish to attract EEA credit institutions as investors. And the due diligence requirements that apply to credit institutions are intended to bring them benefits by ensuring risk is better managed.

6.10 Several respondents requested further information on the timetable for the publication of the CEBS guidelines on Article 122a of CRD2 and further detail on our approach to adopting the guidelines into our Handbook.

Our response: The CEBS guidelines were published on 1 July 2010 and will be subject to a three month public consultation period. Depending on the nature of feedback received, we expect the final guidelines to be published in Q4 2010. We believe the guidelines cover all provisions in Article 122a in detail. In light of this, and consistent with our support for European convergence in this area, we do not intend to provide guidance in advance of CEBS completing its consultation process on its guidelines. After the final guidelines are published, we will consider whether any further guidance is necessary and finalise our approach to adopting the guidelines.

6.11 Several respondents asked us to clarify the definition of mezzanine securitisation position, introduced in CRD2. To satisfy the definition, an exposure must be subject to a risk weight lower than 1250% and must be more junior than the most senior position in the relevant securitisation. It must also be more junior than any securitisation position in the relevant securitisation to which a Credit Quality Step 1 (CQS1) is assigned under the Standardised Approach (TSA) to securitisation or a CQS 1 or 2 is assigned under the Internal Ratings Based (IRB) approach to securitisation.

6.12 One respondent asked if the most senior position for these purposes included swaps or liquidity facilities, with the respondent believing these should be excluded from the determination of the most senior position. Several respondents also asked us to explain whether the definition only needed to be met at the inception of the transaction – when tranching occurred – or whether a position would need to meet the criteria on an ongoing basis. The respondents believed it would be problematic if the definition needed to be met on an ongoing basis. This is because credit rating migration could result in a mezzanine securitisation position at inception later being downgraded to the extent it would be subject to a 1250% risk weight, meaning it would no longer satisfy the definition.

Our response: We recognise that the concept of mezzanine securitisation position introduced in CRD2 has scope for interpretation. We also acknowledge that an interpretation that requires the mezzanine securitisation position criteria to be met at all times may mean that a ratings downgrade of a mezzanine securitisation position to a CQS that

attracts a 1250% risk weight could result in a firm no longer achieving SRT in respect of a securitisation, should the firm consequently hold more than 20% of the securitisation positions subject to deduction from capital or a 1250% risk weight. Particularly when the ratings downgrade is not only based on a deterioration in credit quality, this may not result in an appropriate outcome from an economic substance perspective in circumstances where despite the downgrades the proportion of credit risk transferred continued to be commensurate with the capital relief taken.

We propose to raise this issue for discussion within CEBS, with the possibility of CEBS providing guidance, as this approach is most likely to lead to a consistent pan-EU understanding.

Q24: What guidance do you think should form part of CEBS guidelines? Please detail the specific areas and suggested text in your response.

6.13 Respondents asked for guidance on the following areas:

- the meaning of 'participations' in paragraph 6 of Article 122a;
- the meaning of 'materially relevant data' in paragraph 7 of Article 122a;
- how to apply the penalty charge to originators in paragraph 5 of Article 122a;
- the practical requirements for meeting the investor's due diligence requirements;
- the additional methodologies for retention covered in the CEBS advice on Article 122a;
- how structures that can align interests between originators and investors, but which may not fit any of the four retention options in Article 122a, would be treated, particularly for non-BIPRU firms;
- how requirements for ongoing due diligence requirements should be applied, if at all, to assets held in the trading book for a short period of time;
- how the requirement for an originator, sponsor or original lender to maintain a 5% net economic interest on an ongoing basis would be assessed in practice; and
- the implications for a firm as investor when the originator, sponsor or original lender does not retain a 5% net economic interest in the securitisation.

6.14 One respondent suggested the disclosure requirements for originators and sponsors did not require further guidance as they considered this to be a matter for the industry to resolve.

Our response: The guidelines which CEBS has consulted on deal with all Article 122a provisions, from both a trading book and non-trading book perspective where relevant. We encourage stakeholders to respond to the CEBS consultation. We acknowledge the requests for specific guidance and will consider them when determining our approach to adopting the final CEBS guidelines and whether any additional FSA guidance is necessary.

Significant risk transfer (SRT)

Q25: Do you agree with our approach to notification?

6.15 A range of views were expressed on our proposed approach to SRT notifications and waivers. Although several respondents agreed with our approach, they indicated that further detail was required on how the processes would operate in practice. Those who objected mainly did so based on the premise that the practical effect of the requirements will be to restrict UK firms' ability to undertake securitisation transactions in a timely manner. One respondent argued that the UK's implementation of the SRT requirements was super-equivalent and would put UK firms at a competitive disadvantage.

Our response: We still believe that the approach to implementing the CRD2 SRT provisions, as consulted on in CP09/29, is the most appropriate available to us. The new SRT provisions allow a mechanistic approach to assessing SRT. While satisfying the mechanistic tests may in many circumstances be consistent with a reduction in Risk Weighted Exposure Amounts (RWEA) commensurate with the credit risk transferred to third parties, we continue to believe it is possible to satisfy the mechanistic tests while taking an amount of capital relief that is disproportionate to the amount of credit risk transferred.

The Directive allows a competent authority to override a firm's assessment of SRT when the authority does not believe the reduction in RWEA is commensurate with the credit risk transferred to third parties. We consider it important that we have information on firms' securitisation transactions so we are in a position to exercise the supervisory oversight provided for by the Directive. This will reduce the potential for regulatory arbitrage resulting from compliance with the letter – but not the spirit – of the new SRT provisions.

6.16 Several respondents asked whether the proposed waiver and notification requirements in respect of SRT would apply to transactions which firms had already undertaken. They believed the requirements should not apply to existing transactions as this would be burdensome for firms and us. They requested that the requirements should only be applied to transactions undertaken from 1 January 2011 onwards, and then only to transactions involving different asset classes to transactions previously undertaken by the firm.

Our response: We do not intend to apply the SRT waiver and notification requirements to transactions that were concluded before 31 December 2010. A distinction should be made between the new processes introduced to enable us to oversee firms' assessment of SRT, and the policy that any reduction in RWEA resulting from securitisation transactions should be commensurate with the credit risk transferred to third parties.

While the new processes will only apply to new transactions, BIPRU 9.3 currently includes provisions that require any reduction in RWEA to be commensurate with the credit risk transferred, so the overarching policy is generally applicable, including to existing transactions.

6.17 It was also argued that the proposed SRT notification approach would require firms to have full economic models to assess SRT, which would reduce the potential benefits from the simplicity of the mechanistic approach that CRD2 provided. The respondent described the mechanistic approach as a 'safe harbour approach'.

Our response: It was not our intention that firms would be required to have full economic models to assess SRT, nor do we believe that the notification provisions introduce the requirement for such models. We expect firms to use appropriate methods to assess SRT, and while using a full economic model may constitute an appropriate method, we do not consider use of such a model to be a precondition for assessing SRT.

We also note that we do not consider the mechanistic approach to be a safe harbour. Any reduction in a firm's RWEA will need to be commensurate with the level of credit risk transfer on an ongoing basis, and meeting a mechanistic test at a specific point in time does not preclude us from potentially requiring a firm to increase its capital requirements at any time, should we consider that the commensurate risk transfer principle is not, or is no longer, satisfied.

6.18 Several respondents noted that the change to the title of BIPRU 9.3 could be interpreted as widening the application of BIPRU 9.3 to apply SRT requirements to sponsors. They considered this was not required by the CRD and it would be inappropriate as the assets being transferred during securitisation would not have previously been on a sponsor's balance sheet.

Our response: We agree that it is not appropriate to apply the SRT provisions to sponsors and it is not our intention to do so. We have clarified the scope of the provisions in BIPRU 9.3 accordingly.

Q26: Do you agree that the high level information requested should be set out in guidance? Please detail any additional areas the firms should submit to help our analysis.

6.19 Several respondents indicated that they would be keen to engage with us to discuss the types of information that would be necessary and how the notification requirements more generally could work in practice. One respondent asked for clarification of whether firms would need to notify us on an ongoing basis that they were continuing to achieve SRT.

Our response: We will continue to discuss the operation of the notification requirement with the industry, in particular via the Securitisation Standing Group, to reach a common understanding of how the process will work in practice.

Q27: Do you agree that one month is a reasonable long–stop time period to receive any notifications?

6.20 The majority of respondents felt that, in practice, firms would want to contact us in advance of concluding securitisation transactions, meaning the length of the long-stop period would not be a material consideration. The basis for this view was that a firm would be unwilling to accept the uncertainty that we may not accept a judgement that a reduction in RWEA was justified by a commensurate transfer of credit risk to third parties and may require the firm to unwind any capital relief taken on the transaction. It was argued that this made the notification approach potentially unworkable. One respondent expressed a concern that the notification requirement would become an iterative process between firms and us, rather than a one-off requirement. One respondent suggested the long-stop period should be

extended to three months. Several respondents also questioned whether we would have sufficient resources to review the volume of transactions that we may be notified of.

Our response: As outlined in CP09/29, we do not consider it a necessary condition for an SRT notification to be made before a transaction is concluded. However, we acknowledge the industry concerns and accept that, in practice, most firms may wish to notify us of transactions before closing.

However, we do not consider the possibility that we may reject a firm's judgement in respect of SRT (and may require the firm to unwind any capital relief taken on a transaction) to be a significant change from the current position. In circumstances where we currently have concerns that a firm may have taken inappropriate capital relief under BIPRU 9, we have the power to review a transaction and require additional capital to be held if we consider the firm is underestimating its capital requirements. So we believe the risk to firms of our view being different to theirs on a transaction where SRT has been assumed is a feature of both the current and future SRT framework.

We acknowledge the potential for an increase in the number of transactions we will be required to review in the future. However, since the financial crisis, we have been closely engaged with firms to review existing transactions and new structures. We accept that our workload may increase, but should this be the case, we will continue to take a risk-based approach to reviewing transactions, focusing our resources on transactions and structures which have the greatest potential for the underestimation of capital requirements and which pose the greatest risk to our objectives.

Waivers

Q28: Do you agree with our proposal to assess firms' compliance via a waiver?

6.21 Several respondents agreed that the waiver-based approach was sensible. Several others objected to the process in general. Most respondents raised concerns about how the waiver process would work in practice. Several respondents expressed the view that the proposed six-month maximum period for us to review a waiver application was too long. They believed this timeframe could restrict new issuance of securitisation transactions, which could damage the securitisation market recovery. A request was made for a three-month maximum review period.

6.22 Several respondents asked whether the text in paragraph 5.27 of CP09/29, which stated that firms wishing to apply for an SRT waiver should approach us at an early stage, amounted to a shadow waiver process. An 'in-principle' approach where firms could self-certify their compliance with SRT provisions was also proposed, particularly concerning securitisation transactions similar to a firm's previous transactions in terms of the structure and type of assets securitised.

6.23 Concerns were raised that we may tightly define the scope of waivers, and this could result in waivers being required on a transaction by transaction basis should new structures not be identical to those covered by the waiver. One respondent suggested the scope of a waiver should correspond to the CEBS COREP guidelines plus additional categories where necessary.

Our response: We still believe that a waiver based approach is the most appropriate means of implementing the CRD2 provisions that provide for an alternative to the mechanistic approach for assessing SRT. The waiver approach will ensure a formal and consistent process is used to determine whether a firm has policies and methodologies in place to ensure any reduction in capital requirements is commensurate with the credit risk transferred, and that a firm can demonstrate that such transfer of credit risk is also recognised for its internal risk management and internal capital allocation.

Our intention would be to process waiver applications in less than six months, but we believe this remains an appropriate maximum period given the potential complexity of some applications. We do not believe this timeframe may restrict new issuance of securitisation transactions, and potentially damage the recovery of the securitisation market, as firms can use the notification approach for any transactions not covered by a waiver, including in any period during which we are reviewing a waiver application.

We will continue to discuss the operation of the waiver approach with the industry, in particular via the Securitisation Standing Group, to reach a common understanding of how the process will work in practice.

Q29: Do you agree with our interpretation of the CRD?

6.24 The respondents who answered this question agreed with our interpretation of the CRD.

Q30: Do you consider further guidance necessary in this area?

6.25 One respondent gave a view that the 'L shaped' retention requirement outlined in the CEBS advice on Article 122a should be explicitly allowed under Article 122a. They also argued that the requirement for an originator, sponsor or original lender to retain a 5% net economic interest in the securitisation should relate to the retained risk of the securitisation rather than the nominal amount.

Our response: The CEBS guidelines seek to provide some general considerations on the application of Article 122a and clarify specific aspects of the detailed requirements. The guidelines elaborate, but cannot amend, the meaning of the Directive requirements and they cannot add new provisions to the Directive.

Q31: Do you agree with our approach of providing guidance when the CEBS guidance is issued? Please provide detail of what the guidance should cover.

6.26 Several respondents indicated that it was important that there was a consistent approach to implementing the requirements across Europe and did not want the UK to diverge from what was agreed at a CEBS level.

Our response: As previously noted, we agree with the proposition that the guidelines should be implemented on a consistent basis across the EEA. Consistent with the 'comply or explain' policy of CEBS, we will only diverge from the CEBS guidelines where we consider there to be a clear justification for doing so.

Q32: How should we implement the Directive to make the sanction for non-compliance practically effective to assets originated on the trading book? Please provide detailed reasoning for your proposed approach.

6.27 No detailed responses were received to this question.

Reporting

Q33: Are the changes to FSA046 clear? Please detail if you think there are any areas where the form could be improved.

6.28 There was a mixed response to the proposed changes to FSA046. Several respondents agreed with the proposed changes. Some others questioned the need for the new reporting requirements in respect of securitisations held in the trading book to be included in a separate form (i.e. the new FSA058 report). They believed the additional information should be captured in an expanded FSA046 report. One respondent questioned the CBA undertaken when the FSA046 was introduced and whether the report had delivered the benefits anticipated.

Our response: The proposed CRD3 provisions in respect of securitisation Pillar 3 disclosures require separate disclosures for trading book and non-trading book securitisations. Achieving consistency with the Pillar 3 approach is a key rationale for having two separate reports. We also believe there will be materially fewer firms required to complete FSA058 than FSA046 and we do not consider it appropriate to include a significant number of cells in FSA046 that may not be relevant to a large proportion of firms were there only one report covering both trading book and non-trading book.

We consider that FSA046 has delivered material benefits. It has provided us with a more comprehensive overview of the types and number of securitisation transactions taking place in the UK. It has also given us a more detailed understanding of the extent to which FSA-regulated institutions have exposures to securitisations. This enables us to more effectively assess the risk posed to our statutory objectives by securitisation activity. It also enables us to identify and follow up on specific transactions where we have concerns with a firm's compliance with the provisions of BIPRU 9.

6.29 We were asked to clarify the following:

- how firms should treat reductions in RWEA taken under BIPRU 9.10.4R and BIPRU 9.10.6R in respect of value adjustments;
- how to report exposures capped in accordance with BIPRU 9.12.8R in the risk positions sections of the report;
- how to complete the new columns I to P of FSA046 for transactions that pre-date the new CRD2 requirements; and
- whether exposures subject to the Asset Backed Commercial Paper (ABCP) Internal Assessment Approach (IAA) should be reported in column M of FSA046 or allocated to a CQS.

Our response: We agree that it would be useful to capture information on reductions in RWEA under BIPRU 9.10.4R and BIPRU 9.10.6R. Consequently, we have added an additional row in FSA046 for firms to report this information.

Originators and sponsors will be required to report exposures to which BIPRU 9.12.8R applies in the transaction level information section of the report (column M requires disclosure of post securitisation capital requirements pre cap and column N requires disclosure of post securitisation capital requirements post cap). We believe this will cover most exposures where the BIPRU 9.12.8R cap is relevant. We do not propose to also capture this information in the risk positions sections of the report.

We would expect firms to complete columns I-N in the transaction level information section of the report for both existing and new transactions. Columns O and P in this section relate to the material net economic interest retention requirement in CRD2 Article 122a, which only applies to new transactions issued on or after 1 January 2011. These columns do not therefore apply to transactions issued before this date. Firms should enter a zero in column O and 'not applicable' in column P concerning pre 1 January 2011 transactions.

We would expect firms to allocate exposures to a CQS where the IAA approach has been used.

Q34: Do you agree with the securitisation CBA?

6.30 Several respondents believed the CBA had underestimated the increase in capital requirements that would result from the CRD2 and CRD3 changes in total. Some respondents also thought that our resource implications relating to review of SRT waivers and notifications, and monitoring firms' compliance with Article 122a requirements, may be greater than that indicated in the CBA. One respondent questioned the size of the sample used to estimate the costs, while another noted that some non-capital compliance costs for firms may be higher than what was presented in CP09/29. Some respondents believed the main benefits from the CRD changes will come from the Article 122a due diligence requirements and the increased likelihood that investors will only invest in products where they understand the risks. It was argued that increased risk weights for certain exposures was not necessary in light of the due diligence requirements.

Our response: We acknowledge that the SRT waivers and notifications process may generate additional workload for us. We have reassessed our cost for the SRT notification review process and believe that these costs could be between £130,000 and £390,000 p.a. depending on the number and complexity of the transactions we receive. However, as stated above, since the financial crisis, we have been closely engaged with firms to review existing transactions and new structures. This will slightly reduce incremental costs.

Our workload is significantly dependent on the level of new securitisation activity, and the extent to which firms choose to apply for waivers rather than using the notification process. We anticipate there will be a peak in our workload around the time the new requirements come into force should a majority of firms involved in securitisation seek a waiver. If, however, most firms use the notification approach, we would expect a more consistent workload over time. We are not able to quantify this waiver/notification split at this time.

Our CBA attempted to quantify the impact of the SRT notification and waiver requirements, and the Article 122a due diligence, disclosure and underwriting requirements using a sample of firms. The sample size on which our estimates were based was relatively small

but representative of the industry. The firms sampled hold about 70% of UK banking assets. We also surveyed smaller institutions with the aim of assessing potential distributional effects. Some respondents suggested certain compliance costs may be higher than the estimates presented. We expect that for individual firms, incremental compliance costs may vary depending on firms' current baseline and the extent to which they would already be compliant with the new requirements, were they in force.

We also note that our costs from monitoring firms' compliance with the Article 122a requirements were not presented in the CBA. We acknowledge that monitoring will result in us incurring incremental costs, but the extent of these will largely depend on the methodologies adopted for the Article 122a supervisory review, which are being discussed by CEBS. However, we do not expect our costs to exceed £125,000 p.a. Depending on the supervisory review methodologies adopted, these costs could be significantly lower.

The BCBS QIS has taken place since the publication of CP09/29, and included a sample of UK firms. The QIS assessed the impact of the changes to the BCBS securitisation framework set out in July 2009. These will be implemented in the EU via changes to the CRD. Following the QIS, we still believe that the capital impact of implementing the CRD2 securitisation proposals is in line with our original estimations in the CP. We will use the QIS results to inform our final CRD3 CBA.

Change in commencement date

6.31 As set out in Chapter 1, the CRD2 requirements will come into force on 31 December 2010 rather than 1 January 2011 as indicated in CP09/29. The potential impact of this date change for the securitisation CRD changes can be split into four categories:

- Article 122a;
- SRT waivers and notifications;
- capital charges relating to the removal of the 6% risk weight and changes to liquidity facility conversion factors; and
- FSA046.

Article 122a

6.32 CRD2 is clear that the Article 122a requirements apply to new securitisations issued on or after 1 January 2011, and after 31 December 2014 for existing securitisations where new underlying exposures are added or substituted after that date. So, the commencement date change will have no impact on these CRD changes. This is also the case for the Article 122a changes in the trading book.

SRT waivers and notifications.

6.33 The date change may have an impact if firms were intending to close securitisation transactions on 31 December 2010. For transactions closing on this date, the commencement date change would mean firms would either need to have a waiver in place or otherwise be required to notify us of the transaction. The notification requirement would have costs for the firm (and for us as we would need to review)

that would be incremental to the costs of a 1 January 2011 commencement date. It is unclear how many, if any, transactions are likely to close on 31 December 2010, but the impact should be minimal as firms can aim to close deals on 30 December 2010 instead of 31 December 2010 to avoid this impact, which should not in itself have significant incremental costs.

Capital charges relating to the removal of the 6% risk weight and changes to liquidity facility conversion factors.

6.34 The CBA indicated that removing the 6% risk weight would have an impact on individual firms' capital between £0 and £4.8m. The CBA indicated that firms are not using the liquidity facility conversion factors that we are removing, so there should be no capital impact. We do not consider that the direct impact of firms having to hold additional capital due to using a 7% rather than 6% risk weight one day earlier would be material.

FSA046

6.35 The FSA046 report for the 31 December 2010 reporting date will now capture new information relating to the CRD2 changes. There may therefore be some incremental costs to firms in relation to FSA046 resulting from the commencement date change. The potential costs are set out in paragraph 1.15.

7 Trading book

7.1 This chapter summarises the responses we have received on Chapter 6 of CP09/29, which covers the introduction of new trading book capital requirements.

7.2 The proposals set out in CP09/29 are brought about by the introduction of CRD2 and CRD3 and they affect the trading book in several ways:

- increasing the level of capital held against trading book risks;
- reducing the relative cyclicality of market risk requirements;
- reducing the opportunity for arbitrage between the non-trading book and trading book; and
- improving the capture of credit and liquidity risk.

The key amendments proposed are:

- to introduce a stressed VaR measure;
- to introduce an IRC model for debt instruments;
- to apply the standardised method to securitisations; and
- to introduce an all price risks measure for the correlation trading portfolio.

Our general approach has been one of 'intelligent copy-out' from the European Directives.

7.3 The majority of trading book proposals consulted on relate to CRD3. The final agreed CRD3 text should be available when this paper is published, and we will need to evaluate it and decide what further consultation is needed. Therefore, we have not yet been able to finalise our proposals for implementing the new CRD3 amendments and the final Handbook text is not included. We have, however, summarised the feedback received on the CRD3 trading book provisions. We will provide further feedback and consultation on any material amendments to the text as well as those areas in CP09/29 we said we felt it appropriate to defer consultation (for example, the introduction of a capital charge floor to the correlation trading portfolio and our super-equivalent standard rules for securitisation credit derivatives), as soon as practicable.

7.4 Omitting CRD3 amendments results in changes to the Handbook and reporting forms for the trading book that solely encompass CRD2. The sole CRD2 proposal that relates to the trading book (Article 122a: Exposures to transferred credit risk) has been covered in Chapter 6 of this paper on Securitisation.

7.5 We received several general comments on the trading book proposals in CP09/29. The majority were concerned with the ongoing uncertainty surrounding the final content of the CRD3 Directive and ensuring that the overall Directive package is consistent with international agreements. Respondents were clear that the uncertainty was heightened by the tight timescale for implementing these new requirements. This in turn raised concerns that we would introduce detailed model guidance before the policy has been settled and, therefore, create an implementation approach that diverges from other international regulatory authorities. Other general comments raised points that are attached to particular sections of the trading book proposals. We identify and respond to these comments in the relevant sections below.

Our response: We recognise the ongoing uncertainty concerning the content, and timing, of the final CRD3 Directive. With this in mind, we have outlined above our future consultation process to reflect these timescales. We intend to provide guidance in implementing the new trading book requirements, which will be communicated through the most appropriate channels depending on the nature of the guidance supplied. The draft CRD3 text requires CEBS to provide guidance on aspects of the implementation of stressed VaR and IRC, and on Probabilities of Default (PD) and Losses Given Default (LGD) as inputs in the supervisory formula method, so as to facilitate comparable treatment across EU member states. We are active participants in this process and we will use this to inform our thinking on how to introduce FSA guidance and on how to implement the model requirements in the new proposals.

Stressed VaR

7.6 CP09/29 explains that introducing a stressed VaR measure will increase the risk capture of the market risk framework by explicitly incorporating 'tail' events into the capital charge. The stressed VaR capital charge should also be less cyclical than the current VaR-based capital charge. CP09/29 discusses the key areas where firms may require guidance in order to calculate a stressed VaR measure:

- identifying a period of stressed market conditions relevant to a firm's portfolio;
- ongoing review to ensure that the period chosen continues to be relevant; and
- calibrating the model inputs to historical data periods of significant financial stress.

We asked the following questions on stressed VaR:

> Q35: Do you believe that we should provide more detailed guidance on the factors that firms should consider when selecting a stressed historical period?

7.7 Most respondents, in general, indicated that they do not require detailed guidance to define the approach in selecting a stressed historical period. In contrast, one

respondent stated that the cost of implementing stressed VaR could be reduced were we to publish a set of clear guidelines where they can select stress data periods. A further respondent suggested that we should define a default one-year stressed historical period. One area of concern where firms did request specific guidance was how to address instances where firms have positions in products that did not exist in the stressed historical period.

Q36: What other areas of the stressed VaR capital charge would you find useful to have guidance on?

7.8 Similar to the previous question, respondents generally felt that no further guidance was required to implement stressed VaR. Drilling down into the responses, however, indicates areas where firms feel that they would benefit from further direction. These include clarifying expectations around the 'Use Test for stressed VaR', confirming the relationship between a firm's stressed VaR multiplier and its VaR multiplier, and how to appropriately apply the stressed VaR methodology (including multiplication factors and selecting stressed time periods) across subsidiaries and parent entities. We thank firms for their informative comments in these areas, which we will take forward in our thinking in these areas.

7.9 A minority of respondents indicated that we should engage with firms to understand the various stressed VaR methodologies being considered, so we can steer ongoing implementation by UK firms. One firm questioned our example in footnote 94 of CP09/29 as to how a firm's stressed period should reflect a material change in their portfolio composition. One firm correctly informed us that our method for calculating the stressed VaR capital requirement in paragraph 6.15 of CP09/29 was inconsistent with the draft EU Directive text. Our proposed Handbook text (BIPRU 7.10.113 R) on page 17 of Appendix 4 of CP09/29 states the correct stressed VaR capital calculation.

Our response: Despite firms generally stating that they do not require further detailed guidance in implementing a stressed VaR measure, reviewing firm's responses to CP09/29 and CRD3 implementation questionnaire, and bilateral and multilateral discussions with firms, suggests otherwise. We have identified common areas where we believe that firms would benefit from some general guidance. These would cover among others:

- selecting and updating an appropriate historical time period;
- dealing with historical data problems;
- the Use Test;
- identifying the stressed VaR multiplier; and
- applying stressed VaR across consolidated entities.

We feel this guidance will help firms understand what we would expect at a high-level when implementing stressed VaR from a UK perspective, while also recognising that we should not be overly prescriptive and thereby 'promoting a standard approach'. We continue to engage with firms through bilateral and multilateral fora to understand the various methodological approaches being considered by firms and the issues that arise in implementing them. This extensive information gathering exercise will guide the scope and nature of our guidance

and, with that in mind, the most appropriate channels through which to disseminate it. We will detail the outcome from this exercise in the subsequent consultation paper for CRD3.

To provide some initial, but by no means conclusive, thinking on some of the areas identified in our information gathering exercise, we agree that our approach in reviewing a firm's stressed historical period should be flexible so we can accommodate issues such as bank specific portfolio construction. We do not, therefore, intend to define a default one-year stressed historical data period for all firms. Instead we prefer firms to justify the reasonableness of their selected stressed period, its continued relevance to the firm's portfolio while recognising the less cyclical intention of a stressed VaR measure. We envisage the firm's processes in identifying an appropriate historical time period that is relevant to the firm's portfolio and subsequent review will be particularly important in our stressed VaR model validation process. Furthermore, when there is no historical data for the stressed period, we will use proxies; in a similar vein to the approach undertaken in existing VaR models. Therefore, as part of our stressed VaR model validation process, we will review firms approaches for calibrating proxy data.

The incremental risk charge (IRC)

7.10 The IRC aims to improve the risk capture of the market risk framework by requiring firms to capitalise the default and migration risk for traded debt instruments that is incremental to that identified by their VaR model. We asked the following questions:

Q37: What additional guidance on IRC should we provide?

7.11 Respondents generally judged the CRD text to be sufficiently clear on the model parameters and validation techniques necessary to introduce an appropriate IRC model. Some respondents identified areas where they would seek additional guidance. These include clarifying how to determine appropriate liquidity horizons, and how to treat maturity mismatches between a product and its hedge and reconciling these mismatches with the constant level of risk assumption.

7.12 A minority of respondents had specific views on aspects of the new requirements. The concerns expressed included the likelihood that an IRC capital charge would lead to double counting with charges already calculated under stressed VaR and VaR, and the CBA of attempting to model product basis risk in the IRC given the likely materiality of such risks compared to default risk.

Our response: Although firms generally stated that they do not require further detailed guidance in implementing IRC, our CRD3 implementation questionnaire and follow-up bilateral meeting with firms have identified common areas, as well as those mentioned in firms' responses, where we believe firms would benefit from general guidance. These include, but are not limited to:

- product scope;
- the use of data sources;
- the copula assumptions; and
- single-period vs multi-period models.

We continue to engage with firms through bilateral and multilateral fora to understand the various methodological approaches being considered and any issues that arise in implementing them. We are also involved in discussions at an international level to identify common implementation and methodological issues. This extensive information gathering exercise will guide the scope and nature of our guidance and inform our thinking on how to introduce guidance. We will supply further detail on the outcome of this exercise in the subsequent consultation paper for CRD3.

Application of the standardised measure to securitisations

7.13 The CRD3 amendments aim at reducing the opportunity for capital arbitrage by aligning the capital charges for securitisations in the trading book with the existing capital charges in the non-trading book. They will also require firms to apply provisions on implicit support and due diligence for trading book securitisations. We asked the following questions on trading book securitisations:

> Q38: Do you believe that we should provide additional guidance on the application of the implicit support rules and due diligence requirements to securitisation positions in the trading book?

7.14 There was a mixed response to this question. Some respondents stated that no further guidance is required; other respondents raised queries as to how to identify trades that are subject to implicit support, and requested further guidance on applying the due diligence requirements.

Our response: The amendments to CRD2 relating to securitisations request CEBS to elaborate guidelines for the convergence of supervisory practices with regard to, amongst other things, due diligence requirements, which CEBS published for consultation[19] on 1 July 2010. We will use the outcome of this consultation process and the final CEBS guidelines to inform our thinking on the nature and form of our guidance that we will prepare. The responses on where guidance could be provided in terms of implicit support do not suggest that general guidance is necessary; these queries can, instead, be dealt with on a bilateral basis.

> Q39: What other additional guidance would you find useful in helping to apply the non-trading book securitisation requirements to securitisation positions in the trading book?

7.15 A range of specific observations were raised by respondents. The concerns were primarily fourfold:

1. The continuing uncertainty as to the construction of the final securitisation rules, especially as the capital charges are likely to be significant.

2. Whether a maximum loss principle could apply; whereby the capital charge calculated on an individual securitisation position would be restricted to the maximum permissible loss on the position.

19 *CP40 CEBS consultation paper on guidelines on Article 122a of the Capital Requirements Directive*, Committee of European Banking Supervisors – www.c-ebs.org/Publications/Consultation-Papers/All-consultations/CP31-CP40/CP40.aspx

3. How to apply the supervisory formula approach to securitisations in the trading book.

4. One respondent raised concerns that because trading book securitisations span two chapters of the Handbook, this could lead to ambiguities in treatment between banking book and trading book securitisations. Equally, there are concerns that the BIPRU 7 sections on trading book securitisations do not fully encapsulate the relevant sections in BIPRU 9, nor wholly reflect the draft CRD language.

Our response: We recognise the ongoing uncertainty concerning the content, and timing, of the final CRD3 Directive. With this in mind, we have clearly outlined our future consultation process and will, where necessary, consult on any material amendments to the current draft Directive. We note the suggestion that capital charges on individual securitisation positions should be restricted to the maximum possible loss and will explore this suggestion further. Equally, we will investigate further some respondents' suggestions for guidance in applying the supervisory formula in the trading book. Finally, in constructing the new BIPRU 7 handbook text on trading book securitisations, and its link with BIPRU 9 handbook text we will consider the comments and suggestions that have been made.

Correlation trading floor – all price risk measure and capital floor

7.16 The CRD amendments incorporate a correlation trading portfolio carve-out for securitisations and nth-to-default credit derivatives that meet specific criteria. Subject to our approval, firms would be able to calculate an all price risk model capital charge for correlation trading portfolio products. The all price risk model capital charge would be subject to a floor based on a percentage of the standardised charge for such products.

> Q40: Do you believe that we should provide additional guidance regarding what additional positions can be included in the correlation trading portfolio for hedging?

7.17 Limited responses to this question suggest that some firms would benefit from additional guidance on what hedges are permissible, but this does not appear to be an issue for most firms.

> Q41: Which key areas should we focus on when developing industry guidance for the all price risks measure?

7.18 Respondents to questions 40 and 41 were generally concerned that it is premature to formalise an approach to the all price risk measure while there are ongoing discussions as to the scope and calibration of the correlation trading portfolio at an international level.

7.19 Most responses were not directly relevant to the questions that we posed, and focused instead on their concerns in introducing an all price risks measure. They principally covered:

- the likelihood that there will be multiple-counting of capital charges across a number of risk capital calculations;
- the complexity and computational challenges in creating such a model; and
- the imposition, methodology and calibration of a capital floor to the all price risk measure.

Our response: Although respondents generally did not answer the questions posed, we consider that the all price risk measure requirements are challenging and that firms would benefit from some general guidance to help them implement the legislation. The responses to our CRD3 implementation questionnaire and follow-up bilateral meeting with firms have identified common implementation themes that support our view. We continue to engage with firms through bilateral and multilateral fora to understand the various methodological approaches being considered and the issues that arise in implementing them. This extensive information gathering exercise will guide the scope and nature of our guidance and, inform our thinking on how to introduce guidance. We will supply further detail on the outcome of this exercise in the subsequent consultation paper for CRD3.

We note respondents concerns about introducing a capital floor. We continue, however, to support imposing a capital floor; methodological and computational complexities in creating an all price risk model demand a capital floor backstop. We recognise, however, the need for international agreement on the methodology and calibration of such a floor. At the time of publication of the CP discussions on the composition of a capital floor were ongoing, and so we did not consult on its introduction. We intend, however, to consult on the final capital floor methodology and calibration in our subsequent consultation paper.

Improvements to VaR modelling standards

7.20 The CRD amendments include several modifications to the VaR modelling standards. Any relevant comments to these modifications centred on the implications of introducing an actual ten-day holding period to calculate regulatory VaR, as opposed to a ten-day equivalent holding period.

Our response: We note the concerns that respondents have raised concerning the introduction of an actual ten-day holding period to calculate regulatory VaR, but reiterate that we expect firms to implement best practice as industry standards evolve.

Equity position risk adjustment

7.21 The adjustments will impact firms that use standard rules to calculate their specific risk on equity positions. In particular, having a standard 8% specific risk Position Risk Adjustment (PRA) across the board and removing the reduced specific risk charge for qualifying equities. We asked:

Q42: What is the impact of this increase in the standard rules specific risk PRA on your firm?

7.22 One response noted that it is unclear what this amendment attempts to resolve. In general, however, there were few responses to this question, and those that did respond recognised the immaterial impact of these proposed amendments.

Nth-to-default credit derivatives

7.23 The CRD amendment requires the seller of protection on nth-to-default credit derivatives that are externally rated to calculate the capital charge using the rating of the derivative and apply the relevant securitisation framework risk weighting. We asked:

> Q43: What is the impact of this change in the treatment on nth-to-default credit derivatives on your firm?

7.24 Where mentioned, responses were in favour of the proposed change. Equally, responses noted the insignificant impact of this amendment.

BIPRU 7.11 – Securitisation credit derivatives

7.25 Our standard rules for securitisation credit derivatives require firms to hold capital equal to the higher of the CRD minimum capital requirement and our more risk-sensitive super-equivalent rules. As the CRD minimum capital requirements are changing, we are reassessing whether it is appropriate to continue with our super-equivalent rules.

7.26 Where mentioned, respondents generally considered the new CRD capital requirements would make the BIPRU 7.11 super-equivalent rules unnecessary. One respondent also raised a query concerning the application of notional values for credit derivatives, arguing that market values would be more appropriate.

Our response: We continue to reiterate what we stated in the CP. We will be seeking further information from firms on the costs and benefits of retaining our super-equivalent rules for securitisation credit derivatives and we will subject this area of our rules to further consultation. We note the suggestion to use market value as opposed to notional value for credit derivatives, which we will investigate further.

Reporting requirements

7.27 We propose to reflect the CRD amendments on reporting requirements through changes to the main market risk reporting form (FSA005) and creating a new reporting form (FSA058) for securitisations that originated or are held in the trading book. This new form reflects the alignment of the capital treatments for securitisations in the trading book and non-trading book, and therefore, is founded on the existing non-trading book securitisation reporting form (FSA046).

7.28 One response questioned why a new reporting form FSA058 had been introduced when they believed that FSA046 can cater for this requirement.

Our response: The proposed CRD3 provisions in respect of securitisation Pillar 3 disclosures require separate disclosures for trading book and non-trading book securitisations. Achieving consistency with the Pillar 3 approach is a key rationale for having two separate reports. We also believe there will be materially fewer firms required to complete FSA058 than FSA046 and we do not consider it appropriate to include a significant number of cells in FSA046 that may not be relevant to a large proportion of firms were there only one report covering both trading book and non-trading book.

Cost-benefit analysis

Q44: Do you agree with this CBA?

7.29 Respondents generally believed that the CBA assessment underestimated the true marginal impact of the trading book proposals. Respondents also stressed that the ongoing QIS exercises should provide a clearer indication of the capital impact.

7.30 In particular, it seems a respondent may have interpreted our estimate of the incremental capital compliance cost (4.7%) as an estimate of firms' cost of capital and thought this estimate was too low. One firm also suggested that several firms will need to raise capital in a short period of time, which would push the returns investors required higher. The same respondent noted that at the time of our baseline capital requirements capital ratio had already increased as a result of deteriorations in credit quality and the tightening of the supervisory approach to models.

Our response: Since the publication of the CP we have continued to seek our own regular impact assessments from sample UK firms. In addition, further BCBS trading book quantitative impact studies have been performed, which include a sample of UK firms. We continue to believe that the capital impact of implementing the CRD market risk amendments is in line with our original estimations in the CP.

In terms of our estimate of the incremental capital compliance cost (4.7%), this number is not an estimate of firms' cost of capital. This number represents the difference between firms' cost of equity and cost of debt. It assumes that banks comply with the policy by keeping the size of their total balance sheet constant and 'swapped' some of their debt for equity to improve their capital ratio.

This estimate is based on historical relationships and does not reflect potential market pressure which could affect the return on equity required by investors. However, when firms raise this capital, this incremental cost will not only be affected by the number of firms raising capital in a short period of time, but also by other demand factors (such as investors' appetite for banking exposure) and wider economic conditions. Providing a cost estimate which would take these dynamics into account is an inherently complex task that was not deemed a proportionate use of our resources. As explained in CP09/29, our estimate is conservative in many respects and we still believe that it is an appropriate estimate of the incremental ongoing cost of funding additional capital.

Finally, we still consider our baseline to be appropriate. Banks' adjustments due to market pressure or other supervisory initiatives would not be incremental to the particular proposals set out in CP09/29.

Change in CRD2 commencement date

7.31 As with the non-trading book (see Chapter 6: Securitisation), in the CRD2 introduction to the trading book (article 122a of BCD) the Directive clearly states that this will only apply to new securitisations issued on or after 1 January 2011 and only for existing securitisations after December 2014. So, on 31 December 2010, this will have no impact on article 122a for the trading book. Because of this, and the fact that FSA058 was only implemented because of article 122a, reporting form FSA058 will not have to be completed at 31st December 2010.

8 Other feedback

Prudent valuation

8.1 This chapter summarises the responses we received on specific aspects of the proposals set out in CP09/29 about implementing the CRD amendments to the prudent valuation framework. The proposed amendments were based on the July 2009 package published by the BCBS to strengthen the Basel II framework. It is noted that these amendments, which relate to CRD3, will not be implemented at the time of this feedback, but we expect to address them in a subsequent statement.

8.2 The proposals set out in CP09/29 affected the prudent valuation framework in several ways, including more specific requirements around policies and procedures for valuation, an explicit requirement to consider the need for valuation adjustments arising from model risk and a change to terminology used in GENPRU 1.3 to remove a reference to valuation 'reserves'.

8.3 We only received a limited number of general comments concerning the proposed changes to the prudent valuation framework. In general, respondents presented mixed views towards the proposed changes, although they were supportive of the current approach where the prudent valuation framework is applied to all fair value positions in the trading book and banking book.

Comments on the proposed changes

Q45: Do you have any observations on the amendments to the prudent valuation framework?

8.4 Several general concerns were raised about the proposals, including possible issues around interpreting the requirements, firms' ability to demonstrate compliance and the current exclusion of application to insurers. In addition, a number of respondents noted that the proposals outlined in CP09/29 do not represent a substantive change in policy and were not expected to generate significant additional costs for firms, provided that they are not accompanied by other changes to the framework arising from our work examining current prudent valuation practices (such as through a need for major systems development or unintended regulatory consequences).

8.5 Several respondents had specific observations on the amendments to the prudent valuation framework. Again, they expressed mixed views, although most were not in favour of the proposed changes. Those in favour expressed their support subject to the changes being essentially procedural and the burden of the changes not outweighing the benefits. However, for those not in favour of the proposed changes, their main concern was that this might constitute either a change in regulatory interpretation of, or an extension to, the prudent valuation framework, which could result in large-scale divergence of regulatory valuations from those determined for audited financial statements purposes, i.e. resulting in 'two sets of books'.

Our response: While in many cases valuation for regulatory purposes will be expected to be the same as for financial statement purposes, the prudent valuation requirements have provided a mechanism where additional adjustment to valuations for prudential purposes may also be required. We note that certain respondents appeared unaware of the potential consequence of the existing framework that regulatory valuations may, if required, be more prudent than those used for audited financial statement purposes. We do not accept, therefore, that the proposals constitute a significant extension or reinterpretation of the existing framework.

Policies and procedures

8.6 Several respondents who were not in favour of the changes noted a specific concern about the amendment requiring firms to mark-to-model conservatively. They were unclear what the actual impact of the insertion of the word 'conservatively' would be, as there was no detailed explanation to support the use of the term.

Our response: This change to the CRD is not accompanied by further description and we agree the term gives rise to potential uncertainty over its application. However, mark-to-model valuation techniques contain considerable scope for judgement and in our view this should facilitate application of the requirement.

Model risk

8.7 Where mentioned, respondents were in favour of the proposed changes.

Valuation adjustments

8.8 Respondents who were not in favour of the changes were specifically concerned about the proposal to deduct from tier one capital valuation adjustments arising from the requirements. Respondents suggested the deduction should be taken against the relevant tier of capital alongside, for example, net interim trading book profits.

Our response: We consider that deduction from tier one capital represents an appropriate treatment for valuation adjustments being made for prudential purposes.

Pillar 2 and Pillar 3

8.9 We combined consultation on the CRD2 Pillar 2 (supervisory review) and CRD 2 and 3 amendments to Pillar 3 (disclosure) in the same chapter in the CP.

Pillar 2

8.10 The proposed amendments in CP09/29 are designed to clarify the expectations and outcome of Pillar 2 reviews in the EU. In particular, the additional paragraph to Article 136 (2) BCD is useful in creating greater certainty that a key output of the supervisory review process is an adjustment to the minimum level of own funds to capture additional risks.

8.11 We received no comments about the Pillar 2 amendments and so we welcome this clarity and strengthening of the text. As mentioned in CP09/29, we do not believe that changes to our Handbook are required.

Pillar 3

8.12 In CP09/29, we consulted on implementing amendments to the Pillar 3 disclosure requirements introduced by the CRD2 and CRD3 amendment packages. These included changes enhancing disclosures on securitisation, market risk and operational risk.

8.13 However, as discussed in Chapter 1, we are only implementing the changes introduced by CRD2 at this time. We conducted a separate CBA on these changes, and believe that the costs of implementing these changes will be insignificant. The new requirements introduce limited changes to disclosures on market risk and operational risk:

- firms that calculate their market risk capital requirements using a VaR model will have to give more information on the daily VaR measures during the period; and
- firms using the Advanced Measurement Approach (AMA) to calculate their operational risk capital requirement will have to provide more information on risk mitigation.

8.14 We are also confirming changes to disclosure requirements linked to hybrid capital.

Q46: Do you believe that our approach to implementing Pillar 3 remains appropriate?

8.15 Respondents indicated that they continued to support the current implementation approach to Pillar 3, which uses straight copy-out with no additional guidance.

8.16 One respondent said that they would welcome periodic feedback from us on observed examples of good and bad practice, to help firms provide adequate disclosure.

Our response: We intend to continue with our copy-out approach to implementing Pillar 3 requirements.

CEBS assessed banks' Pillar 3 disclosures for 2008 and 2009, and has published two reports[20] indicating examples of good practice and areas where there is room for improvement.

20 *Assessment of banks' Pillar 3 disclosures*, Committee of European Banking Supervisors, June 2009, www.c-ebs.org/getdoc/6efe3a55-b5c5-4f73-a6af-a7b24177e773/CEBS-2009-134-Final-published-(Transparency-assess.aspx and *Assessment of 2009 audited annual report disclosures and Assessment of 2009 Pillar 3 disclosures, 30 June 2010* – www.c-ebs.org/News-Communications/Latest-news/CEBS-today-publishes-two-follow-up-reports-present.aspx

Q47: Do you have any comments on our approach to implementing the changes to public disclosure requirements?

8.17 Most comments made by respondents referred to the changes introduced by CRD3. As we are only implementing changes introduced by CRD2 at this time, these comments are not given here, but will be taken into account when implementing the final amendments introduced by CRD3.

8.18 One response noted that the assessment of implementation costs appeared to be a reasonable estimate. There were no comments on the Handbook text proposed for the CRD2 amendments.

Our response: As there were no comments on the Handbook text proposed to implement the Pillar 3 amendments in the CRD2 package, we shall implement the draft text without further changes.

However, the removal of the CRD3 amendments will mean slight revisions to the structure of BIPRU 11.5.13 R. In particular, the requirement consulted upon as BIPRU 11.5.13 R (4) (a) will move to BIPRU 11.5.13 R (1) (d), and the requirement consulted upon as BIPRU 11.5.13 R (6) will move to BIPRU 11.5.13 R (1) (e).

9 Technical amendments

Introduction

9.1 The technical amendments chapter in CP09/29 contained amendments for several areas. We have kept the same categorisation for our responses, shown below.

Q48: Do you agree with our proposed approach to implementing the CRD technical amendments?

Internal ratings based approach

9.2 Respondents broadly supported the changes proposed in the IRB technical amendments, and we accordingly intend to apply these unchanged.

9.3 One respondent requested that the amendment on requirements to be satisfied by IRB firms be deferred pending consideration by the BCBS of this issue.

Our response: We are not aware of any active consideration on this issue by the BCBS and, in any event, this would not be sufficient grounds for deferring implementation of a change to the CRD.

9.4 On the extended exemption for sovereign exposures from the UK to all EEA member states, one respondent suggested it might be coherent to extend this to further countries outside the EEA.

Our response: This would be outside the scope of the CRD amendment was targeted at cases where the CRD requirements were resulting in inconsistent answers depending upon the reporting entity within the group. We do not believe it is more widely desirable to treat as risk free exposures that a firm believes has a non-zero risk, as reflected in its internal systems, and the quantification of which for existing IRB firms has already been approved by the FSA and/or other relevant supervisor. We do confirm that, in response to a request for clarification on inconsistency between the CP and draft Handbook text, the scope of the extension is to all EEA member states and not just those within the EU.

Treatment of counterparty credit risk (CCR)

9.5 CCR technical amendments arising from CRD2 and CRD3 were presented in CP09/29. As the draft CRD3 text is still outstanding, and in line with the approach

taken in this feedback statement, we will comment on the responses to both sets of technical amendments and only incorporate CRD2 amendments in the accompanying policy statement Handbook text.

9.6 We thank one respondent for identifying a typographical error in the proposed Handbook text for BIPRU 13.3.14 that was inconsistent with the CRD2 Directive text. We received no other comments from respondents.

Standardised approach to credit risk

9.7 Standardised approach technical amendments arising from CRD2 and CRD3 were presented in CP09/29. As the draft CRD3 text is still outstanding, and in line with the approach taken in this feedback statement, we will comment on the responses to both sets of technical amendments and only incorporate CRD2 amendments in the accompanying Policy Statement Handbook text.

Treatment of short-term exposures

9.8 This amendment involved replacing the reference to original maturity in BIPRU 3.4.35R and 3.4.37R with residual maturity. We also proposed to make minor amendments to BIPRU 3.4.112 to improve clarity.

9.9 We received no feedback from respondents on these changes, and so will implement the Handbook changes proposed in CP09/29.

Treatment of residual lease exposures

9.10 This amendment sought to improve clarity on the treatment of the residual value of leases and furthermore, the calculation of the risk weighted exposure of residual leases was only set out for firms on IRB and not also TSA to credit risk.

9.11 We received no feedback on these changes so we will implement the Handbook changes proposed in CP09/29.

Treatment of exposures to regional and local governments

9.12 Changing how exposures are treated by regional and local governments was inadvertently positioned as a CRD2 amendment in CP09/29. We can confirm that this is part of the CRD3 package and as such, we have not included it in the final rules with this Paper.

9.13 We received no feedback on this amendment; however we will communicate the final outcome of the CRD3 amendments as soon as possible.

Credit risk mitigation

9.14 Respondents who commented on the proposed changes about credit risk mitigation issues were generally supportive. However, industry representative bodies pointed out that, for certain transactions, the current practice is for firms to apply conversion factors before collateral when calculating RWEA. In support of their

rationale, they referred to the Commissions response to question 483[21] on its electronic query service for certain legislative acts falling within the policy area managed by Directorate General (DG) Internal Market & Services.

Our response: Our view is that the Commission's answer supports the approach we originally set out, and we therefore propose to maintain the position that CRM will be applied to the full amount of the potential exposure before applying conversion factors in those situations covered by the amended rules.

9.15 In respect of life policies to be used as credit risk mitigants, industry representative bodies asked whether we can provide periodic equivalence assessments for major third country insurance companies, and to publish a list of eligible insurance firms.

Our response: The new requirement is for '…supervision by a competent authority of a third country which applies supervisory and regulatory arrangements at least equivalent to those applied in the Community'. On this basis, we have suggested an approach which addresses the question of supervisory equivalence rather than assessing insurance providers. An alternative might have been to allow firms to make this assessment, but we believe our suggested approach is more appropriate and it may be less costly for firms. We will therefore maintain our proposal to make a general equivalence assessment of relevant third country regulators as required.

Operational risk

Limits to capital alleviation from risk transfer mechanisms

9.16 The feedback we received did not question our proposal to clarify that the total possible reduction in firms' operational risk capital requirements arising from the use of risk transfer mechanisms is 20%, with insurance and other transfer mechanisms counting towards this limit. However, it was suggested that we should jointly review the 20% limit with CEBS and BCBS as it may have the unintended consequence of creating a disincentive to mitigate risk. A periodic review of this limit is also suggested to determine whether the theoretical limit has any detrimental impact on risk transfer practices.

Our response: During the past 18 months, the Operational Risk Working Groups of both CEBS and the BCBS has considered Insurance as an Operational Risk Mitigation technique and, as a result, CEBS have published guidelines on this. While no evidence was forthcoming to suggest that the limit is creating a disincentive, we feel our ongoing discussions with participants in this field will enable us to identify if this issue arises.

New business line for mapping exceptional institution-wide loss events

9.17 No respondents argued against our proposal to allow firms to use a new business line, 'corporate items', to categorise losses that affect the entire firm due to exceptional circumstances and we therefore propose to implement this change.

21 http://ec.europa.eu/yqol/index.cfm?fuseaction=question.show&questionId=483

However, two issues were raised in the responses:

- coverage of new business line, corporate items; and
- definition of exceptional circumstances.

Our response: Corporate function related loss events which affect the entire firm may be allocated to the additional business line 'corporate items' due to exceptional circumstances.

We do not propose to define exceptional circumstances. BIPRU 6.5.21 R (3) requires Advanced Measurement Approach (AMA) firms to 'have documented objective criteria for allocating losses to the specified business lines and event types'. AMA firms who wish to categorise losses as 'corporate items' must include this category in their documented criteria with their definition of exceptional circumstances.

Standardised approach calculation

9.18 No comments were received on our proposal to copy-out the CRD amendment which clarifies the steps involved in calculating operational risk capital requirements for firms using TSA, so we will implement this change.

Extending the large exposures and capital requirements exemptions for specialist commodity derivatives firms

9.19 Articles 45 and 48 of the Capital Adequacy Directive (CAD) have been amended to extend the deadline for the expiry of exemptions for specialist commodity derivatives firms from the large exposures regime and capital requirements provisions under the CRD to the end of 2014.

9.20 We received no comments on these amendments and so will implement the Handbook changes as proposed in CP09/29.

Calculating capital requirements for position risk

9.21 The position risk (trading book) technical amendments involved minor changes to the market risk treatment of first and nth-to-default credit derivatives, debt instruments and the treatment of internal hedges in the trading book. We received no feedback from respondents on these changes, and so will implement the Handbook changes proposed in CP09/29.

Treatment of counterparty credit risk (CCR) – CRD3 amendments

9.22 Please refer to the treatment of CCR for in the CRD2 section above.

Part II

Further consultation

10 Further consultation

10.1 After publishing CP09/29 '*Strengthening Capital Standards 3*' in December 2009, CEBS issued guidelines on core tier one capital, large exposures and operational risk, which elaborate on aspects of the CRD2[22] amendments. We are also consulting on an amendment to the criteria for allowing a 0% risk weight for intra-group exposures under The Standardised Approach (TSA) to credit risk, which is tied to the definition of the core UK group, as consulted on in CP09/29.

10.2 The credit risk amendment will have a one-month consultation so the final rules can be put in place by the end of October 2010, to be applied by firms from 1 January 2011.

10.3 The Committee of European Banking Supervisors (CEBS) guidelines on core tier one instruments does not need to be in place by the transposition date set out in the Directive, and so will be subject to a three-month consultation. Subject to the outcome of this consultation, the CEBS guidelines will be included as rules and guidance in our Handbook to be effective for implementation, from the start of 31 December 2010.

22 'Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management'. In addition , the Commission has also adopted technical changes to the CRD in accordance with the comitology procedure. The technical changes to Directive 2006/49/EC were adopted by the Commission on 7 April 2009 (Commission Directive 2009/27/EC amending certain Annexes to Directive 2006/49/EC of the European Parliament and of the Council as regards technical provisions concerning risk management). The technical changes to Directive 2006/48/EC were adopted by the Commission on 27 July 2009 (Commission Directive 2009/83/EC amending certain Annexes to Directive 2006/48/EC of the European Parliament and of the Council as regards technical provisions concerning risk management.

11 Core tier one capital

Introduction

11.1 We published our proposed approach to implementing the CRD amendments and giving effect to the related guidance from CEBS in respect of 'hybrid tier one' capital in December 2009.[23] As part of the CRD amendments, CEBS was also mandated to elaborate guidelines to converge supervisory practices with regard to instruments referred to in Article 57(a) of the Banking Consolidation Directive (BCD) or 'core tier one' instruments. CEBS published its final core tier one guidelines in June 2010.[24] This consultation outlines our approach to adopting those guidelines into our Handbook rules and guidance.

11.2 The CEBS guidelines for core tier one instruments outline criteria they should meet to be included within Article 57(a). These criteria reflect the key characteristics that an instrument must have to be eligible as part of core tier one capital. The 'eligibility criteria' are similar, although not identical, to the criteria issued in the Basel Committee on Banking Supervision (BCBS) in December 2009.[25]

11.3 This consultation focuses on the areas where we propose to add rules and guidance to our Handbook to meet these guidelines. (In some areas our current rules and guidance or other provisions, such as company law, are sufficient to ensure we meet the guidelines.)

Changes to current rules

11.4 As noted above, the CEBS guidelines introduce detailed eligibility criteria for core tier one capital which we propose to incorporate into our Handbook rules. These are listed below.

23 *Strengthening Capital Standards 3*, FSA, December 2009 – www.fsa.gov.uk/pages/Library/Policy/CP/2009/09_29.shtml

24 *Implementation Guidelines regarding Instruments referred to in Article 57(a) of Directive 2006/48/EC recast*, Committee of European Banking Supervisors, 14 June 2010 – www.c-ebs.org/Publications/Standards-Guidelines/CEBS-Guidelines-on-instruments-referred-to-in-Arti.aspx

25 *Strengthening the resilience of the banking sector*, Basel Committee on Banking Supervision, December 2009 – www.bis.org/publ/bcbs164.htm

Table 1: Changes to core tier one capital

Proposal	Reference paragraph
Definition of capital	11.7 – 11.10
Permanence	11.11
Flexibility of payments	11.12 – 11.15
Loss absorbency	11.16

Areas of super-equivalence

11.5 While most of this consultation features amendments to our rules and guidance to give effect to the provisions of the CEBS guidelines as written, we are proposing to be stricter than the CEBS elaboration of the criteria to be met by Article 57 (a) instruments, to maintain the spirit and purpose of the rules in these areas:

Table 2: Areas of super-equivalence: Core tier one capital

Provision	Our proposal	Rationale
'Original own funds referred to in Article 57(a)…should include all instruments that are regarded under national law as equity capital, rank pari passu with ordinary shares during liquidation and fully absorb losses on a going concern basis *pari passu* with ordinary shares.'	Core tier one instruments for joint stock companies limited to ordinary shares.	Risk of the inclusion in core tier one of instruments which do not have sufficient loss absorbency.
'It should be possible for those instruments to include instruments providing a preferential right for dividend payment on a non cumulative basis…'	A preferential right to a dividend will not be permitted as a feature of core tier one capital instruments.	The creation of preferences within core tier one capital would undermine loss absorbency as the preferred securities may not absorb losses *pari passu* with other core tier one instruments.

Characteristics

11.6 The CEBS guidelines introduce detailed eligibility criteria for core tier one instruments. The purpose of these criteria is to ensure these instruments meet the highest standards for going concern capital. We outline below how we plan to give effect to the guidelines to ensure that instruments counted as core tier one capital have the appropriate characteristics – permanence, flexibility of payments and principal loss absorbency – so they are consistent with the guidelines. Where permissible and practical for UK firms, we have also introduced exceptions in the guidelines that CEBS has specifically agreed for mutuals and similar institutions. The purpose of these 'exceptions' is to ensure that the guidelines adequately accommodate the particular legal forms of these institutions as contemplated by Recital 4 of the Directive.

Definition of capital

11.7 The CEBS guidelines (criteria 1 to 3) outline some general features that an instrument must contain to be eligible as core tier one capital, such as its legal form, accounting status and that it is paid up. We comment below on our approach to adopting those guidelines in our Handbook.

Core tier one instruments for joint-stock companies restricted to ordinary shares

11.8 CRD2 and the CEBS guidelines allow joint-stock companies (i.e. those owned by shareholders) to include instruments within core tier one that are not ordinary shares. (This consultation does not cover reserves, which in most cases can also be included within core tier one capital.) However, we propose to make ordinary shares the only instrument that joint stock companies can include within core tier one capital. The main reasons for this are:

- Certainty: Ordinary shares meet the eligibility criteria for core tier one capital. They are also regarded as the highest form of capital by market participants, who may be uncertain as to the qualities of non-ordinary shares if these were included within core tier one capital.
- Simplicity: Restricting joint stock companies to ordinary shares will limit the types of instrument that can be included within core tier one capital. This will therefore restrict any possibilities of 'financial engineering' that could weaken the quality of core tier one capital.

11.9 Further, the BCBS currently proposes to restrict joint stock companies' core tier one capital instruments to ordinary shares.

> Q1: Do you agree with our proposed restriction of core tier one instruments to ordinary shares?

11.10 We also propose to amend our rules and guidance in the following areas to ensure consistency with the CEBS guidelines on definition of capital (criteria 1 to 3). This has mainly been achieved by proposed amendments to Chapter 2.2 of our General Prudential sourcebook (GENPRU), in particular GENPRU 2.2.83R (permanent share capital) and a new rule GENPRU 2.2.83AR, in which we propose details of eligibility criteria for core tier one capital instruments. Our detailed proposals are:

- Non-Joint Stock (NJS) companies: We propose to add provisions to ensure that core tier one capital for NJS companies (e.g. mutuals, partnerships and Limited Liability Partnerships (LLPs)) is equivalent to ordinary shares in capital qualities. In particular, we propose to achieve this by linking the relevant rules for partnerships and LLPs, for example, to the relevant eligibility criteria for permanent share capital.
- We also propose amending our rules so that the ability of core tier one instruments to absorb losses should be clear and that these instruments must absorb losses immediately as they arise.

- We propose to add rules to ensure that core tier one capital instruments must be accounted for as equity and must not allow the holder to petition for winding up.
- We also propose to add a rule to clarify that voting rights may be relevant in considering an instrument's eligibility as core tier one, if these rights create privileges, and that any shares of the same class with different voting rights must be notified to us before issue.

Permanence

11.11 The CEBS guidelines also cover the permanence characteristic of core tier one capital (criteria 4 and 5). The main features here are that the instrument should be perpetual and not redeemable outside of liquidation. The guidelines also set out the conditions under which instruments may be bought back, which includes a requirement for the firm to obtain supervisory approval. To meet these guidelines, we propose the following changes to our Handbook:

- Repurchases and redemptions: We propose to amend our rules and guidance to align them with the CEBS guidelines. This includes amending our rules to require firms to:
    - give us one month's notice so that we can consider the proposed transaction before any repurchase is due to take place;
    - not announce a repurchase until we have responded to that notification (our proposal clarifies that such an announcement should not be made in respect of any tier one instrument); and
    - to deduct proposed repurchases from capital at the point of notification to us of the proposed repurchase (again our proposal clarifies that this is the appropriate treatment for all tier one instruments).
- The type of information required when submitting a notice of repurchase of a core tier one instrument is the same as that required by the rules we consulted on in CP09/29 for a hybrid tier one repurchase. The information requirement will now apply to the repurchase of any tier one capital instrument and this information will be required when a firm is giving notice of a repurchase.
- We have also proposed clarifications that core tier one capital should be undated, that issuers are not permitted to have a call and that holders only have a proportional claim on a firm's residual assets in a winding up.

Flexibility of payments

11.12 A key feature of a core tier one instrument is that a firm should have full discretion over dividend payments. So, criteria 6 and 7 of the CEBS guidelines set out how the distribution on a core tier one instrument should function to ensure that it absorbs losses on a going concern basis.

Preferential right to a dividend not permitted

11.13 CRD2 and the CEBS guidelines permit institutions to include instruments that contain a preferential right to a dividend. (This preference is restricted by the guidelines to a fixed or constant multiple of the dividend on a firm's ordinary shares.) We propose not to permit core tier one instruments to have such a preferential right. The significant benefit we anticipate is simplicity – prohibiting a preferential right to a dividend will limit the types of instrument that can be included within core tier one capital. This will therefore restrict any possibilities of 'financial engineering' that could weaken the quality of core tier one capital. (We are proposing, however, to allow building societies to have a preferential right to a dividend within certain core tier one instruments if it arises as a consequence of complying with the terms of the exception under the CEBS guidelines that we propose to extend to building societies. Please see the details of this proposal in paragraph 11.18 below.)

11.14 Further, the current BCBS proposals would not permit a preferential right to a dividend. So, any instruments with a preferential right may not be eligible within core tier one once the BCBS proposals are implemented.

Q2: Do you agree with our proposal to disallow a preferential right to a dividend in core tier one?

11.15 We also propose to amend our rules to clarify that:

- non-payment of dividends should not be an event of default;
- instruments should not contain an alternative coupon satisfaction mechanism;
- instruments should not include dividend pushers or stoppers; and
- a dividend policy can be disclosed if it only reflects the current intention of the Board and does not undermine the discretionary feature of payments.

Loss absorbency

11.16 The guidelines (criteria 8 to 10) elaborate the way in which the principal amount of a core tier one instrument should absorb losses on a going and gone concern basis. The amendments we propose to our rules to reflect the guidelines under these criteria include proposals to clarify that core tier one instruments:

- must fully absorb losses proportionately with other core tier one instruments and take first loss to allow a firm to continue as going concern;
- must rank below all other instruments in a liquidation; and
- cannot include any features, such as guarantees, assets pledges or other credit enhancements that could legally or economically enhance the seniority of the instruments.

Adjustments for mutuals

11.17 The guidelines set out measures for the equivalent treatment for NJS companies that are intended to accommodate their specific legal structures. Not all of these measures are applicable to NJS compares in the UK due to the legislative framework supporting UK mutuals and the operating models currently in existence. We have proposed rules and guidance to reflect measures that can be applied or are appropriate in the UK context. However, we would note that NJS companies wishing to issue instruments that take advantage of these measures should engage with us as soon as possible and must give at least one month's notice and submit the documentation surrounding these instruments to us.

11.18 The exception we propose to introduce is the ability for a building society to include in its core tier one capital a share which is subject to a cap on distribution. These shares are permitted for building societies if the cap is:

- imposed by law;
- included within a society's constitutional documents;
- designed to protect reserves; and
- if dividends continue to be fully variable and at the society's full discretion.

Where a distribution cap applies to a share included in core tier one capital, the same cap must apply to all other core tier one instruments issued by the society and all other core tier one instruments must comply with the core tier one instrument requirements. The distributions on any other core tier one instruments are limited to a fixed multiple of the dividend on the capped instrument where a preferential right to a dividend arises on the uncapped instrument. This final requirement ensures any preferential right to a dividend on the uncapped instruments is a fixed, constant multiple of the dividend paid on a capped instrument. This exception (where building societies have both capped and uncapped instruments within core tier one capital) is the only instance in which we propose to permit a preferential right to a dividend within core tier one capital. We do not propose to implement this exception (or the other exceptions that are outlined below) for industrial and provident societies (I&PS). This is because there are, to our knowledge, currently no I&PS that undertake banking or investment business that will be affected by these proposals. There are also restrictions on I&PS ability to undertake banking business and we consider it unlikely that they will be able to benefit from this exception in the future. We will, however, review this position if circumstances change.

11.19 We have not proposed introducing into our rules the exceptions in the CEBS guidelines that:

- permit mutuals to include instruments in core tier one capital which gives the holder the right to redeem the instrument;
- deal with the scenario where shareholders have limited access to reserves; and
- deal with the scenario where shareholders have limited rights to net assets in a liquidation.

11.20 With regard to shareholders having limited access to reserves and limited rights to net assets in liquidation, we are not aware of any UK mutuals including such provisions in their membership terms. Such terms are common in European mutual structures, where upon becoming a member, shareholders give up their rights to net assets and reserves in return for a fixed claim in liquidation, but are not, to our knowledge, currently used in the UK. Indeed, UK mutuals are owned by their members, who would have a proportionate claim on the net assets of the mutual in a winding up. There are no provisions in current legislation in the UK providing for limited access to reserves, limited payment in a liquidation or payment of reserves to charitable entities. We are therefore of the view that these limitations do not currently exist in practice and are unlikely to arise. Should this situation change, we will consult further on amending our rules to include the appropriate parts of the CEBS guidelines.

11.21 With regard to core tier one instruments including a right to return the instrument to the firm, the CEBS guidelines state this exception applies 'where there is a right under the law for shareholders to return their shares to the issuing institutions (in particular cooperative and mutual banks)'. UK building societies can only issue instruments qualifying as 'deferred shares' as core tier one capital. However, the Building Societies (Deferred Shares) Order 1991 does not permit deferred shares to be redeemed other than in the case of a winding up or with our consent (such consent to be freely requested and not as a consequence of the terms of issue of an instrument). Consequently there is no right or ability under law for holders of deferred shares in UK building societies to return their deferred shares. Therefore we have not proposed including such a provision in our Handbook.

11.22 If building society legislation is amended to allow building societies to issue redeemable deferred shares we will consult further on changing our rules to reflect the CEBS guidelines.

Q3: Do you agree with our proposed approach to implementing the exceptions for mutuals as permitted in the CEBS guidelines?

Transitional provision

11.23 We are proposing a transitional provision to clarify that The Royal Bank of Scotland plc B Shares, a core tier one instrument issued under state aid provisions, will continue to be eligible as core tier one capital. We are also proposing a transitional provision to give firms six months to notify us if, prior to 31 December 2010, they had in issue any ordinary shares with different voting rights to other ordinary shares. Our proposed rule on voting rights is explained in paragraph 11.10 above – and this transitional provision will allow existing instruments with different voting rights to remain potentially eligible as core tier one capital without the need to provide a pre-notification to us under our proposed new rule.

Small firms

11.24 Small firms will be interested in this consultation, as it impacts the core tier one instruments that they will be allowed to include within their capital resources.

Consumers

11.25 The rules and guidance for core tier one capital consulted upon here are not likely to have a direct impact upon consumers.

Q4: Are our proposed rules clear?

Cost-benefit analysis

Areas of super-equivalence

11.26 The CP outlines two areas where we propose to be super-equivalent to CRD2 as elaborated in the CEBS guidelines on the definition of core tier one capital.

11.27 The first of these is the limitation of core tier one instruments for joint stock companies to ordinary share capital. The second is the proposal not to allow for any core tier one instrument to have a preferential right to a dividend. We discuss the costs and benefits of these two proposals in turn below. As noted above, we have decided not to implement some of the exceptions in the CEBS guidelines relating to mutuals. However, as mutuals are not currently able to make use of these exceptions due to legislative restrictions or because certain types of mutuals (i.e. I&PS) do not undertake business that is affected by these proposals, there are no costs and benefits arising.

Costs

11.28 Implementing these measures should not have any upfront cost to the firms as they will not have to change their current practice. One could argue that the measures could disadvantage UK firms either by raising their cost of capital compared to their European counterparts or by restricting innovation. However, we believe these costs are unlikely to be material.

For limiting core tier one instruments for joint stock companies to ordinary shares

11.29 The CEBS guidelines do not explicitly limit compliant instruments to ordinary shares. If an instrument can be designed that meets all the criteria outlined in the guidelines, it does not have to be an ordinary share. We are thus going further than the guidance here as we propose to restrict core tier one instruments to ordinary shares for joint stock companies.

11.30 The option of using core tier one instruments that are not ordinary shares is not currently available to UK joint stock companies, so there will be no immediate costs

to firms. There is, however, also a potential opportunity cost arising from potential higher costs of capital associated with the restriction of core tier one instruments to ordinary shares relative to an instrument that could be designed that is not required to be an ordinary share.

11.31 These opportunity costs are likely to be minimal, since restricting core tier one instruments to ordinary shares has been our policy for many years. There is also no evidence that there is a higher cost of capital in the UK relative to European counterparts due to this factor. Moreover, if an instrument were to be designed that complied with all CEBS guidelines' criteria, its characteristics should result in the instrument being priced identically to ordinary share capital by virtue of its compliance.

For not allowing core tier one instruments to have preferential rights to dividends compared with other core tier one instruments.

11.32 This potentially reduces the amount of flexibility UK firms will have with regards to issuing capital instruments, and may allow European counterparts to offer more 'attractive' capital instruments. However, we are not aware of any instruments with preferential rights to dividends in core tier one capital under current rules apart from ordinary shares used as part of state aid. Since firms have revealed a preference for instruments without preferential rights to dividend, there will be no immediate costs to firms and the opportunity costs from the loss of an option to issue these instruments in the future are likely to be low.

Benefits

11.33 We believe limiting core tier one instruments to ordinary shares will result in greater financial stability than would otherwise be the case, thereby yielding market confidence and consumer protection benefits. This is because ordinary share capital is the only instrument that guarantees loss absorbency on a going concern basis and thus gives us comfort that it will behave as expected during times of crisis.

11.34 Past experience has shown that innovation can result in regulatory arbitrage and has given rise to instruments that meet rules yet fail to behave as regulators had expected them to during times of crisis. This is particularly true in the case of hybrid tier one instruments, which failed to demonstrate the loss absorbency characteristics that were supposedly built into their design. Thus, we feel it is important to ensure that during times of stress, core tier one capital consists only of instruments that are proven to exhibit loss absorbency. This view is in line with the market behaviour during the 2008-2009 crisis, during which market participants primarily focused on narrower definitions of core tier one capital when assessing the capital adequacy of financial sector firms.

11.35 The decision not to allow preferential rights to dividends is aimed at avoiding different classes of preference between core tier one instruments. Allowing this characteristic in core tier one instruments creates an effective subordination within core tier one and, for the sake of enhancing transparency and minimising investor confusion, we propose to remove this option. There is also potential for such a feature to lead to an unintended expectation of a 'guaranteed' return on the core

tier one instrument, which could lead to drawbacks reminiscent of hybrid tier one instruments' limited loss absorbency in stress and may pose a risk to market confidence in the case of a failure by a firm to pay a dividend to holders of the preferential instrument.

11.36 The exception that will permit building societies to include instruments with a distribution cap within core tier one may benefit societies by potentially giving them access to a wider pool of high-quality capital than is currently available to them.

Q5: Have the relevant costs and benefits of our proposals been appropriately estimated?

12 Operational risk

CEBS guidelines for the conditions for use of insurance and ORTM in AMA

12.1 In December 2009 CEBS published guidelines on operational risk mitigation techniques.[26] The guidelines are for firms using the Advanced Measurement Approach (AMA) and supervisors of those firms, and address the general conditions in which firms using the AMA for calculation of operational risk capital may recognise operational risk mitigation instruments, and analyse the specific conditions for the use of insurance and the use of Other Risk Transfer Mechanisms (ORTM).

12.2 The guidelines build on the existing provisions of the CRD[27] and CEBS's April 2006 guidelines on the Implementation, Validation, and Assessment of AMA and Internal Ratings Based (IRB) Approaches. The guidelines are primarily intended to provide more complete coverage on the recognition of insurance than existing guidance. In addition to covering general conditions, the section on insurance deals with the eligibility of protection providers, the characteristics of eligible products, and the issue of haircuts for uncertainty of coverage.

12.3 As firms and supervisors have relatively little experience of the use of ORTM, CEBS has limited the specific guidelines on this type of protection. The section on ORTM refers in general to the CRD requirements and CEBS guidelines for insurance, and to relevant sections of the CRD framework for credit risk mitigation. This section therefore focuses on ensuring convergence of supervisory practices in ORTM by providing a framework which is consistent with the one for insurance products.

12.4 We welcome the guidelines and propose to adopt them in our supervision of AMA institutions. BIPRU 6.5.26R to BIPRU 6.5.30R sets out the requirements for the recognition of insurance and ORTM by firms using AMA. Given the small number of firms for whom the guidelines will be relevant, we do not propose to

26 *Implementation Guidelines regarding Operational Risk mitigation techniques*, Committee of European Banking Supervisors, 22 December 2009 – www.c-ebs.org/News--Communications/Archive/2009/CEBS-today-publishes-its-Guidelines-on-operational.aspx

27 The conditions that apply to insurance providers and contracts are set out in Annex X, Part 3, Paragraphs 26 to 29 of Directive 2006/48/EC. Annex X, Part 3, Paragraph 25 of the same Directive states that the impact of Other Risk Transfer Mechanisms shall be recognised only if the institution can demonstrate to the satisfaction of the competent authorities that a noticeable risk mitigation effect is achieved.

copy-out the guidelines into the Handbook at this stage. We propose to include guidance in BIPRU 6.5 saying that firms should take into account the guidelines when considering their use of insurance and ORTM in AMA (see Appendix 4 Draft Handbook text – Operational Risk). The guidelines clarify existing rules and introduce no incremental costs to firms.

Q6: Are the references to CEBS guidelines clear?

13 Large exposures

13.1 CP09/29 highlighted the guidelines that were being developed by CEBS in the areas of exposures to groups of connected clients and exposures to underlying assets. CEBS released these guidelines in December 2009,[28] after CP09/29 had been published.

13.2 CEBS have also now developed guidelines on Article 106(2) (c) and (d) of CRD2. These guidelines relate to exemptions from the large exposure rules for certain short-term exposures arising from the provision of money transmission, correspondent banking, clearing and settlement and custody activities.

13.3 We said in CP09/29 that we would issue further guidance in the Handbook, where appropriate, once the guidelines had been issued. At this point in time, we intend to insert references to the CEBS guidelines in the text of BIPRU 10.

13.4 We plan to undertake a cost-benefit analysis of adopting a copy-out approach to the full CEBS guidelines in due course. At that point we will engage with the relevant stakeholders and consult on our proposed adoption approach.

13.5 Firms should in the meantime have due regard to the CEBS guidelines when considering if counterparties form a group of connected clients, in particular with reference to the concepts of 'control' and 'economic interconnection'.

13.6 Firms should also have due regard to the CEBS guidelines when considering the appropriate counterparty for exposures to schemes with underlying assets. The guidelines outline that large exposure limits should generally be maintained to the scheme itself, even when the most risk sensitive 'look through' approach is used. The guidelines recognise that a look through approach is not always possible or, indeed, feasible and therefore also include more conservative approaches as alternatives.

13.7 Firms should also have due regard to the CEBS guidelines on Article 106(2) (c) and (d). The guidelines clarify the conditions applicable to the short-term exposures referred to in these Articles.

Q7: Are the references to CEBS guidelines clear?

28 *Guidelines on the implementation of the revised large exposures regime,* Committee of European Banking Supervisors, 11 December 2009 – www.c-ebs.org/documents/Publications/Standards---Guidelines/2009/Large-exposures_all/Guidelines-on-Large-exposures_connected-clients-an.aspx

14 Credit risk – 0% risk weight for intra-group exposures under the standardised approach

14.1 The CRD allows for a 0% risk weight to be applied to intra-group exposures between entities in the same Member State if conditions over fungibility of capital, centralised risk management and consolidated supervision are met. This is the basis for the current credit risk provisions in BIPRU 3.2.25 R to BIPRU 3.2.37 G .

14.2 We propose that the current practice of applying a 0% risk weight to certain intra-group exposures within the UK continues, although the provisions allowing this practice will be strengthened in light of concerns over information asymmetries between group members and fungibility of capital between counterparties.

14.3 A key change to the existing provisions will be for all the entities in the core UK group to be incorporated in the UK and be fully owned subsidiaries and fully consolidated within the same UK consolidation group. Another change designed to ensure capital is fungible within the core UK group is the requirement for legally binding commitments of support from the unregulated members of the core UK group to the regulated members.

14.4 A firm will be able to apply for a waiver in order to set up a 'core UK group' (a core UK group waiver) which will allow it to apply a 0% risk weight to qualifying intra-group exposures for credit risk purposes under the Standardised Approach (TSA).

14.5 A firm with a core UK group waiver will also be allowed to exempt those intra-group exposures which would be assigned a 0% risk weight from the large exposure limit.[29] This proposed change to the BIPRU 3 text will therefore align the core UK group criteria used for credit risk and large exposures.

14.6 The proposed change will be implemented on 1 January 2011, although firms which are applying a 0% risk weight under the current rules will be able to make use of a transitional provision to delay switching to the core UK group regime for a further two years until 31 December 2012. This transitional period is aligned to the transitional period for intra-group exposures exempted under the large exposure regime.

29 The criteria to set up a core UK group are also detailed in BIPRU 10.8. Final Handbook text for BIPRU 10 will only be released once this consultation has concluded, due to the interaction between the proposed BIRPU 3 changes and the criteria for the core UK group in BIPRU 10.8.

14.7 Firms should notify us before 31 December 2010 if they want to make use of the transitional period. They should also include details of their preliminary plans to move onto the revised BIPRU 3 intra-group provisions.

Q8: Are the criteria for the core UK group clear?

Q9: Is the proposed transitional option clear?

Areas of super-equivalence

14.8 The availability of the concession for intra-group exposures within the same Member State that meet certain criteria for 0% risk weighting under TSA is not limited to wholly-owned subsidiaries, but may be available to subsidiaries over which the firm effectively exercises a dominant influence and entities linked by unified management absent capital ties that are included in the same consolidated supervision by us, another EEA supervisor or a non-EEA supervisor that undertakes equivalent supervision.

14.9 We propose to restrict the exemption to group entities that are fully owned and are included in the same consolidated supervision by us. This requirement helps to ensure there are no other interests that could interfere with the firm's control over the subsidiaries and on the ability of the firm to require prompt movement of capital within the core UK group.

Cost-benefit analysis

14.10 The proposed change will impact on those firms that currently apply, or plan to apply, a 0% risk weight for credit risk under TSA.

14.11 We surveyed a number of firms to help us understand the benefits and costs of the proposals. The survey asked firms how they expected to respond to the proposed policy change and their responses are tentative.

14.12 We found that the proposed change to the conditions allowing firms to apply a 0% risk weight for exposures in a core UK group will have a limited effect on most of the firms surveyed. Most of the firms impacted had already considered the costs of these proposals at the time the core UK group was introduced for large exposures purposes in CP09/29. In most cases, firms would meet the criteria for the core UK group and they would not incur any additional cost from the 0% risk weight provisions in BIPRU 3.2.25 R being strengthened.

14.13 Strengthening the conditions that allow for counterparties to be eligible for the 0% risk weight will help reduce information asymmetries between group members and also help ensure capital between counterparties is fungible. The benefits of fungible capital will be especially realised if members of a core UK group were to go into insolvency.

Q10: Are there any costs or benefits mentioned above that you believe would not materialise, or any other costs and benefits that we should consider?

Compatibility with our objectives and the principles of good regulation

Introduction and statement of purpose

1 This Annex sets out our views on how our approach to adopting The Committee of European Banking Supervisors (CEBS) guidance proposals, and changes to our rules for 0% risk weighting of intra-group exposures, in relation to CRD2, are compatible with our objectives and the principles of good regulation.

Compatibility with our statutory objectives

2 Our planned implementation of the changes proposed in this Consultation Paper (CP) and the set of draft Handbook text that accompanies it, aims primarily to meet our market confidence objective. However, our consumer protection statutory objective is also relevant. The draft Handbook text is not aimed particularly at promoting public awareness or at reducing financial crime.

Market confidence

3 This objective requires us to maintain confidence in the UK financial system. Our draft Handbook rules and guidance in the areas covered by this CP seek to reduce the risk of market disruption arising from financial failure of an authorised firm or group of firms. This is achieved by:

- making clear to firms the conditions that apply to use core tier one instruments;
- making clear the conditions for using insurance and Other Risk Transfer Mechanisms (ORTM) for firms using the Advanced Measurement Approach (AMA) to calculate operational risk;
- elaborating the guidelines on the exposures to groups of connected clients and exposures to underlying assets; and
- aligning the rules for the 0% risk weighting under the Standardised Approach (TSA) to credit risk with those for intra-group large exposures.

Consumer protection

4 The proposed (CRD) changes seek to align the capital held by firms within the scope of the CRD more closely to the risks arising from their business profile and the strength of their systems and controls. We expect that the enhancements made to the prudential framework for these firms as a result of the changes the CRD requires will make it less likely that they fail, and the guidelines elaborated in this CP will assist. This should have positive outcomes for consumer protection.

Financial stability

5 The CRD aims to ensure the financial soundness of credit institutions by stipulating how much of their own financial resources such firms must have in order to cover their risks and protect their depositors. This legal framework needs to be regularly updated and refined to respond to the needs of the financial system as a whole. The proposals therefore address some of the lessons learned from the credit market turmoil, follow up on aspects of the FSA's Turner Review publications, focus on meeting our market confidence objective by reducing the risks that financial market firms face, and overall, improve stability in the financial sector as a whole by contributing to the protection and enhancement of the UK financial system.

Compatibility with the need to have due regard to the principles of good regulation

6 Under section 2 (3) of the Financial Services and Markets Act 2000 (FSMA), we must consider the specific matters set out below, when carrying out our general functions.

Need to use resources in the most efficient and economic way

7 The publication of this CP allows the industry time to consider and implement the relevant changes to the CRD. Furthermore, the timing enables us to publish, in due course, a Policy Statement in response to comments from industry and other stakeholders on our implementation proposals and still have the final rules in place by the required date.

8 Our approach to implementation includes the following important elements designed to ensure that we use resources efficiently:

- using 'copy-out' wherever appropriate; and
- taking into account, where appropriate, the decisions and/or work of other regulators and international forums, including the preparation of guidelines by CEBS, to which we contribute and which has its own consultation process.

Responsibilities of those who manage the affairs of authorised persons

9 In general, we aim to follow a 'copy-out' approach to implementing the changes wherever possible, consistent with our implementation of the original requirements

of the CRD. This means there will be less prescription and guidance for firms, giving them more responsibility for compliance.

Principle that a burden or restriction should be proportionate to the benefits, considered in general terms, expected to result from imposing that burden or restriction

10 We have undertaken a cost-benefit analysis (CBA) of the material changes to help with this CP. Given the diverse nature of the different policy topics covered in the package of changes as a whole, the results are set out with discussion of each policy topic under the relevant chapters.

11 In general terms, the results suggest that the costs arising from implementing the CEBS guidelines and changes to the 0% risk weighting are proportionate to the benefits. Furthermore, Annex 2 identifies areas of super-equivalence, ensuring that we pay due regard to this principle in areas where it has discretion.

12 We may have overlooked some of the significant effects of the CBA. Differences of opinion may also rise over the nature and extent of these effects. We therefore welcome the input of respondents in helping us identify such areas.

Desirability of facilitating innovation in connection with regulated activities

13 The changes seek to update, strengthen and align more closely various prudential requirements with the risks that firms face, so the CRD can continue promoting the development of strong risk management techniques, which should improve the efficiency of capital allocation. This should also facilitate innovation for risk management and product development.

International character of financial services and markets and the desirability of maintaining the competitive position of the UK

14 Our intention is to adopt a predominantly 'copy-out' approach to implementing changes to the CRD in the UK. In areas where we propose to be super-equivalent, as listed in Annex 2, we have taken account of the competitive implications between firms based in the UK and in other countries. We also continue to work in CEBS to achieve effective implementation, including through its guidelines where appropriate. Annex 3 sets out how we propose to exercise national directions permitted by the CRD.

Need to minimise the adverse effects of competition that may arise from anything done in the discharge of the FSA's functions

15 The CBA indicates that the overall package of proposed changes should not have material adverse effects on competition. However, we remain open-minded and would welcome responses from readers on this matter.

Desirability of facilitating competition between those who are subject to regulation by us

16 The overall effects of the changes should lead to more risk-sensitive capital requirements and promote good risk management. This, in turn, should facilitate more effective competition.

Most appropriate way for us to meet our regulatory objectives

17 We are required to set out why we think our standards are the most appropriate way to meet our obligations. We are required under EU law to comply with CEBS guidance or explain our reasons for not doing so. This CP considers the choices available to us and our reasons for making our proposals in those areas which contain any discretion.

Areas of super-equivalence

1 We have identified the following areas of super-equivalence, which are set out in more detail in the relevant chapters.

- Core tier one capital – Table 2 in Chapter 11.
- Credit risk – 0% risk weight for intra-group exposures under TSA – Chapter 14.

Annex 3

List of national discretions

1 One area of national discretion relates to the amendment to the credit risk rules for 0% risk weight for intra-group exposures under TSA, as detailed in Chapter 14.

Annex 4

List of questions in this Consultation Paper

Chapter 11 Core tier one capital

Q1: Do you agree with our proposed restriction of core tier one instruments to ordinary shares?

Q2: Do you agree with our proposal to disallow a preferential right to a dividend in core tier one?

Q3: Do you agree with our proposed approach to implementing the exceptions for mutuals as permitted in the CEBS guidelines?

Q4: Are our proposed rules clear?

Q5: Have the relevant costs and benefits of our proposals been appropriately estimated?

Chapter 12 Operational risk

Q6: Are the references to CEBS guidelines clear?

Chapter 13 Large exposures

Q7: Are the references to CEBS guidelines clear?

Chapter 14 Amendments – Credit Risk – 0% risk weight under the standardised approach

Q8: Are the criteria for the core UK group clear?

Q9: Is the proposed transitional option clear?

Q10: Are there any costs or benefits mentioned above that you believe would not materialise, or any other costs and benefits that we should consider?

Annex 5

List of non-confidential respondents to the questions in CP09/29

Association for Financial Markets in Europe/British Bankers Association/ International Swaps and Derivatives Association

Association of Private Client Investment Managers and Stockbrokers

Association of Foreign Banks

Bank Leumi (UK) plc

Barclays Bank PLC

Building Societies Association

C. Hoare & Co.

Citigroup

European Repo Council

Goldman Sachs International

Investment Management Association

Jersey Financial Services Commission

Lloyds Banking Group

Macquarie Bank International Limited

Oceanic

Paragon Group

Royal Bank of Scotland Group

Santander UK plc

Smith and Williamson Investment Management Limited

Standard Chartered Bank

The Co-operative Financial Services Limited

UBS Investment Bank

In addition we received five responses where the respondents requested confidentiality for part or all of their response.

Appendix 1

Final Handbook text

CAPITAL REQUIREMENTS DIRECTIVE (HANDBOOK AMENDMENTS) INSTRUMENT 2010

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of:

(1) the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(a) section 138 (General rule-making power);
(b) section 150(2) (Actions for damages);
(c) section 156 (General supplementary powers);
(d) section 157(1) (Guidance); and

(2) the other powers listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.

B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 31 December 2010.

Amendments to the Handbook

D. The modules of the FSA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
General Prudential sourcebook (GENPRU)	Annex B
Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)	Annex C
Supervision manual (SUP)	Annex D

Notes

E. In the Annexes to this instrument, the "notes" (indicated by "**Note:**") are included for the convenience of readers but do not form part of the legislative text.

Citation

F. This instrument may be cited as the Capital Requirements Directive (Handbook Amendments) Instrument 2010.

By order of the Board
22 July 2010

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

deferred share	in relation to a *building society*, a deferred share as defined in the Building Societies (Deferred Shares) Order 1991.
hybrid capital	an item of capital that is stated in *GENPRU* 2.2 as eligible for inclusion at stage B1, B2 or C of the calculation in the *capital resources table*.
mezzanine securitisation positions	for the purposes of *BIPRU* 9.3.7R, 9.4.11R and 9.5.1R(6), *securitisation positions* to which a *risk weight* lower than 1250% applies and which are more junior than the most senior position in the relevant *securitisation* and more junior than any *securitisation position* in the relevant *securitisation* to which: (a) in the case of a *securitisation position* subject to the *standardised approach* to *securitisation* set out in *BIPRU* 9.11.1R and 9.11.2R, a *credit quality step* 1 is assigned; or (b) in the case of a *securitisation position* subject to the *IRB approach* to *securitisation* set out in *BIPRU* 9.12.10R and 9.12.11R, a *credit quality step* 1 or 2 is assigned under *BIPRU* 9.7.2R , 9.8.2R to 9.8.7R and regulation 23 of the *Capital Requirements Regulations 2006*. [**Note**: *BCD*, Annex IX, Part 2, Point 1, paragraph 1b]
ongoing basis	in *BIPRU* 9.15, maintaining on an *ongoing basis* means that the retained positions, interest or exposures are not hedged or sold. [**Note:** *BCD*, Article 122a, paragraph 1]

Amend the following definition as shown.

netting set	(in accordance with Part 1 of Annex III of the *Banking Consolidation Directive* (Definitions) and for the purpose of *BIPRU* 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) a group of transactions with a single counterparty that are subject to a legally

enforceable bilateral netting arrangement and for which netting is recognised under *BIPRU* 13.7 (Contractual netting), *BIPRU* 5 (Credit risk mitigation) and, if applicable, *BIPRU* 4.10 (The IRB approach: Credit risk mitigation); each transaction that is not subject to a legally enforceable bilateral netting arrangement, which is recognised under *BIPRU* 13.7 must be interpreted as its own *netting set* for the purpose of *BIPRU* 13. Under the method set out at *BIPRU* 13.6, all *netting sets* with a single counterparty may be treated as a single *netting set* if negative simulated market values of the individual sets are set to zero in the estimation of *expected exposure* (*EE*).

[**Note:** *BCD*, Annex III, Part 1, point 5]

Annex B

Amendments to the General Prudential sourcebook (GENPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Table: Arrangement of *GENPRU* 2.2

2.2.6 G This table belongs to *GENPRU* 2.2.5G

Topic	Location of text
…	…
Limits on the use of different forms of capital for *banks* and *building societies* (certain types of *capital resources* cannot be used for certain purposes)	*GENPRU* ~~2.2.42R~~ 2.2.44R to *GENPRU* 2.2.45R; *GENPRU* 2.2.47R to *GENPRU* 2.2.48R
…	…
Limits on the use of different forms of capital for *BIPRU investment firms* (certain types of *capital resources* cannot be used for certain purposes)	*GENPRU* ~~2.2.42R~~ 2.2.44R to *GENPRU* 2.2.45R; *GENPRU* 2.2.47R to *GENPRU* 2.2.48R
…	…
Tier one capital instruments: general	*GENPRU* 2.2.9G to *GENPRU* 2.2.10G; *GENPRU* 2.2.62R to *GENPRU* 2.2.69G; *GENPRU* 2.2.80R to *GENPRU* 2.2.82G
Tier one capital: payment of *coupons* (*BIPRU firm* only)	*GENPRU* 2.2.69AR to *GENPRU* 2.2.69FG
…	…
Core tier one capital: *deferred shares* (*building society* only)	*GENPRU* 2.2.108AR to *GENPRU* 2.2.108BG
Tier one capital: perpetual non-cumulative *preference shares* (*insurer* only)	*GENPRU* 2.2.109R to *GENPRU* 2.2.110G
~~*Tier one capital: PIBS*~~	~~*GENPRU* 2.2.76R; *GENPRU*~~

	~~2.2.111R to *GENPRU* 2.2.112G~~
Innovative tier one capital (excluding issues through *SPVs*) (*insurer* only)	*GENPRU* 2.2.76R; *GENPRU* 2.2.113R to *GENPRU* 2.2.122G
Hybrid capital (excluding issues through *SPVs*) (*BIPRU firm* only)	*GENPRU* 2.2.115AR to *GENPRU* 2.2.119G
~~*Innovative tier one capital*~~ *Hybrid capital* (issues through *SPVs*) (*BIPRU firm* only)	*GENPRU* 2.2.123R to *GENPRU* 2.2.137R
…	…
Redemption of *tier one instruments*	*GENPRU* 2.2.64R(3); *GENPRU* 2.2.70R to *GENPRU* 2.2.79G
Purchases of *tier one instruments*: BIPRU firm only	*GENPRU* 2.2.79AR to *GENPRU* 2.2.79HG
…	…

2.2.9 G *Tier one capital* typically has the following characteristics:

(1) it is able to absorb losses;

(2) it is permanent or (in the case of a *BIPRU firm*) available when required;

…

2.2.10 G The forms of capital that qualify for *Tier one capital* are set out in the *capital resources table* and include, for example, *share* capital, reserves, partnership and *sole trader* capital, verified interim net profits and, for a *mutual*, the *initial fund* plus permanent members' accounts. *Tier one capital* is divided into:

(1) in the case of an *insurer*, *core tier one capital*, perpetual non-cumulative *preference shares*~~, *permanent interest bearing shares (PIBS)*~~ and *innovative tier one capital*; and

(2) in the case of a *BIPRU firm*, *core tier one capital* and *hybrid capital*. *Hybrid capital* is further divided into the different stages B1, B2 and C of the calculation in the *capital resources table*.

…

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:

…

(2) (subject to *GENPRU* 2.2.26R and *GENPRU* 2.2.26AR) the *rules* in *GENPRU* governing the eligibility of capital in that *lower stage of capital* continue to apply.

…

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* 2.2.25R is not subject to the requirement to have no fixed maturity date in *GENPRU* 2.2.177R(1).

2.2.27 R ~~A *BIPRU firm* may include in a *lower stage of capital*, *innovative tier one capital* that it is prohibited from using under *GENPRU* 2.2.42R (*BIPRU firms* may not use *innovative tier one capital* to meet the *CRR*). However:~~

~~(1) the *capital resources gearing rules* applicable to that *lower stage of capital* apply to that *innovative tier one capital*; and~~

~~(2) (subject to *GENPRU* 2.2.28R) the *rules* in *GENPRU* governing the eligibility of capital in that *lower stage of capital* continue to apply.~~ [deleted]

2.2.28 R ~~The~~ In the case of a *BIPRU firm*, the requirement to obtain a legal opinion in *GENPRU* 2.2.159R(12) does not apply to ~~*innovative tier one capital*~~ *hybrid capital* treated under *GENPRU* ~~2.2.27R~~ 2.2.25R but the requirements to obtain a legal opinion in *GENPRU* 2.2.118R continue to apply.

Limits on the use of different forms of capital: Limits relating to tier one capital applicable to ~~all firms except BIPRU investment firms~~ insurers

2.2.29 R In relation to the *tier one capital resources* of an *insurer*, ~~*bank* or *building society*,~~ calculated at stage F of the calculation in the *capital resources table* (Total tier one capital after deductions), at least 50% must be accounted for by *core tier one capital*.

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

2.2.30 R In relation to the *tier one capital resources* of an *insurer*, ~~and subject to *GENPRU* 2.2.42R (Restriction on the use of *innovative tier one capital*), those of a *BIPRU firm*,~~ calculated at stage F of the calculation in the *capital resources table* (Total tier one capital after deductions), no more than 15% may be accounted for by *innovative tier one capital*.

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* 2.2.29R and *GENPRU* 2.2.30AR(1) is to ensure that ~~at least 50% of~~ the *firm's tier one capital resources* ~~(net of *tier one capital* deductions) is met by~~ includes a minimum proportion of *core tier one capital* which provides ~~maximum loss absorbency on a going concern basis to protect the firm from insolvency~~ the highest quality capital. ~~Although a perpetual non-cumulative *preference share* or a PIBS is in legal form a *share*, it behaves in many ways like a perpetual fixed interest debt instrument.~~ Within the 50% limit on non-*core tier one capital*~~,~~:

(1) *GENPRU* 2.2.30R places a further sub-limit on the amount of *innovative tier one capital* that ~~a *firm*~~ an *insurer* may include in its *tier one capital resources*; and

(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*.

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

…

~~Limits on the use of innovative tier one capital: BIPRU firm~~

2.2.42 R ~~For the purpose of meeting the *main BIPRU firm Pillar 1 rules*, a *BIPRU firm* may not include *innovative tier one capital* in its *tier one capital resources.*~~ [deleted]

2.2.43 G ~~A *BIPRU firm* may include *innovative tier one capital* in its *tier one capital resources* for the purpose of *GENPRU* 1.2 (Adequacy of financial resources) and BIPRU 10 (Concentration risk). A *firm* may also include it in its *upper tier two capital resources* under *GENPRU* 2.2.25R (Limits on the use of different forms of capital: Use of higher tier capital in lower tiers) for all~~

~~purposes as long as it meets the conditions for treatment as *upper tier two capital.*~~ [deleted]

...

2.2.52 G This table belongs to *GENPRU* 2.2.51G

Description of the stage of the capital resources calculation	Stage in the *capital resources table*	Amount (£)
Total *tier one capital* after deductions ~~(excluding *innovative tier one instruments* – see *GENPRU* 2.2.53G)~~	Stage F	80
Total *tier two capital* ~~(including *innovative tier one instruments* – see *GENPRU* 2.2.53G)~~	Stage K	80
Deductions	Stage M	(20)
Total *tier one capital* and *tier two capital* after deductions	Stage N	140
Upper tier three capital (this example assumes the *firm* has no *lower tier three capital* (*trading book* profits)	Stage Q	50
Total *capital resources*	Stage T	190

2.2.53 G ~~*GENPRU* 2.2.42R (Limits on the use of innovative tier one capital) prohibits the inclusion of *innovative tier one instruments* in the *tier one capital* of a *BIPRU firm* for the purpose of meeting the *capital resources requirement*. Thus they are not included in the calculation of stage F of the *capital resources table*. Instead all *innovative tier one instruments* have been included in *tier two capital* in accordance with *GENPRU* 2.2.25R (Use of higher tiers of capital in lower tiers).~~ [deleted]

…

2.2.61 G The explanation for *GENPRU* 2.2.60R can be found in *GENPRU* ~~2.2.43G~~ 2.1.43G (Base capital resources requirement). ...

…

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) (in the case of an *insurer*) a perpetual non-cumulative *preference share*;

(6) ~~(in the case of a *building society*) *PIBS*; and~~ [deleted]

(7) (in the case of an *insurer*) an *innovative tier one instrument*; and

(8) (in the case of a *BIPRU firm*) *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* 2.2.70R (Basic requirements for redeemability) and *GENPRU* 2.2.76R (Redeemable instrument subject to a *step-up*);

(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) in the case of a *BIPRU firm*, *core tier one capital*; and

(ii) in the case of an *insurer*, included in a *higher stage of capital* or the *same stage of capital* as that first item of 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) in the case of an *insurer*, in particular it complies with *GENPRU* 2.2.80R to *GENPRU* 2.2.81R (Loss absorption) and, in the case of an *innovative tier one instrument*, *GENPRU* 2.2.116R to *GENPRU* 2.2.118R ~~(*Innovative tier one instrument* should not constitute a liability)~~ (Other tier one capital: loss absorption); and

(b) in the case of a *BIPRU firm*, it does not, through appropriate mechanisms, hinder the recapitalisation of the *firm*, and in particular it complies with:

(i) *GENPRU* 2.2.80R to *GENPRU* 2.2.81R (Loss absorption); and

(ii) in the case of *hybrid capital*, *GENPRU* 2.2.116R to *GENPRU* 2.2.118R (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) in the case of an *insurer*, no higher than a *share* of a company incorporated under the Companies Act 2006 (whether or not it is such a *share*); or

(b) in the case of a *BIPRU firm*, 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) and, where it applies, *GENPRU* 2.2.271R (Other requirements: insurers carrying on with-profits business (Insurers only)).

…

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).

…

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 *FSA* 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* 2.2.69CR.

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 (5), *GENPRU* 2.2.69AR, or *GENPRU* 2.2.69BR, the *FSA* 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 *FSA*. If the *FSA* and the *firm* do not agree on the cancellation or deferral of the payment of a *coupon*, then the *FSA* may consider using its powers under section 45 of the *Act* to, on its own initiative, vary a *firm's Part IV permission* to require it to cancel or defer a *coupon* in accordance with the *FSA's* view of the financial and solvency situation of the *firm*.

(2) In considering a *firm's* financial and solvency situation, the *FSA* 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 *FSA*, 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* 2.2.69CR. The *FSA* may consider using its powers under section 45 of the *Act* to, on its own initiative, vary a *firm's Part IV 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; ~~and~~

(2) the *firm* cannot exercise that redemption right:

(a) before the fifth anniversary of its date of issue;

(b) unless it has given notice to the *FSA* in accordance with *GENPRU* 2.2.74R; and

(c) unless at the time of exercise of that right it complies with *GENPRU* 2.1.13R (the main capital adequacy *rule* for *insurers*) or 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 *FSA* 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* 2.2.138R and the *rule* on step-ups in *GENPRU* 2.2.147R.

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* 2.2.70R are met;

(2) the circumstance that entitles the *firm* to exercise that right is:

(a) (in the case of an *insurer*) a change in law or regulation in any relevant jurisdiction or in the interpretation of such law or regulation by any court or authority entitled to do so; and

(b) (in the case of a *BIPRU firm*) a change in the applicable tax

treatment or regulatory classification of those instruments;

(3) (a) (in the case of an *insurer*) it would be reasonable for the *firm* to conclude that it is unlikely that that circumstance will occur, judged at the time of issue or, if later, at the time that the term is first included in the terms of the *tier one instrument*; and

(b) (in the case of a *BIPRU firm*) 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 *FSA's* consent in the form of a *waiver* of *GENPRU* 2.2.72R.

…

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 *FSA* 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*; ~~and~~

(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 *FSA* considers that, in order to comply with *GENPRU* 2.2.74R, the *firm* should, at a minimum, provide the *FSA* 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*.

…

Step-ups and redeemable tier one instruments: Insurer only

2.2.76 R In the case of an *insurer*, in relation to an *innovative tier one instrument* ~~or a *PIBS*~~ which is redeemable and which satisfies the following conditions:

…

…

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) it is on or after the fifth anniversary of the date of issue of the instrument; and

(3) the *firm* has given notice to the *FSA* in accordance with *GENPRU* 2.2.79GR.

2.2.79B G In exceptional circumstances a *BIPRU firm* may apply for a *waiver* of *GENPRU* 2.2.79AR(2) under section 148 (Modification or waiver of rules) of the *Act*.

2.2.79C R *GENPRU* 2.2.79AR(2) 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(2) 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* 2.2.79DR, 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* 2.2.79AR unless it has notified the *FSA* 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 *FSA* considers that:

(1) in order to comply with *GENPRU* 2.2.79GR, the *firm* should, at a minimum, provide the *FSA* 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.

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):

…

(2) (in the case of a *building society*) it is a *deferred share* ~~"deferred share" as defined in the Building Societies (Deferred Shares) Order 1991~~; or

…

…

2.2.82 G There are additional loss absorption requirements for (in the case of an *insurer*) *innovative tier one capital* and (in the case of a *BIPRU firm*) *hybrid capital* in *GENPRU* 2.2.116R to *GENPRU* 2.2.118R ~~(*Innovative tier one instrument* should not constitute a liability)~~ (Other tier one capital: loss absorption).

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* 2.2.64R) meets the following conditions:

(1) it is:

…

(c) part of the *initial fund* of a *mutual*; or

(d) a *deferred share*;

…

…

2.2.85 R (1) …

(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 ~~stages~~ stage A (Core tier one capital) ~~and B (Perpetual non-cumulative preference shares)~~ in the *capital resources table*.

…

…

2.2.97 R The items *permanent share capital* and *share* premium account (which form part of *core tier one capital*) ~~and perpetual non-cumulative *preference shares* (which forms stage B of the *capital resources table*)~~ do not apply to a *BIPRU firm* that is a partnership or a *limited liability partnership*.

…

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* 2.2.62R (Tier one capital: General), *GENPRU* 2.2.64R (General conditions for eligibility as tier one capital), *GENPRU* 2.2.65R (Connected transactions) and *GENPRU* 2.2.80R (Loss absorption).

Other tier one capital: perpetual non-cumulative preference shares (insurer only)

2.2.109 R ~~A~~ In the case of an *insurer*, a perpetual non-cumulative *preference share* may be included at stage B of the calculation in the *capital resources table* if…

…

2.2.110 G The other main provisions relevant to the eligibility of a perpetual non-cumulative *preference share* for inclusion by an *insurer* in *tier one capital* are…

~~Other tier one capital: permanent interest bearing shares (building societies only)~~

2.2.111 R ~~A *building society* may include a *PIBS* at stage B 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 a "deferred share" as defined in the Building Societies (Deferred Shares) Order 1991.~~ [deleted]

2.2.112 G ~~The other main provisions relevant to inclusion of a *PIBS* in *tier one capital* are *GENPRU* 2.2.62R (Tier one capital: General), *GENPRU* 2.2.64R (General conditions for eligibility as tier one capital), *GENPRU* 2.2.65R (Connected transactions), *GENPRU* 2.2.70R to *GENPRU* 2.2.75R (Redemption of tier one instruments), GENPRU 2.2.76R (Step-ups and redeemable tier one instruments) and *GENPRU* 2.2.80R (Loss absorption). However many of the *rules* in this section about features of *capital instruments* that result in treatment as *innovative tier one capital* do not apply.~~ [deleted]

Other tier one capital: innovative tier one capital: general (insurer only)

2.2.113 R If, in the case of an *insurer*, an item of capital is stated to be an *innovative tier one instrument* by the *rules* in *GENPRU* 2.2, it cannot be included in stages A (Core tier one capital) or B (Perpetual non-cumulative preference shares) of the calculation in the *capital resources table*.

Other tier one capital: innovative tier one capital: redemption (insurer only)

2.2.114 R If, in the case of an *insurer*, a *tier one instrument*~~, other than a *PIBS*~~:

(1) is redeemable; and

(2) a reasonable *person* would think that:

(a) the *firm* is likely to redeem it; or

(b) the *firm* is likely to have an economic incentive to redeem it;

that *tier one instrument* is an *innovative tier one instrument*.

2.2.115 G Any feature that in conjunction with a call would make ~~a *firm*~~ an *insurer* more likely to redeem a *tier one instrument*~~, other than a *PIBS*,~~ would normally result in classification as *innovative tier one capital resources*….

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 *FSA* may require its conversion into *core tier one capital* when the *FSA* 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* 2.2.115AR 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 *FSA* may require the *firm* to convert the instrument into *core tier one capital* based on its financial and solvency situation. The *FSA* 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 *FSA* 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 *FSA* 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* 2.2.115AR.

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* 2.2.62R (Tier one capital: General), *GENPRU* 2.2.64R (General conditions for eligibility as tier one capital), *GENPRU* 2.2.65R (Connected transactions), *GENPRU* 2.2.68AR (Dividend stoppers), *GENPRU* 2.2.70R to *GENPRU* 2.2.75R (Redemption of tier one instruments), *GENPRU* 2.2.80R (Loss absorption) and *GENPRU* 2.2.116R to *GENPRU* 2.2.118R (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* 2.2.115FR 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: ~~innovative tier one capital:~~ loss absorption

2.2.116 R ~~A *firm* may~~ An *insurer* must not include a *capital instrument* that is not a *share* in its *innovative tier one capital resources* ~~if~~ unless (in addition to satisfying all the other requirements in relation to *tier one capital* and *innovative tier one capital*) ~~it satisfies the condition in this *rule*. In addition a *firm* may not include any other capital in its *innovative tier one capital resources* unless it satisfies the condition in this *rule*. The condition in this *rule* is that~~ 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…

…

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* 2.2.116R and *GENPRU* 2.2.116AR 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. As *tier one capital resources* for an *insurer* should be undated, this will generally only be relevant on a solvent winding up of the *firm*….

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* 2.2.117AR 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 *FSA* may consider using its powers under section 45 of the *Act* to, on its own initiative, vary the *firm's Part IV permission* to require it to operate the mechanism.

2.2.118 R (1) ~~*A firm*~~ An *insurer* may not include an *innovative tier one instrument*, unless it is a *preference share*, in its *tier one capital resources* unless it has obtained a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the criteria in *GENPRU* 2.2.64R(6) (loss absorption) and *GENPRU* 2.2.80R to *GENPRU* 2.2.81R (Loss absorption) are met.

(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* 2.2.62R (Tier one capital: General), *GENPRU* 2.2.64R(1) to (9) (General conditions for eligibility as tier one capital) and *GENPRU* 2.2.80R to *GENPRU* 2.2.81R (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.

…

Other tier one capital: innovative tier one capital: coupons (insurer only)

2.2.120 R ~~A~~ In the case of an *insurer*, a *tier one instrument*~~, other than a *PIBS*,~~ with a cumulative or mandatory *coupon* is an *innovative tier one instrument*.

Other tier one capital: innovative tier one capital: step-ups (insurer only)

2.2.121 R If, in the case of an *insurer*:

(1) a *potential tier one instrument*~~, other than a *PIBS*,~~ is or may become subject to a *step-up*;

(2) …

that *potential tier one instrument* is an *innovative tier one instrument*.

…

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

…

2.2.124 R …

(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* 2.2.127R, *GENPRU* 2.2.129R and *GENPRU* 2.2.132R; or

(~~a~~b) (in any other case)…

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

…

2.2.127 R The *SPV* referred to in *GENPRU* 2.2.124R (2)(a) must satisfy the following conditions:

…

(2) …; ~~and~~

(3) …; and

(4) it is incorporated under, and governed by, the laws and jurisdiction of England and Wales, Scotland or Northern Ireland.

…

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* 2.2.130R, as if the *SPV* was itself a *firm* seeking to include that capital in its *tier one capital resources*;

(2) ~~its terms must include an obligation on the *firm*, when the *capital resources* of the *firm* fall below, or are likely to fall below its *capital resources requirement*, to substitute for the instrument issued by the *SPV* a *tier one instrument* issued by the *firm* that:~~

~~(a) is not an *innovative tier one instrument*; or~~

~~(b) is an *innovative tier one instrument* provided that~~

~~(i) it is only being classified as such because it is or may become subject to a *step-up*, and~~

~~(ii) the terms of the original instrument issued by the *SPV* included a *step-up*.~~

(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*

2.2.117AR 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*; ~~and~~

(4) to the extent that investors have the benefit of an obligation by a *person* other than the *SPV*:

…

(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 ~~*innovative tier one capital*~~ *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*.

…

2.2.131 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 ~~*tier one instruments* that are not *innovative tier one instruments* or that are *innovative tier one instruments* only because they are or may become subject to a *step-up* (and the authority to issue them)~~ *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* 2.2.131R allow a *firm* to replace the capital issued by the *SPV* with ~~a~~ *capital instruments* which are *core tier one capital* ~~*instrument* that is not an *innovative tier one instrument* or that is an *innovative tier one instrument* provided that:~~

~~(1) it is only being classified as such because it is or may become subject to a *step-up*, and~~

~~(2) the terms of the original instrument issued by the *SPV* included a *step-up*.~~

~~In all other respects, the *innovative tier one instrument* issued by the *firm* must meet the conditions to be an item of *tier one capital* capable of inclusion in Stage B or higher of the *capital resources table*.~~

…

2.2.138 R …

(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 ~~200%~~:

(i) in the case of a *BIPRU firm*,150%; and

(ii) in the case of an *insurer*, 200%; or

…

…

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, which uses the conversion ratio applicable to an *insurer*.

(2) ~~A *firm*~~ An *insurer* issues innovative notes with a par value of £100 each.…

…

2.2.144 G (1) In addition to the maximum conversion ~~ratio~~ ratios of 200% for an *insurer* and 150% for a *BIPRU firm*, *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.

…

…

2.2.147 R ...

(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*.

…

2.2.157 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* 2.2.26AR 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*.

…

2.2.179 G …

(3) *GENPRU* 2.2.26AR 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.*

…

2 Annex 2R Capital resources table for a bank

The capital resources calculation for a bank		
Type of capital	**Related text**	**Stage**
Core tier one capital		**(A)**
Permanent share capital	*GENPRU* 2.2.83R	
Profit and loss account and other reserves (taking into account interim net losses)	*GENPRU* 2.2.85R to 2.2.90R	
Eligible partnership capital	…	…
…		
Hybrid capital ~~**Perpetual non-cumulative preference shares**~~		~~**(B)**~~
Stage B1 ~~Perpetual non-cumulative *preference shares*~~	*GENPRU* ~~2.2.109R~~ 2.2.115AR to *GENPRU* 2.2.117BR	(B1)
Stage B2	*GENPRU* 2.2.115DR to *GENPRU* 2.2.117BR	(B2)
~~**Innovative tier one capital**~~		~~**(C)**~~
~~*Innovative tier one instruments*~~ Stage C	*GENPRU* ~~2.2.113R~~ 2.2.115FR ~~to *GENPRU* 2.2.137R~~ to *GENPRU* 2.2.117BR	(C)
Total tier one capital before deductions = A + ~~**B**~~ **B1 + B2 + C**		**(D)**
…		

~~Note (3): Stage C must be omitted except where *capital resources* are being used for a purpose for which *innovative tier one capital* may be used (see *GENPRU* 2.2.27R)~~

2 Annex 3R Capital resources table for a building society

The capital resources calculation for a building society		
Type of capital	**Related text**	**Stage**
Core tier one capital		**(A)**
<u>*Deferred shares*</u>	<u>*GENPRU* 2.2.108AR</u>	
Profit and loss account and other reserves (taking into account interim net losses)	*GENPRU* 2.2.85R to 2.2.90R	
…	…	…
~~**Perpetual non-cumulative preference shares**~~		
~~*PIBS*~~	~~*GENPRU* 2.2.111R~~	~~(B)~~
<u>Hybrid capital</u>		
<u>Stage B1</u>	<u>*GENPRU* 115AR to *GENPRU* 2.2.117BR</u>	<u>(B1)</u>
<u>Stage B2</u>	<u>*GENPRU* 2.2.115DR to *GENPRU* 2.2.117BR</u>	<u>(B2)</u>
~~**Innovative tier one capital**~~		~~**(C)**~~
~~*Innovative tier one instruments*~~ <u>Stage C</u>	*GENPRU* ~~2.2.113R~~ <u>2.2.115FR</u> ~~to *GENPRU* 2.2.137R~~ <u>to *GENPRU* 2.2.117BR</u>	<u>(C)</u>
Total tier one capital before deductions = A + ~~B~~ <u>B1 + B2</u> + C		**(D)**
…		

~~Note (3): Stage C must be omitted except where *capital resources* are being used for a purpose for which *innovative tier one capital* may be used (see *GENPRU* 2.2.27 R)~~

2 Annex 4R Capital resources table for a BIPRU investment 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)**
Permanent share capital	*GENPRU* 2.2.83R	
Profit and loss account and other reserves (taking into account interim net losses)	*GENPRU* 2.2.85R to 2.2.90R	
Eligible partnership capital	…	…
…		
Hybrid capital ~~**Perpetual non-cumulative preference shares**~~		~~**(B)**~~
Stage B1 ~~Perpetual non-cumulative *preference shares*~~	*GENPRU* ~~2.2.109R~~ 2.2.115AR to *GENPRU* 2.2.117BR	(B1)
Stage B2	*GENPRU* 2.2.115DR to *GENPRU* 2.2.117BR	(B2)
~~**Innovative tier one capital**~~		~~**(C)**~~
~~*Innovative tier one instruments*~~ Stage C	*GENPRU* ~~2.2.113R~~ 2.2.115FR ~~to *GENPRU* 2.2.137R~~ to *GENPRU* 2.2.117BR	(C)
Total tier one capital before deductions = A + ~~**B**~~ **B1 + B2 + C**		**(D)**
…		
…		

~~Note (3): Stage C must be omitted except where *capital resources* are being used for a purpose for which *innovative tier one capital* may be used (see *GENPRU* 2.2.27R)~~

2 Annex 5R Capital resources table for a BIPRU investment 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)**
Permanent share capital	*GENPRU* 2.2.83R	
Profit and loss account and other reserves (taking into account interim net losses)	*GENPRU* 2.2.85R to 2.2.90R	
Eligible partnership capital	…	…
…		
Hybrid capital ~~Perpetual non-cumulative preference shares~~		~~(B)~~
Stage B1 ~~Perpetual non-cumulative *preference shares*~~	*GENPRU* ~~2.2.109R~~ 2.2.115AR to *GENPRU* 2.2.117BR	(B1)
Stage B2	*GENPRU* 2.2.115DR to *GENPRU* 2.2.117BR	(B2)
~~Innovative tier one capital~~		~~(C)~~
~~*Innovative tier one instruments*~~Stage C	*GENPRU* ~~2.2.113R~~ 2.2.115FR ~~to *GENPRU* 2.2.137R~~ to *GENPRU* 2.2.117BR	(C)
Total tier one capital before deductions = A + ~~B~~ B1 + B2 + C		(D)
…		

…
~~Note (3): Stage C must be omitted except where *capital resources* are being used for a purpose for which *innovative tier one capital* may be used (see *GENPRU* 2.2.27R)~~

2 Annex 6R Capital resources table for a BIPRU investment 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)**
Permanent share capital	*GENPRU* 2.2.83R	
Profit and loss account and other reserves (taking into account interim net losses)	*GENPRU* 2.2.85R to 2.2.90R	
Eligible partnership capital	…	…
…		
Hybrid capital ~~**Perpetual non-cumulative preference shares**~~		~~**(B)**~~
Stage B1 ~~Perpetual non-cumulative *preference shares*~~	*GENPRU* ~~2.2.109R~~ 2.2.115AR to *GENPRU* 2.2.117BR	(B1)
Stage B2	*GENPRU* 2.2.115DR to *GENPRU* 2.2.117BR	(B2)
~~**Innovative tier one capital**~~		~~**(C)**~~
~~*Innovative tier one instruments*~~ Stage C	*GENPRU* ~~2.2.113R~~ 2.2.115FR ~~to *GENPRU* 2.2.137R~~ to *GENPRU* 2.2.117BR	(C)
Total tier one capital before deductions = A + ~~**B**~~ **B1 + B2 + C**		**(D)**
…		

…
~~Note (3): Stage C must be omitted except where *capital resources* are being used for a purpose for which *innovative tier one capital* may be used (see *GENPRU* 2.2.27R)~~
…

After GENPRU TP 8 insert the following new transitional provisions. The text is not underlined.

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 R If a *BIPRU firm* treats a *capital instrument* as eligible for inclusion as *hybrid capital* under *GENPRU* TP 8A.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) except where it is a *building society*, 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) in the case of a *building society*, must not include *hybrid capital* at stage C of the calculation in the *capital resources table* under *GENPRU* 2.2, except as provided by (4), if the amount of *PIBS* with incentives to redeem treated under *GENPRU* TP 8A.2R exceeds the limit in *GENPRU* 2.2.30AR(3);

(4) in the case of a *building society*, may include *hybrid capital* at stage C of the calculation in the *capital resources table*, notwithstanding (3), if the *firm* issued it after 30 December 2010 and:

(a) the *capital instrument* would otherwise be eligible for inclusion as *hybrid capital* at stage C of the calculation in the *capital resources table* under *GENPRU* 2.2; and

(b) the *firm* issued it in order to replace a *PIBS* with an incentive to redeem that the *firm* treated as *hybrid capital* under *GENPRU* TP 8A.2R;

(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* TP 8A.4R, if and to the extent that the aggregate of the following exceeds the limit in *GENPRU* 2.2.30AR(2):

(a) *capital instruments* included at stage C in the *capital resources table* under (1) and *GENPRU* 2.2; and

(b) *capital instruments* included at stage B of the calculation in the *capital resources table* as at 30 December 2010 and treated under *GENPRU* TP 8A.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* TP 8A.4R, must include *capital instruments* treated under *GENPRU* TP 8A.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* TP 8A.5R, if and to the extent that the aggregate of the following exceeds the limit in *GENPRU* 2.2.30AR(1):

(a) *capital instruments* included at stage C in the *capital resources table* under (1) and *GENPRU* 2.2; and

(b) *capital instruments* included at stage B of the calculation in the *capital resources table* as at 30 December 2010 and treated under *GENPRU* TP 8A.2R; and

(8) if it includes *hybrid capital* at stage B1 of the calculation in the *capital resources table* under *GENPRU* 2.2, except as provided by *GENPRU* TP 8A.5R, must include *capital instruments* treated under *GENPRU* TP 8A.2R in the calculation of the limit in *GENPRU* 2.2.30AR(1).

8A.4 R A *BIPRU firm* may include *hybrid capital* at stage B2 of the calculation in the *capital resources table*, notwithstanding *GENPRU* TP 8A.3R(5), if the *firm* issued it after 30 December 2010 and:

(1) the *capital instrument* would otherwise be eligible for inclusion as *hybrid capital* at stage B2 of the calculation in the *capital resources table* under *GENPRU* 2.2; and

(2) the *firm* issued it in order to replace another *capital instrument* that the *firm* treated as *hybrid capital* under *GENPRU* TP 8A.2R.

8A.5 R A *BIPRU firm* may include *hybrid capital* at stage B1 of the calculation in the *capital resources table*, notwithstanding *GENPRU* TP 8A.3R(7), if the *firm* issued it after 30 December 2010 and:

(1) the *capital instrument* would otherwise be eligible for inclusion as *hybrid capital* at stage B1 of the calculation in the *capital resources table* under *GENPRU* 2.2; and

(2) the *firm* issued it in order to replace another *capital instrument* that the *firm* treated as *hybrid capital* under *GENPRU* TP 8A.2R.

8A.6 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) from 31 December 2020 until 30 December 2030:

(a) no more than 20% may be accounted for by items treated under *GENPRU* TP 8A.2R as *tier one capital*; and

(b) in the case of a *building society*, any *PIBS* with an incentive to redeem treated under *GENPRU* TP 8A.2R is to be treated as *hybrid capital* included at stage C of the calculation in the *capital resources table* and as subject to the limit in *GENPRU* 2.2.30AR(3); and

(2) from 31 December 2030 until 30 December 2040, no more than 10% may be accounted for by items treated under *GENPRU* TP 8A.2R as *tier one capital*.

8A.7 R *BIPRU firms* which do not comply by 31 December 2010 with the limits set out in *GENPRU* 2.2.29R 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* TP 8A.6R.

…

Schedule 2

Notification and reporting requirements

…

3 Table

Handbook reference	Matter to be notified	Contents of notification	Trigger events	Time allowed
…	…	…	…	…
GENPRU 2.2.74R	Intention to redeem *tier one instrument* included in *tier one capital resources*	Fact of intention and details of the *firm's* position after such redemption in order to show how it will meet the *capital resources requirement*, ~~and~~ how it will have sufficient financial resources to meet the *overall financial adequacy rule* and, in the case of a *BIPRU firm*, 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
GENPRU 2.2.79GR	Intention to purchase a *tier one instrument* in accordance with *GENPRU* 2.2.79AR	Fact of intention and details of the *firm's* position after the purchase in order to show how, over an	Intention to purchase	At least one month prior to becoming committed to purchase

		appropriate timescale, adequately stressed, and without planned recourse to the capital markets, it will meet its *capital resources requirement* and have sufficient financial resources to meet the *overall financial adequacy rule*		
…	…	…	…	…

Annex C

Amendments to the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

1.2 Definition of the trading book

…

Internal hedges

…

1.2.16 R ~~Notwithstanding~~ By way of derogation from *BIPRU* 1.2.14R to *BIPRU* 1.2.15R, when a *firm* hedges a *non-trading book* credit risk exposure using a credit derivative booked in its *trading book* (using an internal hedge), the *non-trading book* exposure is not deemed to be hedged for the purposes of calculating capital requirements unless the *firm* purchases from an eligible third party protection provider a credit derivative meeting the requirements set out in *BIPRU* 5.7.13R (Additional requirements for credit derivatives) with regard to the *non-trading book* exposure. ~~Where~~ Without prejudice to the second sentence of *BIPRU* 14.2.10R, where such third party protection is purchased and is recognised as a hedge of a *non-trading book* exposure for the purposes of calculating capital requirements, neither the internal nor external credit derivative hedge must ~~may~~ be included in the *trading book* for the purposes of calculating capital requirements.

[**Note:** *CAD* Annex VII Part C point 3]

…

3.4 Risk weights under the standardised approach to credit risk

…

Exposures to institutions: Credit assessment based method

3.4.34 R *Exposures* to *institutions* ~~with an original effective maturity of more than three months~~ with a residual maturity of more than three months for which a credit assessment by a *nominated ECAI* is available must be assigned a *risk weight* according to the table in *BIPRU* 3.4.35R in accordance with the assignment by the *FSA* in accordance with the *Capital Requirements Regulations 2006* of the credit assessments of *eligible ECAI*s to six steps in a *credit quality assessment scale*.

[**Note:** *BCD* Annex VI Part 1, point 29]

Table: Exposures to institutions ~~with an original effective maturity of more than three months~~ with a residual maturity of more than three months for which a credit assessment by a nominated ECAI is available

…

3.4.37 R *Exposures* to an *institution* ~~with an original effective maturity of three months or less~~ with a residual maturity of three months or less for which a credit assessment by a *nominated ECAI* is available must be assigned a *risk weight* according to the table in *BIPRU* 3.4.38R in accordance with the assignment by the *FSA* in accordance with the *Capital Requirements Regulations 2006* of the credit assessments of *eligible ECAI*s to six steps in a *credit quality assessment scale*.

[**Note:** *BCD* Annex VI Part 1, point 31]

Table: Exposures to an institution ~~with an original effective maturity of three months or less~~ with a residual maturity of three months or less for which a credit assessment by a nominated ECAI is available

…

~~Short-term exposures~~ Exposures to institutions and corporates with a short-term credit assessment

3.4.112 R ~~Short-term *exposures* to an *institution* or *corporate*~~ *Exposures* to *institutions* where *BIPRU* 3.4.34R to *BIPRU* 3.4.39R apply, and *exposures* to *corporates* for which a short-term credit assessment by a *nominated ECAI* is available must be assigned a *risk weight* according to the table in *BIPRU* 3.4.113R in accordance with the mapping by the *FSA* in accordance with the *Capital Requirements Regulations 2006* of the credit assessments of *eligible ECAIs* to six steps in a *credit quality assessment scale*.

[**Note:** *BCD* Annex VI Part 1, point 73]

3.4.113 R Table: ~~Short-term exposures on an institution or corporate~~ *Exposures* to *institutions* where *BIPRU* 3.4.34R to *BIPRU* 3.4.39R apply, and *exposures* to *corporates* for which a short-term credit assessment by a nominated ECAI is available
This table belongs to *BIPRU* 3.4.112R.

…

…

3.4.134 R The *exposure* value for leases must be the discounted minimum lease payments. Minimum lease payments are the payments over the lease term that the lessee is or can be required to make and any bargain option (i.e. an option the exercise of which is reasonably certain). Any guaranteed residual value fulfilling the set of conditions in *BIPRU* 5.7.1R (Eligibility), regarding the eligibility of protection providers as well as the minimum requirements

for recognising other types of guarantees provided in *BIPRU* 5.7.6R (Minimum requirements: General) to *BIPRU* 5.7.12R (Additional requirements for guarantees) must also be included in the minimum lease payments. These *exposures* must be assigned to the relevant *exposure* class in accordance with *BIPRU* 3.2.9R, *BIPRU* 3.2.10R, *BIPRU* 3.2.11R, *BIPRU* 3.2.12R, *BIPRU* 3.2.13R and *BIPRU* 3.2.14G. When the *exposure* is a residual value of leased properties, the *risk weighted exposure amounts* must be calculated as follows:

1/t * 100% * *exposure* value;

where t is the greater of 1 and the nearest number of whole years of the lease term remaining.

[**Note:** *BCD* Annex VI Part 1, point 90]

…

4.2.26 R …

(5) A *firm* may apply the *standardised approach* to *exposures* to the central ~~government~~ governments of ~~the *United Kingdom*~~ *EEA States* and ~~to its~~ their regional governments, local authorities and administrative bodies, provided that:
…

…

4.2.29 R For the purposes of *BIPRU* 4.2.26R(4), the *equity exposure IRB exposure class* of a *firm* must be considered material if its aggregate value, excluding *equity exposures* incurred under legislative programmes as referred to in *BIPRU* 4.2.26R(8)~~,~~ but including *exposures* in a *CIU* treated as *equity exposures* in accordance with *BIPRU* 4.9.11R to *BIPRU* 4.9.15R, exceeds, on average over the preceding year, 10% of the *firm's capital resources*. If the number of those *equity exposures* is less than 10 individual holdings, that threshold is 5% of the *firm's capital resources*.

[Note: *BCD* Article 89(2)]

...

4.4.67 R …

(4) For *exposures* arising from fully or nearly-fully collateralised *financial derivative instruments* transactions and fully or nearly-fully collateralised *margin lending transactions* which are subject to a master netting agreement M must be the weighted average remaining maturity of the transactions where M must be at least 10 days. For *repurchase transactions* or securities or commodities lending or borrowing transactions which are subject to a master netting agreement, M must be the weighted average remaining maturity of transactions, where M must be at least 5 days. The notional amount

of each transaction must be used for weighting the maturity.

…

4.4.68 R Notwithstanding *BIPRU* 4.4.67R(2) ~~(3)~~(4) and (8)-(9), M shall be at least one day for:

…

…

4.7.24 R The *risk weighted exposure amount* is the potential *loss* on the *firm's equity exposures* as derived using internal value-at-risk models subject to the 99th percentile, one-tailed confidence interval of the difference between quarterly returns and an appropriate risk-free rate computed over a long-term sample period, multiplied by 12.5. The *risk weighted exposure amounts* at the ~~individual *exposure*~~ *equity exposure* portfolio level must not be less than the ~~sum~~ total of the sums of the minimum *risk weighted exposure amounts* required under the *PD/LGD approach* and the corresponding *expected loss* amounts multiplied by 12.5 and calculated on the basis of the *PD* values set out in *BIPRU* 4.7.18R(1) and the corresponding *LGD* values set out in *BIPRU* 4.7.20R and *BIPRU* 4.7.21R.

[**Note**: *BCD* Annex VII Part 1 point 25]

…

4.9.6 R The *risk weighted exposure amounts* must be calculated according to the formula:

Risk-weighted exposure amount = 100% * *exposure* value except for when the *exposure* is a residual value of leased properties in which case it ~~should be provisioned for each year and will~~ must be calculated as follows:

1/t * 100% * *exposure* value;

where t is the greater of 1 and the nearest number of whole years of the lease ~~contract term~~ remaining.

[**Note**: *BCD* Annex VII Part 1 point 27]

…

4.9.11 R (1) Where *exposures* in the form of a ~~CIU~~ *CIU* meet the criteria set out in *BIPRU* 3.4.121R to *BIPRU* 3.4.122R (Conditions for look through treatment under the standardised approach) and the *firm* is aware of all of the underlying *exposures* of the *CIU*, the *firm* must look through to those underlying *exposures* in order to calculate *risk weighted exposure amounts* and *expected loss* amounts in accordance with the methods set out in *BIPRU* 4. *BIPRU* 4.9.12R applies to the part of the underlying *exposures* of the *CIU* of which the *firm* is not aware or could not reasonably be aware. In particular, *BIPRU*

4.9.12R must apply where it would be unduly burdensome for the *firm* to look through the underlying *exposures* in order to calculate *risk weighted exposure amounts* and *expected loss* amounts in accordance with methods set out in this *rule*.

(2) Where (1) applies but a *firm* does not meet the conditions for using the methods set out in *BIPRU* 4 for all or part of the underlying *exposures* of the *CIU*, *risk weighted exposure amounts* and *expected loss* amounts must be calculated in accordance with the following approaches.

…

(4) For all other underlying *exposures*, the *standardised approach* must be used, subject to the following modifications:

(a) ~~the *exposures* are assigned to the appropriate *exposure* class under the *standardised approach* and attributed the *risk weight* of the *credit quality step* immediately above the *credit quality step* that would normally be assigned to the *exposure*; and~~ [deleted]

(b) ~~*exposures* assigned to the higher *credit quality steps*, to which a *risk weight* of 150% would normally be attributed, are assigned a *risk weight* of 200%.~~ [deleted]

(c) for *exposures* subject to a specific *risk weight* for unrated *exposures* or subject to the *credit quality step* yielding the highest *risk weight* for a given exposure class, the *risk weight* must be multiplied by a factor of two, but cannot be higher than 1250%; and

(d) for all other *exposures*, the *risk weight* must be multiplied by a factor of 1.1 and subject to a minimum of 5%.

[**Note**: *BCD* Article 87(11)]

4.9.12 R …

(2) Alternatively to the method described in (1), a *firm* may calculate itself or rely on a third party to calculate and report the average *risk weighted exposure amounts* based on the *CIU's* underlying *exposures* and calculated in accordance with the ~~remaining provisions of this *rule*,~~ approaches in *BIPRU* 4.9.11R(3) to *BIPRU* 4.9.11R(4), provided that the correctness of the calculation and the report is adequately ensured.

(3) ~~For *exposures* belonging to the *equity exposure IRB exposure class*, the approach set out in *BIPRU* 4.7.9R - *BIPRU* 4.7.12R (Simple risk weight approach) must be used. If, for those purposes, a *firm* is unable to differentiate between private equity, exchange-traded and other *equity exposures*, it must treat the *exposures* concerned as other~~

~~equity *exposures*.~~ [deleted]

(4) ~~For all other underlying *exposures*, the *standardised approach* must be used, subject to the following modifications:~~

~~(a) the *exposures* must be assigned to the appropriate *exposure* class under the *standardised approach* and attributed the *risk weight* of the *credit quality step* immediately above the *credit quality step* that would normally be assigned to the *exposure*; and~~

~~(b) *exposures* assigned to the higher *credit quality steps*, to which a *risk weight* of 150% would normally be attributed, must be assigned a *risk weight* of 200%.~~ [deleted]

…

4.10.25 R Where the ratio of the value of the collateral (C) to the *exposure* value (E) is below a threshold level of C* (the required minimum collateralisation level for the *exposure*) as laid down in *BIPRU* 4.10.28R, LGD* must be the *LGD* laid down in the other sections of *BIPRU* 4 for uncollateralised *exposures* to the counterparty. For this purpose, the *exposure* value of items listed in *BIPRU* 4.4.37R to *BIPRU* 4.4.39R and *BIPRU* 4.8.29R must be calculated using a *conversion factor* or percentage of 100% rather than the *conversion factors* or percentages indicated in those rules.

[**Note:** *BCD* Annex VIII Part 3 point 69]

…

4.10.41 R The requirements in *BIPRU* 4.10.40R(2) and *BIPRU* 4.10.42R - *BIPRU* 4.10.48R do not apply ~~for~~ to guarantees provided by *institutions*, ~~and~~ central governments, ~~and~~ *central banks* and other *corporate* entities which meet the requirements in *BIPRU* 5.7.1R(7) if the *firm* has received approval under *BIPRU* 4.2 to apply the *standardised approach* for *exposures* to such entities. In this case the requirements of *BIPRU* 5 (credit risk mitigation) apply.

[**Note**: *BCD* Annex VII Part 4 point 96]

…

4.10.49 R …

(4) For the covered portion of the *exposure* value E (based on the adjusted value of the credit protection G_A), the *PD* for the purposes of *BIPRU* 4 may be the *PD* of the protection provider, or a *PD* between that of the borrower and that of the guarantor if a full substitution is deemed not to be warranted. In the case of subordinated *exposures* and non-subordinated unfunded protection, the *LGD* to be applied for the purposes of *BIPRU* 4 may be that

associated with senior claims.

(5) For any uncovered portion of the *exposure* value E the *PD* must be that of the borrower and the *LGD* must be that of the underlying *exposure*.

(6) G_A is the value of G* as calculated under *BIPRU* 5.7.17R (Valuation of unfunded credit protection) further adjusted for any maturity mismatch as laid down in *BIPRU* 4.10.51R (Maturity mismatches).

(7) E is the *exposure* value as related to the following rules: *BIPRU* 4.4.38R, *BIPRU* 4.4.39R, *BIPRU* 4.4.71R to *BIPRU* 4.4.78R, *BIPRU* 4.7.7R, *BIPRU* 4.8.28R, *BIPRU* 4.8.29R and *BIPRU* 4.9.9R. For this purpose, the *exposure* value of the items referred to in *BIPRU* 4.4.37R to *BIPRU* 4.4.39R and *BIPRU* 4.8.29R must be calculated using a *conversion factor* or percentage of 100% rather than the *conversion factors* or percentages indicated in those rules.

[**Note:** *BCD* Annex VIII Part 3 points 90 to 92]

…

5.4.6 R (1) Units in *CIUs* may be recognised as eligible collateral if the following conditions are satisfied:

(a) they have a daily public quote; ~~and~~

(b) the *CIU* is limited to investing in instruments that are eligible for recognition under *BIPRU* 5.4.2R to *BIPRU* 5.4.5R; and

(c) if the *CIU* is not limited to investing in instruments that are eligible for recognition under *BIPRU* 5.4.2R to *BIPRU* 5.4.5R, units may be recognised with the value of the eligible assets as collateral under the assumption that the *CIU* has invested to the maximum extent allowed under its mandate in non-eligible assets. In cases where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, the *firm* must calculate the total value of the non-eligible assets and must reduce the value of the eligible assets by that of the non-eligible assets in case the latter is negative in total.

…

…

5.4.8 R (1) In addition to the collateral set out in *BIPRU* 5.4.2R to *BIPRU* 5.4.7R, where a *firm* uses the *financial collateral comprehensive method*, the following financial items may be recognised as eligible collateral:

…

(b) units in *CIUs* if the following conditions are met:

…

(ii) the *CIU* is limited to investing in instruments that are eligible for recognition under *BIPRU* 5.4.2R to *BIPRU* 5.4.5R and the items mentioned in (a); and

(c) if the *CIU* is not limited to investing in instruments that are eligible for recognition under *BIPRU* 5.4.2R to *BIPRU* 5.4.5R and the items mentioned in (a) of this *rule*, units may be recognised with the value of the eligible assets as collateral under the assumption that the *CIU* has invested to the maximum extent allowed under its mandate in non-eligible assets. In cases where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, the *firm* must calculate the total value of the non-eligible assets and must reduce the value of the eligible assets by that of the non-eligible assets, in case the latter is negative in total.

…

…

5.4.16 R A *firm* must not use both the *financial collateral simple method* and the *financial collateral comprehensive method*, unless such use is for the purposes of *BIPRU* 4.2.17R to *BIPRU* 4.2.19R and *BIPRU* 4.2.26R, and such use is provided for by the *firm's IRB permission*. A *firm* must demonstrate to the *FSA* that this exceptional application of both methods is not used selectively with the purpose of achieving reduced minimum capital requirements and does not lead to regulatory arbitrage.

[**Note:** *BCD* Annex VIII Part 3 point 24 (part)]

…

5.4.18 R The *risk weight* that would be assigned under the *standardised approach* to credit risk if the *lending firm* had a direct *exposure* to the collateral instrument must be assigned to those portions of ~~claims~~ *exposure* values collateralised by the market value of recognised collateral. For this purpose, the *exposure* value of an off-balance sheet item listed in *BIPRU* 3.7.2R must be 100% of its value rather than the *exposure* value indicated in *BIPRU* 3.2.1R. The *risk weight* of the collateralised portion must be a minimum of 20% except as specified in *BIPRU* 5.4.19R to *BIPRU* 5.4.21R. The remainder of the *exposure* value receives the *risk weight* that would be applied to an unsecured *exposure* to the counterparty under the *standardised approach*.

[**Note:** *BCD* Annex VIII Part 3 point 26]

…

5.4.28 R …

(4) For the purpose of (3)(a), for a *firm* calculating *risk weighted exposure amounts* under the *standardised approach* the *exposure* value of an off-balance sheet item~~s~~ listed in *BIPRU* 3.7 must be 100% of its value rather than the ~~percentages~~ *exposure* value indicated in *BIPRU* 3.2.1R and *BIPRU* 3.7.2R.

[**Note:** *BCD* Annex VIII Part 3 point 33]

…

5.5.5 R For life insurance policies pledged to a *lending firm* to be recognised the following conditions must be met:

(1) the party providing the life insurance ~~may be recognised as an eligible unfunded credit protection provider under *BIPRU* 5.7.1R~~ must be subject to Directive 2002/83/EC and Directive 2001/17/EC of the European Parliament and of the Council, or is subject to supervision by a competent authority of a third country which applies supervisory and regulatory arrangements at least equivalent to those applied in the Community;

(2) the life insurance policy is openly pledged or assigned to the *lending firm*;

(3) the party providing the life insurance is notified of the pledge or assignment and as a result may not pay amounts payable under the contract without the consent of the *lending firm*;

(4) ~~the declared surrender value of the policy~~ the *surrender value* is declared by the company providing the life insurance and is non-reducible;

(4A) the *surrender value* must be paid in a timely manner upon request;

(4B) the *surrender value* must not be requested without the consent of the *lending firm*;

(5) the *lending firm* must have the right to cancel the policy and receive the *surrender value* in the event of the default of the borrower;

(6) the *lending firm* is informed of any non-payments under the policy by the policyholder;

(7) the credit protection must be provided for the maturity of the loan. Where this is not possible because the insurance relationship ends before the loan relationship expires, the *lending firm* must ensure that

the amount deriving from the insurance contract serves the *lending firm* as security until the end of the duration of the credit agreement; and

(8) the pledge or assignment must be legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement.

[**Note:** *BCD* Annex VIII Part 2 point 13 (part)]

…

5.5.7 R (1) Where the conditions set out in *BIPRU* 5.5.5R are satisfied, ~~credit protection falling within the terms of *BIPRU* 5.5.4R may be treated as a guarantee by the party providing the life insurance. The value of the credit protection recognised must be the surrender value of the life insurance policy.~~ the portion of the *exposure* collateralised by the current *surrender value* of credit protection falling within the terms of *BIPRU* 5.5.4R must be either:

(a) subject to the *risk weights* specified in (3) where the *exposure* is subject to the *standardised approach* to credit risk; or

(b) assigned an *LGD* of 40% where the *exposure* is subject to the *IRB approach* but not subject to the *firm's* own estimates of *LGD*.

(2) In case of a currency mismatch, the current *surrender value* must be reduced according to *BIPRU* 5.7.17R and *BIPRU* 5.5.18R, the value of the credit protection being the current *surrender value* of the life insurance policy.

(3) For the purpose of (1)(a), the following *risk weights* must be assigned on the basis of the *risk weight* assigned to a senior unsecured *exposure* to the company providing the life insurance:

(a) a *risk weight* of 20%, where the senior unsecured *exposure* to the company providing the life insurance is assigned a *risk weight* of 20%;

(b) a *risk weight* of 35%, where the senior unsecured *exposure* to the company providing the life insurance is assigned a *risk weight* of 50%;

(c) a *risk weight* of 70%, where the senior unsecured *exposure* to the company providing the life insurance is assigned a *risk weight* of 100%; and

(d) a *risk weight* of 150%, where the senior unsecured *exposure* to the company providing the life insurance is assigned a *risk weight* of 150%.

[**Note:** *BCD* Annex VIII Part 3 point 80 and *BCD* Annex VIII Part 3 point 80a]

…

5.7.9 R Where an *exposure* is protected by a guarantee which is counter-guaranteed by a central government or *central bank*, a regional government or local authority or a *public sector entity*, claims on which are treated as claims on the central government in whose jurisdiction they are established under the *standardised approach*, a *multilateral development bank* or an *international organisation*, to which a 0% *risk weight* is assigned under or by virtue of the *standardised approach*, or a *public sector entity*, claims on which are treated as claims on *credit institutions* under the *standardised approach*, the *exposure* may be treated as protected by a guarantee provided by the entity in question provided the following conditions are satisfied:

…

…

5.7.23 R For the purposes of *BIPRU* 3.2.20R to *BIPRU* 3.2.26R, g shall be the *risk weight* to be assigned to an *exposure*, the *exposure* value (E) of which is fully protected by *unfunded credit protection* (G_A), where:

(1) g is the *risk weight* of *exposures* to the protection provider as specified under the *standardised approach*; ~~and~~

(2) G_A is the value of G^* as calculated under *BIPRU* 5.7.17 R further adjusted for any maturity mismatch as laid down in *BIPRU* 5.8; and

(3) E is the *exposure* value according to *BIPRU* 3.2.1R to *BIPRU* 3.2.3R and *BIPRU* 13; for this purpose the *exposure* value of an off-balance sheet item listed in *BIPRU* 3.7.2R shall be 100% of its value rather than the *exposure* value indicated in *BIPRU* 3.2.1R.

[**Note:** *BCD* Annex VIII Part 3 point 87]

…

5.7.24 R Where the protected amount is less than the *exposure* value and the protected and unprotected portions are of equal seniority - ~~ie~~ i.e. the *firm* and the protection provider share losses on a pro-rata basis, proportional regulatory capital relief is afforded. For the purposes of *BIPRU* 3.2.20R to *BIPRU* 3.2.26R *risk weighted exposure amounts* must be calculated in accordance with the following formula:
$(E-G_A) \times r + G_A \times g$
where:

(1) E is the *exposure* value according to *BIPRU* 3.2.1R to *BIPRU* 3.2.3R and *BIPRU* 13; for this purpose, the *exposure* value of an off-balance sheet item listed in *BIPRU* 3.7.2R shall be 100% of its value rather

than the *exposure* value indicated in *BIPRU* 3.2.1R;

…

…

6.4.6 R The *ORCR* under the *standardised approach* is ~~the average over three years of the risk weighted relevant indicators calculated each year~~ calculated as the three-year average of the yearly summations of the capital requirements across the business lines referred to in *BIPRU* 6.4.15R.

[**Note:** *BCD* Annex X, Part 2 point 1 (part)]

6.4.7 R ~~In each year, a negative capital requirement in one business line, resulting from a negative relevant indicator, may be imputed to the whole. However, where the aggregate capital charge across all business lines within a given year is negative, then the input to the average for that year must be zero.~~ In any given year, negative capital requirements (resulting from negative gross income) in any business line may offset positive capital requirements in other business lines without limit. However, where the aggregate of the capital requirements across all business lines within a given year is negative, the input to the numerator for that year must be zero.

[**Note:** *BCD* Annex X, Part 2 point 1 (part)]

…

6.5.21 R …

(3) A *firm* must be able to map its historical internal loss data into the business lines defined in *BIPRU* 6.4.15R and into the event type categories defined in *BIPRU* 6.5.25R, and must be able to provide this data to the ~~FSA~~ *FSA* upon request. Loss events which affect the entire *firm* may be allocated to an additional business line 'corporate items' due to exceptional circumstances. The *firm* must have documented, objective criteria for allocating losses to the specified business lines and event types. A *firm's operational risk* losses that are related to credit risk and have historically been included in the internal credit risk databases must be recorded in the *operational risk* databases and be separately identified. Such losses will not be subject to the *ORCR*, as long as they continue to be treated as credit risk for the purposes of calculating the *capital resources requirement*. *Operational risk* losses that are related to market risks must be included in the scope of the capital requirement for *operational risk*.

…

6.5.27 R …

(9) The capital alleviation arising from the recognition of ~~insurance~~ insurances and other risk transfer mechanisms must not exceed 20% of the capital requirement before the recognition of risk mitigation techniques.

[**Note:** *BCD* Annex X Part 3 points 27 to 29]

…

6.5.29 G For the purposes of *BIPRU* 6.5.27R(9), *a firm* should be able to set out clearly how it made its assessment of the appropriate level of capital alleviation, including any assumptions made by the *firm* and how the insurances and other risk transfer mechanisms ~~has~~ have been factored into the *firm's* risk measurement system.

6.5.30 R A *firm* may recognise a risk transfer mechanism other than insurance to the extent that a noticeable risk mitigating effect is achieved and the risk transfer mechanism is included in the *firm's AMA permission*.

[**Note:** *BCD* Annex X Part 3 point 25]

…

7.2 Interest rate PRR

…

Specific risk calculation

…

7.2.44 R Table: specific risk PRAs

This table belongs to *BIPRU* 7.2.43*R*

Issuer	Residual maturity	PRA
…	…	…
(A) …	…	…
(B) …	…	…
(C) …	…	…
(D) Debt *securities* issued or guaranteed by *corporates* which would qualify for *credit quality step* 1, ~~or~~ 2 or 3 under the *standardised approach* to credit risk.	…	…
(E) …	…	…

(A) …	…	…
(B) Debt *securities* issued or guaranteed by *corporates* which would qualify for *credit quality step* ~~3 or~~ 4 under the *standardised approach* to credit risk.		
(C) …	…	…
…	…	…

[**Note:** *CAD* Annex I point 14 Table 1]

…

7.2.47 R …

7.2.47A G *Originators*, investors and *sponsors* of *securitisations* in the *trading book* will have to meet the requirements of *BIPRU* 9.3.1AR, *BIPRU* 9.3.15R to *BIPRU* 9.3.20R and *BIPRU* 9.15.

7.2.47B G Subject to *BIPRU* 7.2.47CG, *BIPRU* 9.15.9R and *BIPRU* 9.15.10R, where the investor, *originator* or *sponsor* of a *securitisation* fails to meet any of the requirements in *BIPRU* 9.3.18R to *BIPRU* 9.3.20R (Disclosure requirements) and *BIPRU* 9.15.11R to *BIPRU* 9.15.16R (investor due diligence requirements) in any material respect by reason of its negligence or omission, the *FSA* will use its powers under section 45 (Variation etc on the Authority's own initiative) of the *Act* to impose an additional capital charge of no less that 250% (capped at 1250%) of the *PRR* that would otherwise apply to the relevant *securitisation positions* under the *rules* in *BIPRU* 7.2. The additional capital charge imposed will be progressively increased with each relevant, subsequent infringement of the requirements in *BIPRU* 9.3.18R to *BIPRU* 9.3.20R and *BIPRU* 9.15.11R to *BIPRU* 9.15.16R.

7.2.47C G When calculating the additional capital charge it will impose under *BIPRU* 7.2.47BG, the *FSA* will take into account the exemption of certain securitisations from the scope of *BIPRU* 9.15.3R under *BIPRU* 9.15.9R and *BIPRU* 9.15.10R and, if those exemptions are relevant, reduce the capital charge it would otherwise impose.

…

7.11 Credit derivatives in the trading book

…

Establishment of positions created by credit derivatives: Treatment of the protection buyer

7.11.12 R For the *protection buyer*, the *positions* are determined as the mirror ~~image~~ principle of the *protection seller*, with the exception of a credit linked note (which entails no short *position* in the issuer). If at a given moment there is a call option in combination with a *step-up*, such moment is treated as the maturity of the protection. In the case of first-to-default credit derivatives and nth to default credit derivatives, ~~a *firm* that is a *protection buyer* may off-set *specific risk* for n-1 of the underlyings (i.e., the n-1 assets with the lowest *specific risk PRR*)~~ the treatment in *BIPRU* 7.11.12AR and *BIPRU* 7.11.12BR applies instead of the mirror principle.

[**Note:** *CAD* Annex I point 8.B]

7.11.12A R Where a *firm* obtains credit protection for a number of reference entities underlying a credit derivative under the terms that the first default among the assets will trigger payment and that this credit event will terminate the contract, the *firm* may off-set specific risk for the reference entity to which the lowest specific risk percentage charge among the underlying reference entities applies according to the Table in *BIPRU* 7.2.44R.

[**Note:** *CAD* Annex I point 8.B]

7.11.12B R Where the nth default among the exposures triggers payment under the credit protection, the *protection buyer* may only off-set specific risk if protection has also been obtained for defaults 1 to n-1 or when n-1 defaults have already occurred. In those cases, the methodology set out in *BIPRU* 7.11.12AR for first-to-default credit derivatives must be followed, appropriately modified for nth-to-default products.

[**Note:** *CAD* Annex I point 8.B]

…

9.1 Application and purpose

Application

9.1.1 R *BIPRU* 9 applies to a *BIPRU firm*, with the exception of the *rules* in *BIPRU* 9.3.15R to *BIPRU* 9.3.20R (dealing with origination criteria and disclosure requirements) and the *rules* in *BIPRU* 9.15 (dealing with requirements for investors) which apply exclusively to *credit institutions*.

…

General obligations: Systems

9.1.6 R The risks arising from *securitisation* transactions in relation to which a *firm* is investor, *originator* or *sponsor*, including reputational risks, must be evaluated and addressed through appropriate policies and procedures, to ensure in particular that the economic substance of the transaction is fully reflected in ~~the~~ risk assessment and management decisions.

[**Note:** *BCD* Annex V, Point 8]

…

Trading book and non-trading book

9.1.9 G *BIPRU* 9 deals with:

(1) requirements for investors, *originators* and *sponsors* of *securitisations* of *non-trading book exposures*; ~~and~~

(2) the calculation of *risk weighted exposure amount* for *securitisation* positions for the purposes of calculating either the *credit risk capital component* or the *counterparty risk capital component*; and

(3) the requirements that investors, *originators* and *sponsors* of *securitisations* in the *trading book* will have to meet (*BIPRU* 9.3.1AR, *BIPRU* 9.3.15R to *BIPRU* 9.3.20R and *BIPRU* 9.15).

…

9.3 Requirements for originators and sponsors

…

9.3.1A R The provisions of *BIPRU* 9.3.15R to *BIPRU* 9.3.20R apply with respect to:

(1) new *securitisations* issued on or after 1 January 2011; and

(2) from 31 December 2014, to existing *securitisations* where new underlying exposures are added or substituted after that date.

[**Note:** *BCD*, Article 122a, paragraph 8]

9.3.2 G ~~Subject to *BIPRU* 9.3.6G, for the purposes of *BIPRU* 9.4.1R and *BIPRU* 9.5.1R the transfer of credit risk to third parties should only be considered significant if the proportion of risk transferred is broadly commensurate with, or exceeds, the proportion by which *risk weighted exposure amounts* are reduced.~~ [deleted]

9.3.3 G ~~For measuring the reduction in risk and *risk weighted exposure amounts*, an *originator* should assess the *securitisation positions* it holds against the underlying *exposures* if they had never been *securitised*.~~ [deleted]

9.3.4 G ~~An *originator* should use an appropriate method, consistent with its own internal processes, to assess whether the risk transferred is significant.~~ [deleted]

9.3.5 G ~~If the result of,~~

~~(1) applying a *risk weight* of 1250% to all positions that an *originator* holds in the *securitisation*; or~~

~~(2) deducting all those positions from *capital resources*;~~

~~is a reduction in the *originator's* capital requirement compared to the capital requirements that would apply had it not transferred the *securitised exposures*, then the *originator* may treat the risk transferred as significant for the purposes of *BIPRU* 9.4.1R and *BIPRU* 9.5.1R.~~ [deleted]

…

9.3.7 R Significant credit risk will be considered to have been transferred for *originators* in the following cases:

(1) the *risk weighted exposure amounts* of the *mezzanine securitisation positions* held by the *originator* in the *securitisation* do not exceed 50% of the *risk weighted exposure amounts* of all *mezzanine securitisation positions* existing in this *securitisation*;

(2) where there are no *mezzanine securitisation positions* in a given *securitisation* and the *originator* can demonstrate that the exposure value of the *securitisation positions* that would be subject to deduction from *capital resources* or a 1250% *risk weight* exceeds a reasoned estimate of the expected loss on the *securitised exposures* by a substantial margin, the *originator* does not hold more than 20% of the exposure values of the *securitisation positions* that would be subject to deduction from *capital resources* or a 1250% risk weight.

[**Note:** *BCD*, Annex IX, Part 2, Point 1, paragraph 1a and Point 2 paragraph 2a]

9.3.8 R An *originator* must notify the *FSA* that it is relying on the deemed transfer of significant credit risk under *BIPRU* 9.3.7R within a reasonable period before or after a relevant transfer, not being later than one month after the date of the transfer. The notification must include the following information:

(1) the *risk weighted exposure amount* of the *securitised exposures* and retained *securitisation positions*;

(2) the *exposure* value of the *securitised exposures* and the retained *securitisation positions*;

(3) details of the *securitisation positions*, including rating, *exposure* value broken down by *securitisation positions* sold and retained;

(4) a statement that sets out why the *firm* is satisfied that the reduction in *risk weighted exposure amounts* is justified by a commensurate transfer of credit risk to third parties;

(5) any relevant supporting documents, for example, a summary of the transaction.

9.3.9 G In the event that the *FSA* decides that the possible reduction in *risk weighted*

exposure amounts which the *originator* would achieve by the *securitisation* referred to in *BIPRU* 9.3.7R is not justified by a commensurate transfer of credit risk to third parties, it will use its powers under section 45 of the *Act* (Variation etc on the Authority's own initiative) to require the *firm* to increase its *risk weighted exposure amount* to an amount commensurate with the *FSA's* assessment of the transfer of credit risk to third parties.

9.3.10 G An *originator* may be granted a *waiver* of the requirements in *BIPRU* 9.3.7R and *BIPRU* 9.3.8R.

9.3.11 D An *originator's* application for a *waiver* of the requirements in *BIPRU* 9.3.7R and *BIPRU* 9.3.8R must demonstrate that the following conditions are satisfied:

(1) it has policies and methodologies in place which ensure that the possible reduction of capital requirements which the *originator* achieves by the *securitisation* is justified by a commensurate transfer of credit risk to third parties; and

(2) that such transfer of credit risk to third parties is also recognised for the purposes of the *originator's* internal risk management and its internal capital allocation.

[**Note:** *BCD*, Annex IX, Part 2, Point 1, paragraph 1c and Point 2 paragraph 2c]

9.3.12 G *BIPRU* 1.3.10G sets out the *FSA*'s approach to the granting of *waivers*. The conditions in *BIPRU* 9.3.11D are minimum requirements. Satisfaction of those does not automatically mean the *FSA* will grant the relevant *waiver*. The *FSA* will in addition also apply the tests in section 148 (Modification or waiver of rules) of the *Act*.

9.3.13 G When considering an application for a *waiver* of the requirements in *BIPRU* 9.3.7R and *BIPRU* 9.3.8R, the *FSA* may undertake a visit to the *firm* in order to examine the *firm's* risk management and governance arrangements. Before such a visit, the *FSA* may request information from the *firm* additional or supplementary to that provided in the *waiver* application.

9.3.14 G An *originator* should clearly state the scope of the *waiver* of the requirements in *BIPRU* 9.3.7R and *BIPRU* 9.3.8R it is seeking in its application. For example, residential mortgage backed securities may be subdivided into prime and sub-prime with only one sub-category within the scope of the *waiver*. Relevant asset classes may therefore be defined according to a *firm's* internal usage of terms.

Origination criteria

9.3.15 R A *credit institution*, whether acting as *sponsor* or *originator*, must apply the criteria used for credit-granting in respect of exposures held on their *trading* and *non-trading book* under *SYSC* 7.1.9R to exposures to be securitised. The criteria applied must include the processes for approving and, where

relevant, amending, renewing and re-financing credits.

[**Note:** *BCD*, Article 122a, paragraph 6]

9.3.16 R A *credit institution*, whether acting as *sponsor* or *originator*, must apply the same standards of analysis as are applied under *BIPRU* 9.3.15R to participations or underwritings in *securitisation* issues purchased from third parties regardless of whether those participations or underwritings are to be held on their *trading book* or *non-trading book.*

[**Note:** *BCD*, Article 122a, paragraph 6]

9.3.17 R Where a *credit institution* as *originator* fails to meet the requirements under *BIPRU* 9.3.15R to *BIPRU* 9.3.16R, it may not rely on and apply *BIPRU* 9.3.1R(1) to reduce its *risk weighted exposure amounts* or exclude the relevant securitised exposures from the calculation of its *risk weighted exposure amounts*, and, as relevant, *expected loss* amounts of those *exposures*.

[**Note:** *BCD*, Article 122a, paragraph 6]

Disclosure requirements

9.3.18 R The *sponsor* or *originator credit institutions* of a *securitisation* must disclose to investors the level of its commitment to maintain a net economic interest in the *securitisation* under *BIPRU* 9.15.3R.

[**Note:** *BCD*, Article 122a, paragraph 7]

9.3.19 R The *sponsor* or *originator credit institutions* of a *securitisation* must ensure that prospective investors have readily available access to all materially relevant data concerning it, including:

(1) on the credit quality and performance of the individual underlying *exposures*;

(2) cash flows and collateral supporting the *securitisation exposure*; and

(3) such information as is necessary to conduct comprehensive and well-informed stress-tests on the cash flows and collateral values supporting the underlying *exposures*.

[**Note:** *BCD*, Article 122a, paragraph 7]

9.3.20 R Under *BIPRU* 9.3.19R, materially relevant data is determined as at the date of the *securitisation* and where appropriate due to the nature of the *securitisation* thereafter.

[**Note:** *BCD*, Article 122a, paragraph 7]

9.3.21 G Subject to *BIPRU* 9.3.22G, *BIPRU* 9.15.9R and *BIPRU* 9.15.10R, where the *originator* or *sponsor* of a *securitisation* fails to meet any of the

requirements in *BIPRU* 9.3.18R to *BIPRU* 9.3.20R (disclosure requirements) in any material respect by reason of its negligence or omission, the *FSA* will use its powers under section 45 (Variation etc on the Authority's own initiative) of the *Act* to impose an additional *risk weight* of no less than 250% (capped at 1250%) of the *risk weight* that would otherwise apply to the relevant *securitisation positions* under the *rules* in *BIPRU* 9.11 to *BIPRU* 9.14. The additional *risk weight* imposed will be progressively increased with each relevant, subsequent infringement of the requirements in *BIPRU* 9.3.18R to *BIPRU* 9.3.20R.

[**Note:** *BCD*, Article 122a, paragraph 5]

9.3.22 G When calculating the additional *risk weight* it will impose, the *FSA* will take into account the exemption of certain *securitisations* from the scope of *BIPRU* 9.15.3R under *BIPRU* 9.15.9R and *BIPRU* 9.15.10R and, if those exemptions are relevant, reduce the *risk weight* it would otherwise impose.

[**Note:** *BCD*, Article 122a, paragraph 5]

9.4 Traditional securitisation

Minimum requirements for recognition of significant credit risk transfer

9.4.1 R The *originator* of a *traditional securitisation* may exclude *securitised exposures* from the calculation of *risk weighted exposure amounts* and *expected loss* amounts if either of the following conditions is fulfilled:

(1) significant credit risk associated with the *securitised exposures* ~~has~~ is considered to have been transferred to third parties; or

(2) the *originator* applies a 1250% *risk weight* to all *securitisation positions* it holds in the *securitisation* or deducts these *securitisation positions* from *capital resources* according to *GENPRU* 2.2.237R;

and the transfer complies with the conditions in *BIPRU* 9.4.2R – *BIPRU* ~~9.4.10R~~ 9.4.14R.

[**Note:** *BCD*, Annex IX, Part 2, Point 1, paragraph 1 ~~(part)~~]

…

9.4.11 R Significant credit risk will be considered to be transferred for an *originator* in the following cases:

(1) the *risk weighted exposure amounts* of the *mezzanine securitisation positions* held by the *originator* in the *securitisation* do not exceed 50% of the *risk weighted exposure amounts* of all *mezzanine securitisation positions* existing in this *securitisation*;

(2) where there are no *mezzanine securitisation positions* in a given

securitisation and the *originator* can demonstrate that the exposure value of the *securitisation positions* that would be subject to deduction from *capital resources* or a 1250% *risk weight* exceeds a reasoned estimate of the expected loss on the *securitised exposures* by a substantial margin, the *originator* does not hold more than 20% of the exposure values of the *securitisation positions* that would be subject to deduction from *capital resources* or a 1250% risk weight.

[**Note:** *BCD*, Annex IX, Part 2, Point 1, paragraph 1a]

9.4.12 R An *originator* must notify the *FSA* that it is relying on the deemed transfer of significant credit risk under *BIPRU* 9.4.11R within a reasonable period before or after a relevant transfer, not being later than one month after the date of the transfer. The notification must include the following information:

(1) the *risk weighted exposure amount* of the *securitised exposures* and retained *securitisation positions*;

(2) the *exposure* value of the *securitised exposures* and the retained *securitisation positions*;

(3) details of the *securitisation positions*, including rating, *exposure* value broken down by *securitisation positions* sold and retained;

(4) a statement that sets out why the *firm* is satisfied that the reduction in *risk weighted exposure amounts* is justified by a commensurate transfer of credit risk to third parties;

(5) any relevant supporting documents, for example, a summary of the transaction.

9.4.13 G In the event that the *FSA* decides that the possible reduction in *risk weighted exposure amounts* which the *originator* would achieve by the *securitisation* referred to in *BIPRU* 9.4.11R is not justified by a commensurate transfer of credit risk to third parties, it will use its powers under section 45 (Variation etc on the Authority's own initiative) of the *Act* to require the *firm* to increase its *risk weight exposure amount* to an amount commensurate with the *FSA*'s assessment of the transfer of credit risk to third parties.

9.4.14 G An *originator* may be granted a *waiver* of the requirements in *BIPRU* 9.4.11R and *BIPRU* 9.4.12R.

9.4.15 D An *originator's* application for a *waiver* of the requirements in *BIPRU* 9.4.11R and *BIPRU* 9.4.12R must demonstrate that the following conditions are satisfied.

(1) it has policies and methodologies in place which ensure that the possible reduction of capital requirements which the *originator* achieves by the *securitisation* is justified by a commensurate transfer of credit risk to third parties; and

(2) that such a transfer of credit risk to third parties is also recognised for the purposes of all the *firm's* internal risk management and internal capital allocation.

[**Note:** *BCD*, Annex IX, Part 2, Point 1, paragraph 1c]

9.4.16 G *BIPRU* 1.3.10G sets out the *FSA*'s approach to the granting of *waivers*. The conditions in *BIPRU* 9.4.15D are minimum requirements. Satisfaction of those does not automatically mean the *FSA* will grant the relevant *waiver*. The *FSA* will in addition also apply the tests in section 148 (Modification or waiver of rules) of the *Act*.

9.4.17 G When considering an application for a *waiver* of the requirements in *BIPRU* 9.4.11R and *BIPRU* 9.4.12R, the *FSA* may undertake a visit to the *firm* in order to examine the *firm's* risk management and governance arrangements. Before such a visit, the *FSA* may request information from the *firm* additional or supplementary to that provided in the *waiver* application.

9.4.18 G An *originator* should clearly state the scope of the *waiver* of the requirements in *BIPRU* 9.4.11R and *BIPRU* 9.4.12R it is seeking in its application. For example, residential mortgage backed securities may be subdivided into prime and sub-prime with only one sub-category within the scope of the *waiver*. Relevant asset classes may therefore be defined according to a *firm's* internal usage of terms.

9.5 Synthetic securitisation

Minimum requirements for recognition of significant credit risk transfer

9.5.1 R (1) An *originator* of a *synthetic securitisation* may calculate *risk weighted exposure* ~~*amount*~~ *amounts*, and, as relevant, *expected loss amounts*, for the *securitised exposures* in accordance with *BIPRU* 9.5.3R and *BIPRU* 9.5.4R, if either of the following conditions is fulfilled:

(a) significant credit risk ~~has~~ is considered to have been transferred to third parties, either through funded or unfunded credit protection; or

(b) the *originator* applies a 1250% *risk weight* to all *securitisation positions* he holds in this *securitisation* or deducts these *securitisation positions* from *capital resources* according to *GENPRU* 2.2.237R;

and the transfer complies with the conditions in (2)-(~~5~~8).

[**Note:** *BCD*, Annex IX, Part 2, Point 2, paragraph 2]

…

(6) Significant credit risk will be considered to have been transferred if either of the following conditions is met:

(a) the *risk weighted exposure amounts* of the *mezzanine securitisation positions* which are held by the *originator* in this *securitisation* do not exceed 50% of the *risk weighted exposure amounts* of all *mezzanine securitisation positions* existing in this *securitisation*;

(b) where there are no *mezzanine securitisation positions* in a given *securitisation* and the *originator* can demonstrate that the *exposure* value of the *securitisation positions* that would be subject to deduction from *capital resources* or a 1250% *risk weight* exceeds a reasoned estimate of the expected loss on the securitised exposures by a substantial margin, the *originator* does not hold more than 20% of the exposure values of the *securitisation positions* that would be subject to deduction from *capital resources* or a 1250% risk weight.

[**Note:** *BCD*, Annex IX, Part 2, Point 2, paragraph 2a]

(7) An *originator* must notify the *FSA* that it is relying on the deemed transfer of significant credit risk under *BIPRU* 9.5.1R(6) within a reasonable period before or after a relevant transfer, not being later than one month after the date of the transfer. The notification must include the following information:

(a) the *risk weighted exposure amount* of the *securitised exposures* and retained *securitisation positions*;

(b) the *exposure* value of the *securitised exposures* and the retained *securitisation positions*;

(c) details of the *securitisation positions*, including rating, *exposure* value broken down by *securitisation positions* sold and retained;

(d) a statement that sets out why the *firm* is satisfied that the reduction in *risk weighted exposure amounts* is justified by a commensurate transfer of credit risk to third parties;

(e) any relevant supporting documents, for example, a summary of the transaction.

9.5.1A G An *originator* may be granted a *waiver* of the requirements in *BIPRU* 9.5.1.R(6) and (7).

9.5.1B D An *originator's* application for a *waiver* of the requirements in *BIPRU* 9.5.1.R(6) and (7) must demonstrate that the following conditions are satisfied:

(1) it has policies and methodologies in place which ensure that the possible reduction of capital requirements which the *originator* achieves by the *securitisation* is justified by a commensurate transfer of credit risk to third parties; and

(2) that such transfer of credit risk to third parties is also recognised for the purposes of all the *originator's* internal risk management and its internal capital allocation.

[**Note:** *BCD*, Annex IX, Part 2, Point 2, paragraph 2c]

9.5.1C G *BIPRU* 1.3.10G sets out the *FSA*'s approach to the granting of *waivers*. The conditions in *BIPRU* 9.5.1BD are minimum requirements. Satisfaction of those does not automatically mean the *FSA* will grant the relevant *waiver*. The *FSA* will in addition also apply the tests in section 148 (Modification or waiver of rules) of the *Act*.

9.5.1D G When considering an application for a *waiver* of the requirements in *BIPRU* 9.5.1.R(6) and (7), the *FSA* may undertake a visit to the *firm* in order to examine the *firm's* risk management and governance arrangements. Before such a visit, the *FSA* may request information from the *firm* additional or supplementary to that provided in the *waiver* application.

9.5.1E G An *originator* should clearly state the scope of the *waiver* of the requirements in *BIPRU* 9.5.1.R(6) and (7) it is seeking in its application. For example, residential mortgage backed securities may be subdivided into prime and sub-prime with only one sub-category within the scope of the *waiver*. Relevant asset classes may therefore be defined according to a *firm's* internal usage of terms.

9.5.1F G In the event that the *FSA* decides that the possible reduction in *risk weighted exposure amounts* which the *originator credit institution* would achieve by the *securitisation* referred to in *BIPRU* 9.5.1R(6) is not justified by a commensurate transfer of credit risk to third parties, it will use its powers under section 45 (Variation etc on the Authority's own initiative) of the *Act* to require the *firm* to increase its *risk weight exposure amount* to an amount commensurate with the *FSA's* assessment of the transfer of credit risk to third parties.

…

Treatment of unrated liquidity facilities

9.11.10 R When the conditions in this paragraph have been met, and in order to determine its *exposure* value, a conversion figure of ~~20% may be applied to the nominal amount of a liquidity facility with an original maturity of one year or less and a conversion figure of~~ 50% may be applied to the nominal amount of a *liquidity facility* ~~with a nominal maturity of more than one year~~.

…

Liquidity facilities that may be drawn only in the event of a general market

disruption

9.11.11 R ~~To determine its *exposure* value a conversion figure of 0% may be applied to the nominal amount of a *liquidity facility* that may be drawn only in the event of a general market disruption (i.e. where more than one *SSPE* across different transactions are unable to roll over maturing commercial paper and that inability is not the result of an impairment of the *SSPE's* credit quality or of the credit quality of the *securitised exposures*), provided that the conditions set out in *BIPRU* 9.11.10R are satisfied.~~

~~[**Note:** *BCD* Annex IX Part 4 point 14]~~ [deleted]

…

9.12 Calculation of risk-weighted exposure amounts under the IRB approach

…

Ratings based method

…

9.12.13 R Subject to ~~*BIPRU* 9.12.16R and~~ *BIPRU* 9.12.17R, the *risk weights* in column A of each table in *BIPRU* 9.12.11R and *BIPRU* 9.12.12R must be applied where the position is in the most senior *tranche* of a *securitisation*.

…

…

9.12.16 R ~~A firm may apply a *risk weight* of 6% to a position in the most senior *tranche* of a *securitisation* where that *tranche* is senior in all respects to another *tranche* of the *securitisation positions* which would receive a *risk weight* of 12% under *BIPRU* 9.12.10R, provided that:~~

~~(1) it can be demonstrated that this is justified due to the loss absorption qualities of subordinate *tranches* in the *securitisation*; and~~

~~(2) either the position has an external credit assessment which has been determined to be associated with credit quality step 1 in *BIPRU* 9.12.11R and *BIPRU* 9.12.12R or, if it is unrated, requirements (1) to (3) in *BIPRU* 9.12.7R are satisfied where 'reference positions' are taken to mean positions in the subordinate *tranche* which would receive a *risk weight* of 12% under *BIPRU* 9.12.10R.~~

~~[**Note:** *BCD* Annex IX Part 4 point 48]~~ [deleted]

…

Liquidity facilities only available in the event of general market disruption

9.12.26 R ~~A conversion figure of 20% may be applied to the nominal amount of a~~

~~*liquidity facility* that may only be drawn in the event of a general market disruption and that meets the conditions to be an eligible *liquidity facility* set out in *BIPRU* 9.11.10R.~~

~~[**Note:** *BCD* Annex IX Part 4 point 56]~~ [deleted]

…

9.12.28 G (1) When it is not practical for the *firm* to calculate the *risk weighted exposure amounts* for the *securitised exposures* as if they had not been *securitised* and the position does not qualify for the *ABCP internal assessment approach*, a *firm* may apply to the *FSA* for a variation of its *IRB permission* under which, on an exceptional basis, it may temporarily apply the method in (2) for the calculation of *risk weighted exposure amounts* for an *unrated securitisation position* in the form of a *liquidity facility* that meets the conditions to be a *liquidity facility* set out in *BIPRU* 9.11.10R ~~or that falls within the terms of *BIPRU* 9.12.26R~~.

(2) Under the method in this paragraph, the highest *risk weight* that would be applied under the *standardised approach* to any of the *securitised exposures* had they not been *securitised* may be applied to the *securitisation position* represented by the *liquidity facility*. To determine the *exposure* value of the position a conversion figure of 50% may be applied to the nominal amount of the *liquidity facility*, if the facility has an original maturity of one year or less. ~~If the *liquidity facility* complies with the conditions in *BIPRU* 9.12.26R a conversion figure of 20% may be applied.~~ In other cases a conversion factor of 100% must be applied.

…

After BIPRU 9.14 insert the following new section. The text is not underlined.

9.15 Requirements for investors

Application

9.15.1 R *BIPRU* 9.15 applies to:

(1) new *securitisations* issued on or after 1 January 2011; and

(2) from 31 December 2014, to existing *securitisations* where new underlying exposures are added or substituted after that date.

[**Note:** *BCD*, Article 122a, paragraph 8]

Purpose

9.15.2 G The purpose of *BIPRU* 9.15 is to implement Article 122a of the *Banking Consolidation Directive*, with the exception of those parts of Article 122a

that are implemented through the *rules* in *BIPRU* 9.3.

Exposures to transferred credit risk

9.15.3 R Subject to *BIPRU* 9.15.9R and *BIPRU* 9.15.10R, a *credit institution*, other than when acting as an *originator*, a *sponsor* or original lender, will be exposed to the credit risk of a *securitisation position* in its *trading book* or *non-trading book* only if the *originator*, *sponsor* or original lender has explicitly disclosed to the *credit institution* that it will retain, on an *ongoing basis*, a material net economic interest which, in any event, must not be less than 5%.

[**Note:** *BCD*, Article 122a, paragraphs 1 and 3]

Retention of net economic interest

9.15.4 R Retention of net economic interest means any of the following:

(1) retention of no less than 5% of the nominal value of each of the *tranches* sold or transferred to the investors;

(2) in the case of *securitisations* of *revolving exposures*, retention of the *originator's* interest of no less than 5% of the nominal value of the *securitised exposures*;

(3) retention of randomly selected *exposures*, equivalent to no less than 5% of the nominal amount of the *securitised exposures*, where those *exposures* would otherwise have been *securitised* in the *securitisation* provided that the number of potentially *securitised exposures* is no less than 100 at origination;

(4) retention of the first loss *tranche* and, if necessary, other *tranches* having the same or a more severe risk profile than those transferred or sold to investors and not maturing any earlier than those transferred or sold to investors, so that the retention equals in total no less than 5% of the nominal value of the *securitised exposures*.

[**Note:** *BCD*, Article 122a, paragraph 1]

9.15.5 R Net economic interest is measured at the origination and must be maintained on an *ongoing basis*. It must not be subject to any *credit risk mitigation* or any short positions or any hedge. The net economic interest must be determined by the notional value for off-balance sheet items.

[**Note:** *BCD*, Article 122a, paragraph 1]

9.15.6 R Multiple applications of the retention of net economic interest requirements for any given *securitisation* are prohibited.

[**Note:** *BCD*, Article 122a, paragraph 1]

9.15.7 R Subject to *BIPRU* 9.15.8R, where an *EEA* parent credit institution or an *EEA*

financial holding company, or one of its *subsidiaries*, as an *originator* or a *sponsor*, *securitises exposures* from several *credit institutions*, *investment firms* or other *institutions* which are included within the scope of supervision on a consolidated basis, the requirement to retain a net economic interest referred to in *BIPRU* 9.15.3R may be satisfied on the basis of the consolidated situation of the related *EEA* parent credit institution or *EEA* financial holding company.

[**Note:** *BCD*, Article 122a, paragraph 2]

9.15.8 R *BIPRU* 9.15.7R only applies where the *credit institutions*, *investment firms* or *institutions* which created the *securitised exposures* have committed themselves to adhere to the requirements in *BIPRU* 9.3.15R to *BIPRU* 9.3.17R and deliver, in a timely manner, to the *originator* or *sponsor* and to the *EEA* parent credit institution or an *EEA* financial holding company the information needed to satisfy *BIPRU* 9.3.18R to *BIPRU* 9.3.20R.

[**Note:** *BCD*, Article 122a, paragraph 2]

9.15.9 R *BIPRU* 9.15.3R does not apply where the *securitised exposures* are claims or contingent claims on, or fully, unconditionally and irrevocably guaranteed by:

(1) central governments or *central banks*;

(2) regional governments, local authorities and public sector entities of *EEA States*;

(3) *institutions* to which a 50% *risk weight* or less is assigned under *BIPRU* 3.4.31R to *BIPRU* 3.4.46R; or

(4) *multilateral development banks*.

[**Note:** *BCD*, Article 122a, paragraph 3]

9.15.10 R The requirements in *BIPRU* 9.15.3R do not apply with respect to the following:

(1) transactions based on a clear, transparent and accessible index, where the underlying reference entities are identical to those that make up an index of entities that is widely traded, or are other tradable securities other than *securitisation positions*; or

(2) syndicated loans, purchased receivables or credit default swaps where these instruments are not used to package and/or hedge a *securitisation* that is within the scope of *BIPRU* 9.15.3R.

[**Note:** *BCD*, Article 122a, paragraph 3]

Investor due diligence

9.15.11 R Before investing, and as appropriate thereafter, a *credit institution* must be

able to demonstrate to the *FSA* for each of its individual *securitisation positions,* that it has a comprehensive and thorough understanding of, and has implemented, formal policies and procedures appropriate to its *trading book* and *non-trading book* and commensurate with the risk profile of its investments in *securitised positions* for analysing and recording:

(1) information disclosed under *BIPRU* 9.15.3R, by *originators* or *sponsors* to specify the net economic interest that they maintain, on an *ongoing basis*, in the *securitisation*;

(2) the risk characteristics of the individual *securitisation position*;

(3) the risk characteristics of the *exposures* underlying the *securitisation position*;

(4) the reputation and loss experience in earlier *securitisations* of the *originators* or *sponsors* in the relevant *exposure* classes underlying the *securitisation position*;

(5) the statements and disclosures made by the *originators* or *sponsors*, or their agents or advisors, about their due diligence on the *securitised exposures* and, where applicable, on the quality of the collateral supporting the *securitised exposures*;

(6) where applicable, the methodologies and concepts on which the valuation of collateral supporting the *securitised exposures* is based and the policies adopted by the *originator* or *sponsor* to ensure the independence of the valuer; and

(7) all the structural features of the *securitisation* that can materially impact the performance of the *credit institution's securitisation position.*

[**Note:** *BCD*, Article 122a, paragraph 4]

9.15.12 R A *credit institution* must regularly perform its own stress tests appropriate to its *securitisation positions*.

[**Note:** *BCD*, Article 122a, paragraph 4]

9.15.13 R For the purposes of *BIPRU* 9.15.12R, a *credit institution* may rely on financial models developed by an *ECAI* provided that the *credit institution* can demonstrate, when requested by the *FSA*, that they took due care prior to investing to validate the relevant assumptions in and structuring of the models and to understand methodology, assumptions and results.

[**Note:** *BCD*, Article 122a, paragraph 4]

Monitoring requirements

9.15.14 R *A credit institution*, other than when acting as *originator* or *sponsor* or original lender, must establish formal procedures appropriate to its *trading*

book and *non-trading book*, and commensurate with the risk profile of its investments in *securitised positions*, to monitor, on an *ongoing basis* and in a timely manner, performance information on the *exposures* underlying its *securitisation positions*.

[**Note:** *BCD*, Article 122a, paragraph 5]

9.15.15 R (1) Where relevant, the information required to be monitored under *BIPRU* 9.15.14R must include:

(a) the *exposure* type;

(b) the percentage of loans more than 30, 60 and 90 days past due, default rates, prepayment rates, loans in foreclosure;

(c) collateral type and occupancy;

(d) frequency distribution of credit scores or other measures of credit worthiness across underlying exposures;

(e) industry and geographical diversification; and

(f) frequency distribution of loan to value ratios with band widths that facilitate adequate sensitivity analysis.

(2) Where underlying exposures are themselves *securitisation positions*, a *credit institution* must have the information set out in paragraph (1) not only on the underlying *securitisation tranches*, such as the issuer name and credit quality, but also on the characteristics and performance of the pools underlying those *securitisation tranches*.

[**Note:** *BCD*, Article 122a, paragraph 5]

9.15.16 R A *credit institution* must have a thorough understanding of all structural features of a *securitisation transaction* that would materially impact the performance of its *exposures* to the *transaction*, such as the contractual waterfall and waterfall related triggers, credit enhancements, *liquidity* enhancements, market value triggers and deal-specific definition of default.

[**Note:** *BCD*, Article 122a, paragraph 5]

Consequences of failure to meet requirements

9.15.17 G Subject to *BIPRU* 9.3.22G, *BIPRU* 9.15.9R to *BIPRU* 9.15.10R and *BIPRU* 9.15.18G, where a *credit institution* fails to meet any of the requirements in *BIPRU* 9.3.18R to *BIPRU* 9.3.20R (disclosure requirements), and *BIPRU* 9.15.11R to *BIPRU* 9.15.16R (investor due diligence requirements) in any material respect by reason of its negligence or omission, the *FSA* will use its powers under section 45 (Variation etc on the Authority's own initiative) of the *Act* to impose an additional *risk weight* of no less than 250% (capped at 1250%) of the risk weight that would otherwise apply to the relevant *securitisation positions* under *BIPRU* 9.11 to *BIPRU* 9.14. The additional

risk weight imposed will be progressively increased with each relevant, subsequent infringement of the requirements in *BIPRU* 9.3.18R to *BIPRU* 9.3.20R and *BIPRU* 9.15.11R to *BIPRU* 9.15.16R.

[**Note:** *BCD*, Article 122a, paragraph 5]

9.15.18 G When calculating the additional *risk weight* it will impose, the *FSA* will take into account the exemption of certain *securitisations* from the scope of *BIPRU* 9.15.3R under *BIPRU* 9.15.9R and *BIPRU* 9.15.10R and, if those exemptions are relevant, reduce the *risk weight* it would otherwise impose.

[**Note:** *BCD*, Article 122a, paragraph 5]

Amend the following as shown.

11 Disclosure (Pillar 3)

…

11.5.3 R A *firm* must disclose the following information regarding its *capital resources*:

(1) summary information on the terms and conditions of the main feature of all *capital resources* items and components thereof, including:

(a) *hybrid capital*;

(b) *capital instruments* which provide an incentive for the *firm* to redeem them; and

(c) *capital instruments* which the *firm* treats as *tier one capital* under *GENPRU* TP 8A;

(2) *tier one capital resources* ~~less any *innovative tier one capital resources*~~, with separate disclosure of:

(a) all positive items and deductions;

(b) the overall amount of *hybrid capital*, with specification of those instruments treated as *tier one capital* under *GENPRU* TP 8A; and

(c) the overall amount of *capital instruments* that provide for an incentive to redeem them, with specification of those instruments treated as *tier one capital* under *GENPRU* TP 8A;

…

…

Disclosure: Use of VaR model for calculation of market risk capital requirement

11.5.13 R The following information must be disclosed by a *firm* which calculates its *market risk capital requirement* using a *VaR model*:

(1) for each sub-portfolio covered:

(a) the characteristics of the models used;

(b) a description of stress testing applied to the sub-portfolio;

(c) a description of the approaches used for back-testing and validating the accuracy and consistency of the internal models and modelling processes;

(d) the highest, the lowest and the mean of the daily *value-at-risk* measures over the reporting period and the *value-at-risk* measure as per the end of the period;

(e) a comparison of the daily end-of-day *value-at-risk* measures to the one-day changes of the portfolio's value by the end of the subsequent *business day* together with an analysis of any important overshootings during the reporting period;

…

[Note: *BCD* Annex XII, Part 2, point 10]

…

11.6 Qualifying requirements for the use of particular instruments or methodologies

…

Disclosure: Insurance for the purpose of mitigating operational risk

11.6.6 R A *firm* using the *advanced measurement approach* for the calculation of its *operational risk capital requirement* must disclose a description of the use of insurance and other risk transfer mechanisms for the purpose of mitigating the risk.

[**Note:** *BCD* Annex XII, Part 3, point 3]

…

Exceptions

13.3.14 R When a *firm* purchases credit derivative protection against a *non-trading book exposure*, or against a *CCR exposure*, it must compute its capital requirement for the hedged asset in accordance with:

(1) *BIPRU* 5.7.16R to *BIPRU* 5.7.25R and *BIPRU* 4.10.49R(4) to (6) (Unfunded credit protection: Valuation and calculation of risk-weighted exposure amounts and expected loss amounts); or

(2) ~~*BIPRU* 4.4.79R (Double default); or~~ where a *firm* calculates *risk weighted exposure amounts* in accordance with the *IRB approach*:

(a) *BIPRU* 4.4.79R (Double default); or

(b) *BIPRU* 4.10.40R to *BIPRU* 4.10.48R. (Unfunded credit protection: Minimum requirements for assessing the effect of guarantees and credit derivatives).

(3) ~~*BIPRU* 4.10.40R to *BIPRU* 4.10.48R (Unfunded credit protection: Minimum requirements for assessing the effect of guarantees and credit derivatives).~~ [deleted]

[**Note**: *BCD* Annex III Part 2 point 3 (part)]

13.3.15 R ~~In the cases in *BIPRU* 13.3.14R, a *firm* must set the *exposure* value for these credit derivatives to zero.~~

~~[**Note**: *BCD* Annex III Part 2 point 3 (part)]~~

(1) In the cases in *BIPRU* 13.3.14R, and where the option in the second sentence of *BIPRU* 14.2.10R is not applied, the *exposure* value for *CCR* for these *credit derivatives* is set to zero.

(2) However, a *firm* may choose consistently to include for the purposes of calculating capital requirements for *counterparty credit risk* all credit derivatives not included in the *trading book* and purchased as protection against a non-trading *exposure* or against a *CCR exposure* where the credit protection is recognised under the *BCD*.

[**Note:** *BCD* Annex III Part 2 point 3 (part)]

…

13.5.6 R This table belongs to *BIPRU* 13.5.5R

Transaction or instrument	Calculation of size of *risk position*
…	
Credit default swap	The notional value of the reference debt instrument multiplied by the remaining maturity of the credit default swap.
'Nth to default' credit default	The effective notional value of the reference debt instrument, multiplied by

swap	the modified duration of the 'nth to default' derivative with respect to a change in the credit spread of the reference debt instrument.
Subject to *BIPRU* 13.5.9R to *BIPRU* 13.5.10R, *financial derivative instrument* with a non-linear risk profile, including *options* and *swaptions* except in the case of an underlying debt instrument.	Equal to the delta equivalent effective notional value of the *financial instrument* that underlies the transaction.
…	

[**Note:** *BCD* Annex III Part 5 points 5 to 9 and 15 (part)]

…

13.5.15 R There is one *hedging set* for each issuer of a reference debt instrument that underlies a credit default swap. 'Nth to default' basket credit default swaps must be treated as follows:

(1) the size of a *risk position* in a reference debt instrument in a basket underlying an 'nth to default' credit default swap is the effective notional value of the reference debt instrument, multiplied by the modified duration of the 'nth to default' derivative, with respect to a change in the credit spread of the reference debt instrument;

(2) there is one *hedging set* for each reference debt instrument in a basket underlying a given 'nth to default' credit default swap; *risk positions* from different 'nth to default' credit default swaps must not be included in the same *hedging set*; and

(3) the *CCR* multiplier applicable to each *hedging set* created for one of the reference debt instruments of an 'nth to default' derivative is 0.3% for reference debt instruments that have a credit assessment from a recognised *ECAI* equivalent to *credit quality step* 1 to 3, and 0.6% for other debt instruments.

[**Note:** *BCD* Annex III Part 5 point 15]

….

13.5.22 R This table belongs to *BIPRU* 13.5.21R.

Hedging set	*CCR* Multiplier (*CCR*M)	

categories		
…	…	…
(9)	Other *commodities* (excluding precious metals and electricity power)	10.0%
(10)	~~Underlying instruments of *financial derivative instruments* that are not in any of the above categories~~ Reference debt instruments of an 'nth to default' derivative that have a credit assessment from a recognised *ECAI* equivalent to *credit quality step* 1 to 3	~~10.0%~~ 0.3%
(11)	Reference debt instruments of an 'nth to default' derivative that do not have a credit assessment from a recognised *ECAI* equivalent to *credit quality step* 1 to 3	0.6%
(12)	Underlying instruments of *financial derivative instruments* that are not in any of the above categories.	10.0%

[**Note:** *BCD* Annex III Part 5 Table 5 and Part 5 point 15 (c)]

…

14.2 Calculation of the capital requirement for CCR

…

Credit derivatives

…

14.2.10 R Where a credit derivative included in the *trading book* forms part of an internal hedge and the credit protection is recognised under the *BCD* ~~for the purposes of the calculation of the *credit risk capital component*~~, there is deemed to be no counterparty risk arising from the position in the credit derivative. Alternatively, a *firm* may consistently include for the purposes of calculating *capital requirements* for *counterparty credit risk* all credit derivatives included in the *trading book* forming part of internal hedges or purchased as protection against *CCR exposure* where the credit protection is recognised under the *BCD*.

[**Note:** *CAD* Annex II point 11]

…

TP 15 Commodities firm transitionals: Exemptions from capital requirements

…

Duration of exemption

15.4 R *BIPRU* TP 15 applies until 31 December ~~2010~~ 2014.

[**Note:** *CAD* Article 48(1)]

…

TP 20 Standardised credit risk transitionals

…

20.5 R Until 31 December ~~2012~~ 2015, a 0% *risk weight* applies to *exposures* to the central government of the *United Kingdom* and of the Bank of England denominated and funded in the currency of another *EEA State*.

…

20.7 R *BIPRU* TP 20.6R applies until 31 December ~~2012~~ 2015 or any earlier date on which the relevant *CRD implementation measure* ceases to apply.

Annex D

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise indicated.

15.3 General notification requirements

…

Breaches of rules and other requirements in or under the Act

15.3.11 R (1) A *firm* must notify the *FSA* of:

…

(e) a breach of any requirement in regulation 4C(3) (or any successor provision) of the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2007; or

(f) it exceeding (or becoming aware that it will exceed) the limit in *BIPRU* 10.5.6R;

…

(2) …

…

16.12 Integrated Regulatory Reporting

…

16.12.3A G The following is designed to assist *firms* to understand how the reporting requirements set out in this chapter operate when the circumstances set out in *SUP* 16.12.3R(1)(a)(ii) apply.

(1) Example 1
A *BIPRU 730K firm* that undertakes activities in both *RAG* 3 and *RAG* 7 Overlaying the requirements of *RAG* 3 (*data items*) with the requirements of *RAG* 7 shows the following:

RAG 3 (*SUP* 16.12.11R) data items	RAG 7 (*SUP* 16.12.22AR) data items
…	

IRB portfolio risk	IRB portfolio risk
Securitisation: non-trading book	Securitisation: non-trading book
…	
Systems and Controls Questionnaire (if it is a *non-ILAS BIPRU firm*)	
Securitisation: trading book	Securitisation: trading book

From this, the additional reports that are required are:

…

(2) Example 2
A *UK bank* in *RAG* 1 that also carries on activities in *RAG* 5
Again, overlaying the *RAG* 1 reporting requirements with the requirements for a *RAG* 5 *firm* gives the following :

RAG 1 requirements (*SUP* 16.12.5R)	*RAG* 5 requirements (*SUP* 16.12.18AR)
…	…
IRB portfolio risk	
Securitisation: non-trading book	
…	…
Currency Analysis (if it is an *ILAS BIPRU firm*)	
Securitisation: trading book	
	Lending - Business flow and rates
	…

In this case, it is more obvious that the firm's reporting requirement in *RAG* 1 is not all the data items listed above. However, for the purposes of this exercise, it is the list of potential data items that is important. Thus comparing *RAG* 1 with *RAG* 5, the additional reporting requirements are:

…

…

Regulated Activity Group 1

16.12.5 R The applicable *data items* and forms or reports referred to in *SUP* 16.12.4R are set out according to *firm* type in the table below:

Description of *data item*	Prudential category of ~~firm~~ *firm*, applicable *data items* and reporting format (Note 1)							
	UK bank	*Building society*	*Non-EEA bank*	*EEA bank* that has *permission* to accept deposits, other than one with permission for cross border services only	*EEA bank* that does not have permission to accept deposits, other than one with permission for cross border services only	Electronic money institutions	*Credit union*	*Dormant account fund operator* (note 15)
…								
IRB portfolio risk	FSA045 (note 13)	FSA045 (note 13)						
Securitisation: non-trading book	FSA046 (note 14)	FSA046 (note 14)						
…								
Currency Analysis	…							
Securitisation: trading book	FSA058 (Note 23)							

…	
Note 14	Only applicable to *firms* that hold *securitisation positions*, or are the *originator* or *sponsor* of ~~undertake~~ *securitisations* of *non-trading book exposures*.
…	
Note 23	Only applicable to *firms* that hold *securitisation positions*, or are the *originator* or *sponsor* of *securitisations* of *trading book exposures*.

16.12.6 R The applicable reporting frequencies for submission of *data items* and periods referred to in *SUP* 16.12.5R are set out in the table below according to *firm* type. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

Data item	Unconsolidated *UK banks* and	Solo consolidated	Report on a *UK consolidation*	Other members of *RAG* 1

	building societies	*UK banks* and *building societies*	*group* or, as applicable, *defined liquidity group* basis by *UK banks* and *building societies*	
…				
FSA046	~~Half yearly~~ Quarterly		~~Half yearly~~ Quarterly	
…				
FSA054	…	…	…	…
FSA058	Quarterly		Quarterly	
…				

16.12.7 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.6R, unless indicated otherwise.

Data item	Daily	Weekly	Monthly submission	Quarterly submission	Half yearly submission	Annual submission
…						
FSA046				20 *business days* (Note 3), 45 *business days* (Note 4)	~~30 business days (note 3), 45 business days (note 4)~~	
…						
FSA054			…			
FSA058				20 *business days* (Note 3), 45 *business days* (Note 4)		
…						

…

Regulated Activity Group 2.2

16.12.9 R The applicable *data items* referred to in *SUP* 16.12.4R are set out according to type of *firm* in the table below.
The applicable reporting frequencies for submission of *data items* and periods

referred to in *SUP* 16.12.4R are set out in the table below and are calculated from a *firm's accounting reference date*, unless indicated otherwise.
The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period.

	Member's adviser (note 3)		the *Society* (note 1)		
Description of *data item* and *data item*	Frequency	Submission deadline	Description of *data item*	Frequency	Submission deadline
…					
Large Exposures					
FSA008 (~~note~~ Notes 20, 21)	Quarterly	20 *business days* (note 19)			
…					
…					
Note 21	This will not be applicable to *BIPRU limited activity firms* or *BIPRU limited licence firms* unless they have a waiver under *BIPRU* 6.1.2G.				

…

Regulated Activity Group 3

…

16.12.11 R The applicable *data items* referred to in *SUP* 16.12.4R are set out according to *firm* type in the table below:

Description of *data item*	~~*Firms*~~ *Firms'* prudential category and applicable *data items* (note 1)							
	BIPRU firms (note 17)			*Firms* other than *BIRPU firms*				
	730K	125K and *UCITS investment firms*	*50K*	*IPRU (INV)* Chapter 3	*IPRU (INV)* Chapter 5	*IPRU (INV)* Chapter 9	*IPRU (INV)* Chapter 13	*UPRU*
…								
Large exposures	FSA008 (~~note~~ Notes 2, 6)	FSA008 (~~note~~ Notes 2, 6)	FSA008 (~~note~~ Notes 2, 6)					

…								
Securitis-ation: non-trading book	FSA046 (note 23)	FSA046 (note 23)	FSA046 (note 23)					
…								
Systems and Controls Question-naire	…							
Securitis-ation: trading book	FSA058 (Note 32)	FSA058 (Note 32)	FSA058 (Note 32)					
…								
Note 6	This will not be applicable to *BIPRU limited activity firms* or *BIPRU limited licence firms* unless they have a waiver under *BIPRU* 6.1.2G.							
…								
Note 23	Only applicable to *firms* that hold *securitisation positions*, or are the *originator* or *sponsor* of ~~undertake~~ *securitisations* of *non-trading book exposures*.							
…								
Note 32	Only applicable to *firms* that hold *securitisation positions*, or are the *originator* or *sponsor* of *securitisations* of *trading book exposures*.							

…

16.12.12 R The applicable reporting frequencies for *data items* referred to in *SUP* 16.12.4R are set out in the table below according to *firm* type. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

Data Item	*BIPRU 730K firm*	*BIPRU 125K firm* and *UCITS investment firm*	*BIPRU 50K firm*	*UK consolidation group* or *defined liquidity group*	*Firm* other than *BIPRU firms*
…					
FSA046	~~Half yearly~~ Quarterly	~~Half yearly~~ Quarterly	~~Half yearly~~ Quarterly	~~Half yearly~~ Quarterly	
…					
FSA055	…			…	

FSA058	Quarterly	Quarterly	Quarterly	Quarterly	
…					

16.12.13 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.12R, unless indicated otherwise.

Data item	…	…	Monthly	Quarterly	Half yearly	Annual
…						
FSA046				20 business days (Note 1), 45 business days (Note 2)	~~30 business days (note 1), 45 business days (note 2)~~	
…						
FSA055						…
FSA058				20 business days (Note 1), 45 business days (Note 2)		
…						

Regulated Activity Group 4

…

16.12.15 R The applicable *data items* referred to in *SUP* 16.12.4R according to type of *firm* are set out in the table below:

Description of *data item*	~~*Firms*~~ *Firms'* prudential category and applicable *data items* (Note 1)							
	BIPRU			*Firms* other than *BIRPU firms*				
	730K	125K and *UCITS investment firms*	50K	*IPRU (INV)* Chapter 3	*IPRU (INV)* Chapter 5	*IPRU (INV)* Chapter 9	*IPRU (INV)* Chapter 13	*UPRU*
…								
Large exposures	FSA008 (~~note~~ Notes 2, 6)	FSA008 (~~note~~ Notes 2, 6)	FSA008 (~~note~~ Notes 2, 6)					
…								

Securitis-ation: non-trading book	FSA046 (note 19)	FSA046 (note 19)	FSA046 (note 19)					
…								
Systems and Controls Question-naire	…							
Securitis-ation: trading book	FSA058 (Note 29)	FSA058 (Note 29)	FSA058 (Note 29)					
…								
Note 6	This will not be applicable to *BIPRU limited activity firms* or *BIPRU limited licence firms* unless they have a waiver under *BIPRU* 6.1.2G.							
…								
Note 19	Only applicable to *firms* that hold *securitisation positions*, or are the *originator* or *sponsor* of ~~undertake~~ *securitisations* of *non-trading book exposures*.							
…								
Note 29	Only applicable to *firms* that hold *securitisation positions*, or are the *originator* or *sponsor* of *securitisations* of *trading book exposures*.							

…

16.12.16 R The applicable reporting frequencies for *data items* referred to in *SUP* 16.12.15R are set out in the table below according to *firm* type. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

Data item	~~Firm's~~ *Firms'* prudential category				
	BIPRU 730K firm	*BIPRU 125K firm* and *UCITS investment firm*	*BIPRU 50K firm*	*UK consolidation group* or *defined liquidity group*	*Firm* other than *BIPRU firms*
…					
FSA046	~~Half yearly~~ Quarterly	~~Half yearly~~ Quarterly	~~Half yearly~~ Quarterly	~~Half yearly~~ Quarterly	
…					
FSA055	…			…	

FSA058	Quarterly	Quarterly	Quarterly	Quarterly	
…					

16.12.17 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.16R, unless indicated otherwise.

~~Data item~~ *Data item*	…	…	Monthly	Quarterly	Half yearly	Annual
…						
FSA046				20 business days (Note 2), 45 business days (Note 3)	~~30 business days (note 2), 45 business days (note 3)~~	
…						
FSA055						…
FSA058				20 business days (Note 2), 45 business days (Note 3)		
…						

…

Regulated Activity Group 7

…

16.12.22A R The applicable *data items* referred to in *SUP* 16.12.4R are set out according to type of *firm* in the table below:

Description of *data item*	~~*Firm*~~ *Firms'* prudential category and applicable *data item* (note 1)					
	BIPRU730K firm	*BIPRU 125K firm* and *UCITS investment firm*	*BIPRU 50K firm*	*Exempt CAD firms* subject to *IPRU (INV)* Chapter 13	*Firms* (other than *exempt CAD firms*) subject to *IPRU (INV)* Chapter 13	*Firms* that are also in one or more of *RAGs* 1 to 6 and not subject to *IPRU (INV)* Chapter 13
…						
Large exposures	FSA008 (~~note~~ Notes	FSA008 (~~note~~ Notes	FSA008 (~~note~~ Notes			

	2, 6)	2, 6)	2, 6)			
…						
Securitis-ation: non-trading book	FSA046 (note 14)	FSA046 (note 14)	FSA046 (note 14)			
…						
Systems and Controls Question-naire	…					
Securitis-ation: trading book	FSA058 (Note 22)	FSA058 (Note 22)	FSA058 (Note 22)			
…						
Note 6	This will not be applicable to *BIPRU limited activity firms* or *BIPRU limited licence firms* unless they have a waiver under *BIPRU* 6.1.2G.					
…						
Note 14	Only applicable to *firms* that hold *securitisation positions*, or are the *originator* or *sponsor* of ~~undertake~~ *securitisations* of *non-trading book exposures*.					
…						
Note 22	Only applicable to *firms* that hold *securitisation positions*, or are the *originator* or *sponsor* of *securitisations* of *trading book exposures*.					

…

16.12.23 R The applicable reporting frequencies for *data items* referred to in *SUP* 16.12.22AR are set out in the table below. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

Data item	Frequency				
	Unconsolidated *BIPRU investment firm*	Solo consolidated *BIPRU investment firm*	*UK Consolidation Group* or *defined liquidity group*	Annual regulated business up to and including £5 million	Annual regulated business revenue over £5 million
…					
FSA046	~~Half yearly~~ Quarterly	~~Half yearly~~ Quarterly	~~Half yearly~~ Quarterly		

…					
FSA055	…	…	…		
FSA058	Quarterly	Quarterly	Quarterly		
…					

16.12.24 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.23R, unless indicated otherwise.

Data item	…	…	Monthly	Quarterly	Half yearly	Annual
…						
FSA046				20 business days (Note 1), 45 business days (Note 2)	~~30 business days (note 1), 45 business days (note 2)~~	
…						
FSA055						…
FSA058				20 business days (Note 1), 45 business days (Note 2)		
…						

Regulated Activity Group 8

…

16.12.25A R The applicable *data items* referred to in *SUP* 16.12.4R are set out according to type of *firm* in the table below:

Description of *data item*	~~*Firms*~~ *Firms'* prudential category and applicable *data items* (note 1)							
	BIPRU			*Firms* other than *BIRPU firms*				
	730K	125K	*50K*	*IPRU (INV)* Chapter 3	*IPRU (INV)* Chapter 5	*IPRU (INV)* Chapter 9	*IPRU (INV)* Chapter 13	*UPRU*
…								
Large exposures	FSA008 (~~note~~ Notes 2,	FSA008 (~~note~~ Notes 2,	FSA008 (~~note~~ Notes 2,					

	6)	6)	6)					
…								
Securitisation: non-trading book	FSA046 (note 19)	FSA046 (note 19)	FSA046 (note 19)					
…								
Systems and Controls Question-naire	…							
Securitisa-tion: trading book	FSA058 (Note 27)	FSA058 (Note 27)	FSA058 (Note 27)					
…								
Note 6	This will not be applicable to *BIPRU limited activity firms* or *BIPRU limited licence firms* unless they have a waiver under *BIPRU* 6.1.2G.							
…								
Note 19	Only applicable to *firms* that hold *securitisation positions*, or are the *originator* or *sponsor* of ~~undertake~~ *securitisations* of *non-trading book exposures*.							
…								
Note 27	Only applicable to *firms* that hold *securitisation positions*, or are the *originator* or *sponsor* of *securitisations* of *trading book exposures*.							

…

16.12.26 R The applicable reporting frequencies for *data items* referred to in *SUP* 16.12.25AR are set out according to the type of *firm* in the table below. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

Data item	*BIPRU 730K firm*	*BIPRU 125K firm*	*BIPRU 50K firm*	*UK consolidation group* or *defined liquidity group*	*Firms* other than *BIPRU firms*
…					
FSA046	~~Half yearly~~ Quarterly	~~Half yearly~~ Quarterly	~~Half yearly~~ Quarterly	~~Half yearly~~ Quarterly	
…					
FSA055	…			…	

FSA058	Quarterly	Quarterly	Quarterly	Quarterly	
…					

16.12.27 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.26R, unless indicated otherwise.

Data item	…	…	Monthly	Quarterly	Half yearly	Annual
…						
FSA046				20 business days (Note 1), 45 business days (Note 2)	~~30 business days (note 1), 45 business days (note 2)~~	
…						
FSA055						…
FSA058				20 business days (Note 1), 45 business days (Note 2)		
…						

16 Annex 24R Data items for SUP 16.12

…

FSA003

Capital adequacy

The firm completing this is subject to the capital rules for (tick one only):

1	A UK bank or a building society	
2	A full scope BIPRU investment firm	
3	A BIPRU limited activity firm	
4	A BIPRU limited licence firm, including a UCITS investment firm	
5	If you are a full scope BIPRU investment firm, do you meet the conditions in BIPRU TP 12.1R?	

If you are a BIPRU investment firm, are you a:

6	BIPRU 730K firm	
7	BIPRU 125K firm (excluding UCITS investment firms)	
8	UCITS investment firm	
9	BIPRU 50K firm	
10	Do you have an investment firm consolidation waiver under BIPRU 8.4?	
11	Have you notified the FSA, at least one month in advance of the date of this report, that you intend to deduct illiquid assets?	
12	Basis of reporting Unconsolidated/Solo-consolidated/Consolidated	

If consolidated, please complete data elements 13 and 14, otherwise go straight to data element 15.

13 For consolidated reporting, provide

	A	B
	Group reference	~~Group name~~

14 For consolidated reporting, provide details of all other FSA authorised firms included in this consolidated report.

	A	B
	FRN	~~Name~~

		A ~~Capital resources for all other purposes~~	B ~~Capital resources omitting Stage C~~
15	Total capital after deductions		
16	Total tier one capital after deductions		
17	Core tier one capital		
18	Permanent share capital		
19	Profit and loss account and other reserves		
20	Interim net losses		
21	Eligible partnership, LLP or sole trader capital		
22	Share premium account		
23	Externally verified interim net profits		
135	Hybrid tier one capital		
136	50% bucket		
137	35% bucket		
138	15% bucket		
24	Other tier one capital		
25	Perpetual non-cumulative preference shares subject to limit		
26	Innovative tier one instruments subject to limit		

FSA003 continued

27	Deductions from tier one capital	
28	Investments in own shares	
29	Intangible assets	
139	Excess on limits for 50% bucket capital instruments	
140	Excess on limits for 35% bucket capital instruments	
141	Excess on limits for 15% bucket capital instruments	
30	Excess on limits for non innovative tier one instruments	
31	Excess on limits for innovative tier one instruments	
32	Excess of drawings over profits for partnerships, LLPs or sole traders	
33	Net losses on equities held in the available-for-sale financial asset category	
34	Material holdings	
35	Total tier two capital after deductions	
36	Upper tier two capital	
37	Excess on limits for tier one capital transferred to upper tier two capital	
38	Upper tier two capital instruments	
39	Revaluation reserve	
40	General/collective provisions	
41	Surplus provisions	
42	Lower tier two capital	
43	Lower tier two capital instruments	
44	Excess on limits for lower tier two capital	
45	Deductions from tier two capital	
46	Excess on limits for tier two capital	
47	Other deductions from tier two capital	
48	Deductions from total of tiers one and two capital	
49	Material holdings	
50	Expected loss amounts and other negative amounts	
51	Securitisation positions	
52	Qualifying holdings	
53	Contingent liabilities	
54	Reciprocal cross-holdings	
55	Investments that are not material holdings or qualifying holdings	
56	Connected lending of a capital nature	
57	Total tier one capital plus tier two capital after deductions	
58	Total tier three capital	
59	Excess on limits for total tier two capital transferred to tier three capital	
60	Short term subordinated debt	
61	Net interim trading book profit and loss	
62	Excess on limit for tier three capital	
63	Unused but eligible tier three capital (memo)	
64	Total capital before deductions	
65	Deductions from total capital	
66	Excess trading book position	
67	Illiquid assets	
68	Free deliveries	
69	Base capital resources requirement	

FSA003 continued

70	**Total variable capital requirement**	
71	Variable capital requirement for UK banks and building societies	
72	Variable capital requirement for full scope BIPRU investment firms	
73	Variable capital requirement for BIPRU limited activity firms	
74	Variable capital requirement for BIPRU limited licence firms	
75	Variable capital requirement for UCITS investment firms	
76	Variable capital requirements to be met from tier one and tier two capital	
77	Total credit risk capital component	
78	Credit risk calculated by aggregation for UK consolidation group reporting	
79	Credit risk capital requirements under the standardised approach	
80	Credit risk capital requirements under the IRB approach	
81	Under foundation IRB approach	
82	Retail IRB	
83	Under advanced IRB approach	
84	Other IRB exposures classes	
85	Total operational risk capital requirement	
86	Operational risk calculated by aggregation for UK consolidation group reporting	
87	Operational risk basic indicator approach	
88	Operational risk standardised/alternative standardised approaches	
89	Operational risk advanced measurement approaches	
90	Reduction in operational risk capital requirement under BIPRU TP 12.1	
91	Counterparty risk capital component	
92	Capital requirements for which tier three capital may be used	
93	Total market risk capital requirement	
94	Market risk capital requirement calculated by aggregation for UK consolidation group reporting	
95	Position, foreign exchange and commodity risks under standardised approaches (TSA)	
96	Interest rate PRR	
97	Equity PRR	
98	Commodity PRR	
99	Foreign currency PRR	
100	CIU PRR	
101	Other PRR	
102	Position, foreign exchange and commodity risks under internal models (IM)	
103	Concentration risk capital component	
104	Fixed overhead requirement	
105	Capital resources requirement arising from capital floors	
106	Surplus (+) / Deficit (-) of own funds	
107	Solvency ratio (%)	
108	Individual Capital Guidance - total capital resources	
109	Individual Capital Guidance - general purpose capital	
110	Surplus/(deficit) total capital over ICG	
111	Surplus/(deficit) general purposes capital over ICG	
	MEMORANDUM ITEMS	
112	Value of portfolio under management - UCITS investment firms	

FSA003 continued

	Prudential filters	
113	Unrealised gains on available-for-sale assets	
114	Unrealised gains (losses) on investment properties	
115	Unrealised gains (losses) on land and buildings	
116	Unrealised gains (losses) on debt instruments held in the available for sale category	
117	Unrealised gains (losses) on cash flow hedges of financial instruments	
118	Unrealised gains (losses) on fair value financial liabilities	
119	Defined benefit asset (liability)	
120	(Deficit reduction amount) if used	
121	Deferred acquisition costs (deferred income) (DACs/DIRs)	
	Minority interests	
122	Minority interests included within capital resources	
123	of which: innovative tier one instruments	
	Profits	
124	Profits not externally verified at the reporting date but subsequently verified	
125	Total capital after deductions after profits have been externally verified	
	Allocation of deductions between tier one and two capital	
126	Material insurance holdings excluded from allocation	
127	Allocated to tier one capital	
128	Allocated to tier two capital	
	Firms on the IRB/AMA approaches	
129	Total capital requirement under pre-CRD rules	
130	Total credit risk capital component under pre-CRD	
131	Expected loss amounts - wholesale, retail and purchased receivables	
132	Expected loss amounts - equity	
133	Total value adjustments and provisions eligible for the "EL less provisions" calculation under IRB	
134	Total deductions from tier 1 and tier 2 capital according to pre-CRD rules	

...

FSA005
Market risk

		A	B	C	D	E	F	G
	Interest rate risk							
	General interest rate risk	**USD**	**GBP**	**EUR**	**CHF**	**YEN**	**Other**	**Total**
1	Valuations of longs							
2	Valuation of shorts							
3	PRR (as per handbook)							
	Specific interest rate risk							
	Amount by risk bucket							**Total**
4	0.00%							
5	0.25%							
6	1.00%							
7	1.60%							
8	8.00%							
9	12.00%							
10	PRR							
11	Securitisation exposures/unrated liquidity facilities PRR							
12	Ordinary CDS PRR							
13	Securitisation CDS PRR							
14	Basic interest rate PRR calculation for equity instruments							
15	Option PRR for interest rate positions							
16	CAD1 PRR for interest rate positions							
17	Other PRR							
18	Total interest rate PRR							
	Equity risk							
	General equity risk (or simplified)							**Total**
19	Valuations of longs							
20	Valuation of shorts							
21	PRR							

FSA005 continued

		A	B	C	D	E	F	G
	Specific equity risk by risk bucket							Total
22	Qualifying equities							
23	Qualifying equity indices							
24	Other equities, equity indices or equity baskets							
25	PRR							
26	Option PRR for equity positions							
27	CAD 1 PRR for equity positions							
28	Other PRR							
29	Total Equity PRR							

	Commodity Risk	**Precious metals**	**Base metals**	**softs**	**energy**	**other**		**Total**
30	Valuation of longs							
31	Valuation of shorts							
32	Outright PRR							
33	Spread PRR							
34	Carry PRR							
35	Simplified PRR							
36	Total PRR							
37	Option PRR for commodity positions							
38	CAD 1 PRR for commodity positions							
39	Other PRR							
40	Total Commodity PRR							

	Foreign currency risk							
	General foreign currency risk	**USD**	**GBP**	**EUR**	**CHF**	**YEN**	**Other**	**Total**
41	Total net long positions							
42	Total net short positions							
43	Net gold position							
44	PRR							

		A USD	B GBP	C EUR	D CHF	E YEN	F Other	G Total
45	Option PRR for foreign currency							
46	CAD 1 PRR for foreign currency							
47	Other							
48	Total foreign currency PRR							

Collective investment undertaking risk

	General CIU risk	USD	GBP	EUR	CHF	YEN	Other	Total
49	Total net long positions							
50	Total net short positions							
51	PRR							
52	Option PRR for CIU							
53	CAD 1 PRR for CIU							
54	Other PRR							
55	Total CIU PRR							

Other PRR

56	Any other PRR	

~~VaR model Risk~~ Internal models-based charges

57	Multiplier	
58	Previous day's VaR PRR	
59	Average of previous 60 days VaR	
60	Incremental Default Risk surcharge	

Add-ons

		A Description	B Value
63	1		
	2		
	3		
	...		
	n		

64	Total Add-ons	
61	~~VaR model based PRR~~ Internal models-based PRR	
62	**GRAND TOTAL PRR**	

• • •

FSA008

Large exposures

		A	B
1	Is this report by a UK consolidation group under BIPRU 8 Ann 1R?		

For consolidated reporters only

2 List the FSA Firm Reference Numbers of the members of the UK consolidation group	Index no	FSA FRN
	1	
	…	
	n	

For unconsolidated/solo-consolidated reporters only

3	Is the firm a member of a UK integrated group	

Part 1: Large exposures at the reporting date (other than to members of integrated groups under BIPRU 10.8 or BIPRU 10.9)

		A		B
4	Capital resources under BIPRU 10.5.3R		Capital resources (BIPRU 10.5.4R)	

5	Exposure no	Counterparty name (or group name)	Gross exposure	% of capital resources under BIPRU 10.5.3R	Funded credit protection	Unfunded credit protection	Exposure after credit risk mitigation	Of which							Trading book concentration risk excesses			CNCOM	PD %	LGD %	EL %	Credit risk capital requirement
								Exempt exposures		Non-exempt exposures												
								Amount	% of capital resources	Non-trading book	% of capital resources	Trading book	% of capital resources	Aggregate %	% of capital resources under 10.5.4R	Existed for 10 business days or less - %	Persisted for more than 10 business days - %					
	A	B	C	D	W	X	E	F	G	H	J	K	L	M	N	P	Q	R	S	T	U	V
	1																					
	…																					
	n																					
	Total																					

		A
6	I confirm that the firm has notified the FSA under ~~BIPRU 10.5.9R~~ SUP 15.3.11R of all exposures that have exceeded, or will exceed, the limits set out in BIPRU 10.5.6R ~~or 10.5.8R~~ (tick to confirm)	

Part 2: Details of connected counterparties at the reporting date ~~(excluding to members of integrated groups under BIPRU 10.8 or BIPRU 10.9)~~

7	Exposure no	Individual counterparties (each individually above 2.5% capital resources)	Gross exposure	% of capital resources under BIPRU 10.5.3R	Funded credit protection	Unfunded credit protection	Exposure after credit risk mitigation	Of which						
								Exempt exposures		Non-exempt exposures				
								Amount	%	Non-trading book	%	Trading book	%	Aggregate %
	A	B	C	D	N	O	E	F	G	H	J	K	L	M
	1	Individually <2.5% of capital resources												
	2													
	…													
	n													

FSA008 continued

Part 3: Trading book concentration risk excesses since the last reporting date (excluding any that exist in Part 1 at the reporting date)

8	Exposure no	Counterparty name	Gross exposure	% of capital resources under BIPRU 10.5.3R	Exposure after credit risk mitigation	Of which: Non-exempt exposures			Is it a member of a diverse block or residual block?
						Non-trading book amount	Trading book amount	Amount in excess of 25% of capital resources under BIPRU 10.5.4R	
	A	B	C	D	E	F	G	H	J
	1								
	...								
	n								

Unconsolidated or solo-consolidated reporters only
Part 4: Significant transactions with the mixed activity holding company and its subsidiaries

9	Transaction no	Counterparty name	Transaction or exposure value	% of capital resources
	A	B	C	D
	1			
	...			
	n			

. . .

FSA046

Securitisation: Non-Trading Book

Transaction level information - Where the firm is an originator or sponsor

		A
1	Location of the most recent Pillar 3 disclosures for securitisation (BIPRU 11.5.17R) ~~disclosures~~	
2	Additional capital requirement for significant risk transfer (BIPRU 9.3.1R)	
21	Additional capital requirements (BIPRU 9.3.21G and BIPRU 9.15.17G)	
22	Reduction in RWAs according to BIPRU 9.10.4R and BIPRU 9.10.6R	

	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P
3	Programme Name	Asset Class	Originator's Interest	Investors' Interest	Location of Investor Reports	Assets appear on FSA001?	BIPRU 9.3.1R applied?	Conversion Factor applied? ~~BIPRU 9.13 applies?~~	Exposure value before securitisation	Capital requirement before securitisation	Exposure value after securitisation	Exposure value deducted from capital resources	Capital requirement after securitisation before cap	Capital requirement after securitisation after cap	Retention of net economic interest (% to 2DP)	Method of retention of net economic interest
1																
…																
n																

Risk positions - standardised exposures

	A	B	C	D	E	F
	CQS1	CQS2	CQS3	CQS4 (only for credit assessments other than short term credit assessments)	~~CQS5 and below~~ All other credit assessments	Deductions from capital
4 ~~As~~ Originator						
5 ~~As s~~Sponsor ~~of an ABCP programme~~						
6 Counterparty credit risk						
7 All other exposures						

Risk positions - IRB exposures

			A	B	C	D	E	F	G	H	I	J	K	L	M	N	P	O
			~~Firms applying~~ ~~BIPRU 9.12.16R~~	CQS 1 ST CQS 1	CQS2	CQS3	CQS4 ST CQS2	CQS5	CQS6	CQS7 ST CQS3	CQS8	CQS9	CQS10	CQS11	Below CQS11 All other credit assessments	Supervisory formula (Exposure Value)	Supervisory formula (Capital Requirement)	Deductions from capital
8	~~As~~ Originator	A																
9		B																
10		C																
11	~~As s~~Sponsor ~~of an ABCP programme~~	A																
12		B																
13		C																
14	Counterparty credit risk	A																
15		B																
16		C																
17	All other exposures	A																
18		B																
19		C																

...

Insert the following data item FSA058 into SUP 16 Annex 24R (Data items for SUP 16.7 and SUP16.12) in the appropriate numerical order. The text is all new and not underlined.

FSA058

Securitisation: Trading book

Transaction level information - Where the firm is an originator or sponsor

		A
21	Additional capital requirements (BIPRU 7.2.47HG)	

		A	B	C	D	E	F	O	P
3		Programme Name	Asset Class	Originator's Interest	Investors' Interest	Location of Investor Reports	Assets appear on FSA001?	Retention of net economic interest (% to 2DP)	Method of retention of net economic interest
	1								
	...								
	n								

SUP 16 Annex 25G Guidance notes for data items in SUP 16 Annex 24R

…

FSA003 – Capital adequacy

…

Columns A and B

~~There are two different measures of capital resources. For the purposes of the capital resources requirement under *GENPRU* 2.1.40R onwards and for disclosure purposes under *BIPRU* 11, it is calculated and set out in Column B of this data item. This column excludes stage C in the capital resources calculation set out in *GENPRU* 2 Annexes 2R, 3R, 4R, 5R and 6R. For the purposes of *GENPRU* 2.2.17R, capital resources are set out in Column A. The difference between them is in relation to innovative tier one capital (ie Stage C) which, for the purposes of *GENPRU* 2.1.9R, cannot be included (*GENPRU* 2.2.42R).~~ [deleted]

…

Data elements

These are referred to by row first~~, then by column, so data element 2B will be the element numbered 2 in column B~~.

…

[Editor's Note: There are no changes to data elements 1A to 13A]

…

13B ~~For consolidated reporting, please provide the Group name~~

~~If 12A is completed as a consolidated report, then please enter the group name here.~~ [deleted]

…

14B ~~For consolidated reporting, please provide the names of the firms included~~

~~List here the names (against the FRN) of all FSA authorised firms included within the *UK consolidation group*.~~ [deleted]

…

15B ~~Total capital after deductions~~

~~This is equivalent to 15A, but excludes stage C (in *GENPRU* 2 Annexes 2R, 3R, 4R, 5R and 6R). It will only differ from 15A if the firm has issued *innovative tier one capital*.~~ [deleted]

…

16B ~~Total tier one capital after deductions~~

~~This is equivalent to 16A, but reflecting *GENPRU* 2.2.42R and *GENPRU* 2.2.43G. It will only differ from 16A if the firm has issued *innovative tier one capital*.~~ [deleted]

…

17B ~~Core tier one capital~~
~~This will have the same value as 17A.~~ [deleted]

…
24A Other tier one capital, subject to limits
Data elements 25A and 26A should only contain items that are subject to grandfathering as they are not compliant with the hybrid capital rules. Instruments that do comply with the hybrid capital rules should be included within elements 136A to 138A, as appropriate.
[*CEBS' CA 1.1.4*]

24B ~~Other tier one capital, subject to limits~~
~~This will have the same value as in 24A. (Although innovative tier one capital is not included for CRR purposes, it is included here and the disallowable portion is reported in 31B.)~~ [deleted]

25A Perpetual non-cumulative preference shares
This data element (after deduction of data element 30A) is equivalent to Stage B in:

• *GENPRU* 2 Annex 2R for a *UK bank*;

• *GENPRU* 2 Annex 3R for a *building society*;

• *GENPRU* 2 Annex 4R for a *BIPRU investment firm deducting material holdings*;

• *GENPRU* 2 Annex 5R for a *BIPRU investment firm deducting illiquid assets*; and

• *GENPRU* 2 Annex 6R for a *BIPRU investment firm* with a waiver from consolidated supervision.

It includes perpetual non-cumulative preference shares (see *GENPRU* 2.2.109R) and *PIBS* (see *GENPRU* 2.2.111R). See also *GENPRU* TP 8.2R to *GENPRU* TP ~~8.6R~~ 8.7R.

All the preceding references to *GENPRU* in this note are to the version of *GENPRU* in force on 30 December 2010.

See also *GENPRU* TP 8A.

[*CEBS' CA 1.1.4.1*]

26A Innovative tier one instruments subject to limit
See *GENPRU* 2.2.113R to *GENPRU* 2.2.137R, before the application of *GENPRU* 2.2.30R. *Also see GENPRU* TP ~~8.7R~~ 8.8R.

This data element (after deduction of data element 31A) is equivalent to Stage C in:

• *GENPRU* 2 Annex 2R for a *UK bank*;

• *GENPRU* 2 Annex 3R for a *building society*;

• *GENPRU* 2 Annex 4R for a *BIPRU investment firm deducting material holdings*;

• *GENPRU* 2 Annex 5R for a *BIPRU investment firm* deducting *illiquid assets*; and

• *GENPRU* 2 Annex 6R for a *BIPRU investment firm* with a waiver from consolidated supervision.

All the preceding references to *GENPRU* in this note are to the version of *GENPRU* in force on 30 December 2010.

See also *GENPRU* TP 8A.

[*CEBS' CA 1.1.4.2*]

…

27B ~~Deductions from tier one capital~~
~~This figure will differ from 27A only if a firm has issued *innovative tier one instruments* in 26A.~~ [deleted]

…

28B ~~Investments in own shares~~
~~This is the same figure as in 28A.~~ [deleted]

…

29B ~~Intangible assets~~
~~This is the same figure as in 29A.~~ [deleted]

30A Excess on limits for non-innovative tier one instruments
The amount reported in 25A which is in excess of the limits set out in *GENPRU* 2.2.29R. See also *GENPRU* 2.2.25R.
All the preceding references to *GENPRU* in this note are to the version of *GENPRU* in force on 30 December 2010.
See also *GENPRU* TP 8A.
[*CEBS' CA 1.1.5.2, but with the opposite sign*]

30B ~~Excess on limits for non-innovative tier one instruments~~
~~This is the same figure as in 30A.~~ [deleted]

31A Excess on limits for innovative tier one instruments
The amount reported in 26A which is in excess of the limits set out in *GENPRU* 2.2.30R. See also *GENPRU* 2.2.25R. As set out in *GENPRU* 2.2.25R to *GENPRU* 2.2.27R, the excess is however available in *upper tier two capital* in 37A.
All the preceding references to *GENPRU* in this note are to the version of *GENPRU* in force on 30 December 2010.
See also *GENPRU* TP 8A.
[*CEBS' CA 1.1.5.3, but with the opposite sign*]

31B ~~Excess on limits for innovative tier one instruments~~
~~In line with *GENPRU* 2.2.42R, *innovative tier one capital* cannot be included in *tier one capital resources*. This figure equates to the whole of the firm's *innovative tier one capital* (26A). As set out in *GENPRU* 2.2.25R to *GENPRU* 2.2.27R, the capital is however available in *upper tier two capital* in 37B.~~
~~It gives effect to Note (3) in:~~
~~• *GENPRU* 2 Annex 2R for a *UK bank*;~~
~~• *GENPRU* 2 Annex 3R for a *building society*;~~
~~• *GENPRU* 2 Annex 4R for a *BIPRU investment firm* deducting *material holdings*;~~
~~• *GENPRU* 2 Annex 5R for a *BIPRU investment firm* deducting *illiquid assets*; and~~
~~• *GENPRU* 2 Annex 6R for a *BIPRU investment firm* with a waiver from consolidated supervision.~~ [deleted]

…

32B ~~Excess of drawings over profits for partnerships, LLPs and sole traders~~
~~This is the same figure as reported in 32A.~~ [deleted]

…

33B ~~Net losses on equities held in the available-for-sale financial assets category~~
~~This is the same figure as reported in 33A.~~ [deleted]

…

34B ~~Material holdings~~
~~This is the same figure as reported in 34A.~~ [deleted]

…

35B ~~Total tier two capital after deductions~~
~~This is broadly similar to 35A, except that it takes account of *GENPRU* 2.2.42R where a firm has *innovative tier one capital* that cannot be included in tier one.~~ [deleted]

…

36B ~~Upper tier two capital, subject to limits~~
~~This data element (after deducting 44B and 46B) is equivalent, after taking account of *GENPRU* 2.2.42R where a firm has *innovative tier one capital*, to Stage G in:~~
~~• *GENPRU* 2 Annex 2R for a *UK bank*;~~
~~• *GENPRU* 2 Annex 3R for a *building society*;~~
~~• *GENPRU* 2 Annex 4R for a *BIPRU investment firm* deducting *material holdings*;~~
~~• *GENPRU* 2 Annex 5R for a *BIPRU investment firm* deducting *illiquid assets*; and~~
~~• *GENPRU* 2 Annex 6R for a *BIPRU investment firm* with a waiver from consolidated supervision.~~ [deleted]

…

37B ~~Excess on limits for tier one capital transferred to upper tier two capital~~
~~As 37A, but includes all *innovative tier one capital* as none of it could be included in *tier one capital resources* as a result of *GENPRU* 2.2.42R. This will not exceed the sum of 30B and 31B.~~ [deleted]

…

38B ~~Upper tier two capital instruments, subject to limits~~
~~This is the same figure as reported in 38A.~~ [deleted]

…

39B ~~Revaluation reserve~~
~~This is the same figure as reported in 39A.~~ [deleted]

…

40B ~~General/collective provisions~~
~~This is the same figure as reported in 40A.~~ [deleted]

…

41B ~~Surplus provisions~~
~~This is the same figure as reported in 41A.~~ [deleted]

…

42B ~~Lower tier two capital~~
~~This figure will differ from 42A if the firm had any *innovative tier one capital* reported in 26A.~~ [deleted]

…

43B ~~Lower tier two capital instruments subject to limits~~
~~This is the same figure as reported in 43A.~~ [deleted]

…

44B ~~Excess on limits for lower tier two capital~~
~~The amount reported in 43B that is in excess of the limits set out in *GENPRU* 2.2.46R (2). If the firm has not reported *innovative tier one capital instruments* in 26A, this number will be the same as 44A.~~ [deleted]

…

45B ~~Deductions from tier two capital~~
~~If the firm has not reported *innovative tier one instruments* in 26A, this number will be the same as 45A.~~
~~Otherwise, this data element (excluding 46B) is equivalent to Stage J (after taking account of Note (3)) in:~~
~~• *GENPRU* 2 Annex 2R for a *UK bank*;~~
~~• *GENPRU* 2 Annex 3R for a *building society*;~~
~~• *GENPRU* 2 Annex 4R for a *BIPRU investment firm* deducting *material holdings*;~~
~~• *GENPRU* 2 Annex 5R for a *BIPRU investment firm* deducting *illiquid assets*; and~~
~~• *GENPRU* 2 Annex 6R for a *BIPRU investment firm* with a waiver from consolidated supervision.~~ [deleted]

…

46B ~~Excess on limits for tier two capital~~
~~If the firm has not reported *innovative tier one instruments* in 26A, this number will be the same as 46A. Otherwise it is the amounts reported in 36B and 42B in excess of the limits set out *GENPRU* 2.2.46R (1).~~ [deleted]

…

47B ~~Other deductions from tier two capital~~
~~This is the same figure as reported in 47A.~~ [deleted]

…

48B ~~Deductions from total of tiers one and two~~
~~This is the same figure as reported in 48A.~~ [deleted]

…

57B ~~Total tier one capital plus tier two capital after deductions~~

~~This may differ from 57A if the firm reported *innovative tier one instruments* in 26A.~~
~~This is equivalent to Stage N of:~~
~~• *GENPRU* 2 Annex 2R for a *UK bank*;~~
~~• *GENPRU* 2 Annex 3R for a *building society*;~~
~~• *GENPRU* 2 Annex 4R for a *BIPRU investment firm* deducting *material holdings*;~~
~~• *GENPRU* 2 Annex 5R for a *BIPRU investment firm* deducting *illiquid assets*; and~~
~~• *GENPRU* 2 Annex 6R for a *BIPRU investment firm* with a waiver from consolidated supervision.~~
~~Firms should note that if this figure is less than the *base capital resources requirement* (reported in data element 69A), the firm's *capital resources* are less than its *capital resources requirement*. See Note (2) in *GENPRU* 2 Annexes 2R, 3R, 4R, 5R and 6R.~~
~~[*CEBS' CA 1.4 plus 1.5 minus 1.3.10*]~~ [deleted]

…

58B ~~Total tier three capital~~

~~This is broadly similar to 58A, except that it takes account of *GENPRU* 2.2.42R where a firm has *innovative tier one capital* that cannot be included in tier one.~~ [deleted]

…

59B ~~Excess on limits for tier two capital transferred to tier three capital~~

~~See *GENPRU* 2.2.25R to *GENPRU* 2.2.27R. This will be no greater than the sum of 44B and 46B. If the firm has not reported *innovative tier one instruments*, the figure should be the same as 59A.~~ [deleted]

…

60B ~~Short term subordinated debt, subject to limits~~

~~This figure will be the same as 60A.~~
~~[*CEBS' CA 1.6.3*]~~ [deleted]

…

61B ~~Net interim trading book profit and loss~~

~~This figure will be the same as 61A.~~
~~[*CEBS' CA 1.6.2*]~~ [deleted]

…

62B ~~Excess on limit for tier three capital~~

~~The amount reported in 59B and 60B in excess of the limits set out in *GENPRU* 2.2.49R to *GENPRU* 2.2.50R. It will only differ from 62A if the firm has reported *innovative tier one capital* in 26A.~~ [deleted]

…

63B ~~Unused but eligible tier three capital (memo)~~

~~See *GENPRU* 2.2.47R.~~
~~This is the sum of data elements 58B less the amount shown in data element 92A. If the result is negative, enter 0. This is the surplus tier three capital which may only be used for the purposes set out in *BIPRU* 2.2.47R.~~
~~It may differ from 63A if the firm has reported *innovative tier one capital* in 26A.~~ [deleted]

…

64B ~~Total capital before deductions~~
~~This figure will differ from 64A if the firm had any innovative tier one capital reported in 26A.~~ [deleted]

…

65B ~~Deductions from total capital~~
~~This will be the same value as reported in 65A.~~ [deleted]

…
[Editor's Note: There are no changes to data elements 66A to 106A]
…

106B ~~Surplus/deficit of own funds~~
~~This is 15B less 70A.~~
~~This should be a positive figure, showing the amount of excess capital over that required for the risks measured at the reporting date, as well as any requirements.~~
~~Firms that have adopted the *IRB approach* for credit risk or *advanced measurement approach* for operational risk should also be monitoring data element 105A against 15B.~~
~~Firms should note that although this figure may show a surplus, if this figure reported in data element 57B is less than the *base capital resources requirement* (reported in data element 69A), the firm's *capital resources* are less than its *capital resources requirement*. See Note (2) in *GENPRU* 2 Annexes 2R, 3R, 4R, 5R and 6R.~~
~~This should be a positive figure and is the calculation required in *GENPRU* 2.1.40R.~~ [deleted]

…

107B ~~Overall solvency ratio~~
~~This is 15B divided by 70A, multiplied by 100 and represents the firm's overall solvency for CRR purposes.~~
~~This ratio represents the firm's solvency in relation to its variable capital requirement under *GENPRU* 2.1.9R(1). In most cases, it may be the same as figure as appears in Column A, but that will not be the case if data element 15 differs between Column A and Column B because of the different treatment of *innovative tier one instruments* (see *GENPRU* 2.2.43R).~~ [deleted]

…
[Editor's Note: There are no changes to data elements 108A to 134A]
…

135A Hybrid tier one capital
This element is equivalent to Stages B1, B2 and C in:
• *GENPRU* 2 Annex 2R for a *UK bank*;

• *GENPRU* 2 Annex 3R for a *building society*;

• *GENPRU* 2 Annex 4R for a *BIPRU investment firm* deducting *material holdings*;

• *GENPRU* 2 Annex 5R for a *BIPRU investment firm* deducting *illiquid assets*; and

• *GENPRU* 2 Annex 6R for a *BIPRU investment firm* with a waiver from consolidated supervision.

[See *GENPRU* 2.2.30AR to 2.2.30CR]

136A 50% Bucket

This data element (after deduction of data element 139A) is equivalent to Stage B1 in:

• *GENPRU* 2 Annex 2R for a *UK bank*;

• *GENPRU* 2 Annex 3R for a *building society*;

• *GENPRU* 2 Annex 4R for a *BIPRU investment firm* deducting *material holdings*;

• *GENPRU* 2 Annex 5R for a *BIPRU investment firm* deducting *illiquid assets*; and

• *GENPRU* 2 Annex 6R for a *BIPRU investment firm* with a waiver from consolidated supervision.

[See *GENPRU* 2.2.30AR]

137A 35% Bucket

This data element (after deduction of data element 140A) is equivalent to Stage B2 in:

• *GENPRU* 2 Annex 2R for a *UK bank*;

• *GENPRU* 2 Annex 3R for a *building society*;

• *GENPRU* 2 Annex 4R for a *BIPRU investment firm* deducting *material holdings*;

• *GENPRU* 2 Annex 5R for a *BIPRU investment firm* deducting *illiquid assets*; and

• *GENPRU* 2 Annex 6R for a *BIPRU investment firm* with a waiver from consolidated supervision.

[See *GENPRU* 2.2.30BR]

138A 15% Bucket

This data element (after deduction of data element 141A) is equivalent to Stage C in:

• *GENPRU* 2 Annex 2R for a *UK bank*;

• *GENPRU* 2 Annex 3R for a *building society*;

• *GENPRU* 2 Annex 4R for a *BIPRU investment firm* deducting *material holdings*;

• *GENPRU* 2 Annex 5R for a *BIPRU investment firm* deducting *illiquid assets*; and

• *GENPRU* 2 Annex 6R for a *BIPRU investment firm* with a waiver from consolidated supervision.

[See *GENPRU* 2.2.30CR]

139A Excess on limit for 50% bucket capital instruments

The amount reported in 136A which is in excess of the limit set out in *GENPRU* 2.2.30AR.

140A Excess on limit for 35% bucket capital instruments

The amount reported in 137A which is in excess of the limit set out in *GENPRU* 2.2.30BR.

141A Excess on limit for 15% bucket capital instruments

The amount reported in 138A which is in excess of the limit set out in *GENPRU* 2.2.30CR.

FSA003 – Capital adequacy validations
Internal validations

Data elements are referenced by row then column.

Validation number	Data element		Validation
1	1A		If (2A+3A+4A)=yes, then no, else yes
2	2A		If (1A+3A+4A)=yes, then no, else yes
3	3A		If (1A+2A+4A)=yes, then no, else yes
4	4A		If (1A+2A+3A)=yes, then no, else yes
5	5A		If 2A = no, then no
6	6A		If (3A+4A) = no, then no
7	7A		If (1A+8A+9A)=yes, then no
8	8A		If (1A+7A+9A)=yes, then no
9	9A		If (1A+7A+8A)=yes, then no
10			[deleted – replaced by validation 114]
11			[deleted – replaced by validation 115]
12			[Not used]
13	15A	=	64A – 65A
14	~~15B~~	=	~~64B – 65B~~ [deleted]
15	16A	=	17A + 24A - 27A + 135A
16	~~16B~~	=	~~17B + 24B - 27B~~ [deleted]
17	17A	=	18A + 19A – 20A +21A +22A + 23A
18	~~17B~~	=	~~17A~~ [deleted]
19	24A	=	25A + 26A
20	~~24B~~	=	~~24A~~ [deleted]
21	27A	=	28A + 29A + 30A + 31A + 32A + 33A+34A + 139A+140A+141A
22		=	[deleted – replaced by validation 116]
23	~~28B~~	=	~~28A~~ [deleted]
24	~~29B~~	=	~~29A~~ [deleted]
25	~~30B~~	=	~~30A~~ [deleted]
26	~~31B~~	=	~~26A~~ [deleted]
27	~~32B~~	=	~~32A~~ [deleted]
28	~~33B~~	=	~~33A~~ [deleted]
29	34A		If 10A = no, then 0
30	~~34B~~	=	~~34A~~ [deleted]
31			[Not used]
32	35A	=	36A + 42A - 45A
33	~~35B~~	=	~~36B + 42B - 45B~~ [deleted]
34	36A	=	37A + 38A + 39A + 40A + 41A
35	~~36B~~	=	~~37B + 38B + 39B + 40B + 41B~~ [deleted]
36	37A	≤	30A + 31A
37	~~37B~~	≤	~~30B + 31B~~ [deleted]
38	~~38B~~	=	~~38A~~ [deleted]
39	~~39B~~	=	~~39A~~ [deleted]
40	~~40B~~	=	~~40A~~ [deleted]
41	~~41B~~	=	~~41A~~ [deleted]

Validation number	Data element		Validation
42	42A	=	43A – 44A
43	~~42B~~	=	~~43B - 44B~~ [deleted]
44	~~43B~~	=	~~43A~~ [deleted]
45	45A	=	46A + 47A
46	~~45B~~	=	~~46B + 47B~~ [deleted]
47	~~47B~~	=	~~47A~~ [deleted]
48	48A	=	49A + 50A + 51A + 52A + 53A + 54A + 55A + 56A
49	~~48B~~	=	~~48A~~ [deleted]
50	49A		If 11A = yes, then 0
51	52A		If 1A = no, then 0
52	53A		If 10A = no, then 0
53	55A		If 1A = no, then 0
54	56A		If 1A = no, then 0
55	57A	=	16A + 35A – 48A
56	~~57B~~	=	~~16B + 35B – 48B~~ [deleted]
57	58A	=	59A + 60A + 61A - 62A
58	~~58B~~	=	~~59B + 60B + 61B - 62B~~ [deleted]
59	59A	≤	44A + 46A
60	~~59B~~	≤	~~44B + 46B~~ [deleted]
61	~~60B~~	=	~~60A~~ [deleted]
62	~~61B~~	=	~~61A~~ [deleted]
63			[deleted – replaced by validation 102]
64			[deleted – replaced by validation 103]
65	64A	=	57A + 58A
66	~~64B~~	=	~~57B + 58B~~ [deleted]
67	65A	=	66A + 67A + 68A
68	~~65B~~	=	~~65A~~ [deleted]
69	66A		If 1A = no, then 0
70	67A		If 11A = no, then (if 10A = no, then 0)
71	69A		If 12A = consolidated, then 0, else >0
72	70A	=	71A + 72A + 73A + 74A + 75A
72a			[deleted]
72b			[deleted]
72c			[deleted]
72d			[deleted]
72e			[deleted]
73			[deleted – replaced by validation 104]
74			[deleted – replaced by validation 105]
75			[deleted – replaced by validation 106]
76			[deleted – replaced by validation 107]
77			[deleted – replaced by validation 108]
78	76A	=	77A + 85A – 90A +91A
79			[Not used]
80	77A	=	78A + 79A + 80A
81	78A		If 12A ≠ consolidated, then 0
82	80A	=	81A + 82A + 83A + 84A
83	85A		86A + 87A + 88A + 89A

Validation number	**Data element**		**Validation**
84	86A		If 12A ≠ consolidated, then 0
85	90A		If 5A = no, then 0
86			[deleted – replaced by validation 109]
87	93A	=	94A + 95A + 102A
88	94A		If 12A ≠ consolidated, then 0
89	95A	=	96A + 97A + 98A + 99A + 100A + 101A
90	104A	=	If 1A = yes, then 0, else (if 2A = yes, then 0, else > 0)
91	106A	=	15A – 70A
92	~~106B~~	~~=~~	~~15B – 70A~~ [deleted]
93			[deleted – replaced by validation 110]
94			[deleted – replaced by validation 111]
95	~~110A~~		~~If 108A = 0, then 0, else (15B – 108A)~~ [deleted – replaced by validation 118]
96	~~111A~~		~~If 109A = 0, then 0, else (57B – 109A)~~ [deleted – replaced by validation 119]
97			[deleted – replaced by validation 112]
98	123A	≤	26A
99			[deleted – replaced by validation 113]
100	~~127A~~	~~≦~~	~~16B~~ [deleted – replaced by validation 120]
101	~~128A~~	~~≦~~	~~35B~~ [deleted – replaced by validation 121]
102	63A	=	Max (59A + 60A + 61A – 62A – 92A), 0
103	~~63B~~	~~=~~	~~Max (59B + 60B + 61B – 62B – 92A), 0~~ [deleted]
104	71A		If 1A = Yes, then 76A + 92A, else 0
105	72A		If 2A = Yes, then 76A + 92A, else 0
106	73A		If 3A = Yes, then 76A + 92A, else 0
107	74A		If 4A = Yes, then (if 8A = Yes, 0, else (Max (77A + 91A + 93A + 103A), 104A)), else 0
108	75A		If 8A = Yes, then (Max ((77A + 91A + 93A + 103A), 104A)), else 0
109	92A	=	93A + 103A + 104A
110	107A	=	(15A/70A) * 100
111	~~107B~~	~~=~~	~~(15B/70A) * 100~~ [deleted]
112	112A		If 8A = no, then 0
113	127A + 128A	=	49A + 50A + 51A – 126A
114	10A		If 1A = yes, then no
115	11A		If 1A = yes, then no
116	~~27B~~	~~=~~	~~28B + 29B + 30B + 31B + 32B + 33B + 34B~~ [deleted]
117	135	=	136A+137A+138A
118	110A		If 108A = 0, then 0, else (15A – 108A)
119	111A		If 109A = 0, then 0, else (57A – 109A)
120	127A	≦	16A
121	128A	≦	35A

…

FSA005 – Market risk

…

56 Any other PRR

PRR arising from other non-standard transactions as required by *BIPRU* 7.1.7R to *BIPRU* 7.1.13E and that is not attributable to any of the other categories e.g. PRR arising from nonfinancial spread betting.

This will have the same value as data element 101A in FSA003.

~~VAR model risk~~ Internal models-based charges

See *BIPRU* 7.10.

57 Multiplier

This is the multiplication factor set out in *BIPRU* 7.10.118R to *BIPRU* 7.10.126G.

[*CEBS' MKR IM total positions column 7*]

…

60 Incremental default risk charge

This is the incremental default risk charge under *BIPRU* 7.10.116R. It also includes the specific risk surcharge under *BIPRU* 7.10.127G.

[*CEBS' MKR IM total positions columns 3 and 4*]

61 ~~VaR model based PRR~~ Internal models-based PRR

See *BIPRU* 7.10.113R to *BIPRU* 7.10.117G.

This will have the same value as data element 102A on FSA003.

[*CEBS' MKR IM total positions column 5*]

…

Add-ons

63 Add-ons

This comprises the add-ons to model based PRR under *BIPRU* 7.10

64 Total Add-ons

The total of items 1 to n in 63

FSA005 – Market risk validations

Internal validations

Data elements are referenced by row then column.

Validation number	Data element		Validation
…			
53	64G	=	SUM (63B)

…

External validations

[Editor's Note: No changes]

FSA008 – Large exposures

This data item captures information on *large exposures*, connected exposures within that, exposures by integrated/core/non-core groups, *trading book concentration risk excesses*, and also significant transactions with mixed activity holding companies and their subsidiaries.

Unless indicated otherwise, the valuation of items should follow *GENPRU* 1.3.

…

3A Are you a member of a UK integrated group
This is only relevant for unconsolidated or solo-consolidated reporters.
The answer is either Yes or No.
If the answer to ~~7~~3A is Yes, and the firm is part of a *UK integrated group*, one of the members of the *UK integrated group* is also required to submit FSA018 on behalf of all members of the *UK integrated group* for the reporting date.

Part 1 – Large exposures at the reporting date
This section should contain details of all *large exposures* at the reporting date, as defined in *BIPRU* 10.5.1R.

~~However, where~~ Where a *BIPRU* firm is relying on *BIPRU* TP 33 ~~has established a *UK integrated group* (as defined in *BIPRU* 10.8)~~, it should exclude from Part 1 any *large exposures* to members of a wider integrated group ~~(as defined in *BIPRU* 10.9)~~ or to members of each *diverse block* ~~(*BIPRU* 10.9)~~ and the *residual block* ~~(*BIPRU* 10 8 and *BIPRU* 10 .9)~~ (see *BIPRU* TP 33 for further details) – these exposures will be reported separately on FSA018 by the *UK integrated group*. They should ~~obviously~~ also be excluded from Part 2 (Connected counterparties) in these circumstances.

Exposures to connected counterparties (other than members of an integrated group) should be reported here in aggregate, with a more detailed breakdown provided in Part 2.

Where a firm has established a *core UK group* (as defined in *BIPRU* 10.8.2R), it should detail these *exposures* in Part 2.

…

5B Counterparty name
List here the names of the *counterparties*, *groups of connected clients*, and *connected counterparties* (as set out in *BIPRU* 10.3) that represent *large exposures* (excluding, as indicated above, by a member of a *UK integrated group* to members of the diverse blocks and the residual block, or by a *core UK group*). Details of individual counterparties comprising the *connected counterparties* will be shown in Part 2, although the aggregate should be shown here. (Details of exposures by members of a *UK integrated group* to a ~~members~~ member of a *diverse block* within its *wider integrated group* or a member of its *residual block* will be reported in FSA018 and should be excluded from this section.)

5C Gross exposure
Report here the gross exposures calculated in accordance with *BIPRU* 10.2 ~~and *BIPRU* 10.4~~.

...

5F Amount of the exposure that is exempt
That part of the amount reported in column E that is an exempt under *BIPRU* 10.6 ~~and *BIPRU* 10.7~~.

...

5N Trading book concentration risk excess

This is the *trading book concentration risk excess*, arising under *BIPRU* 10.10.8R (or *BIPRU* 10.5.20R for those utilising TP33), expressed as a percentage of data element 4B. It should be entered to two decimal places, omitting the % sign.

5P Trading book concentration risk excesses that have existed for 10 business days or less

This is the amount of the *trading book concentration risk excesses* that have existed for 10 business days or less, as a percentage of data element 3B. ~~A total is given for this column to monitor it against *BIPRU* 10.5.12R.~~

5Q Trading book concentration risk excesses that have persisted for more than 10 business days

This is the amount of the *trading book concentration risk excesses* that have persisted for more than 10 business days. ~~A total for this column is given to monitor it against *BIPRU* 10.5.13R.~~

5R CNCOM

The amount of CNCOM calculated as set out in *BIPRU* 10.10.4G to 10.10.10R (or *BIPRU* 10.5.16G to 10.5.24G for those utilising TP33). It should agree with the amount reported in data element 103A on FSA003 for the same reporting date, except when the firm is a member of a *UK integrated group/core UK group* when there may some additional CNCOM attributable to the firm.

…

5W Funded credit protection
Report here the portion of the *exposure* being covered by collateral and for which the *exposure* is assigned to the issuer of the collateral.

5X Unfunded credit protection
Report here the portion of the *exposure* which is guaranteed and is assigned to the protection provider.

6A Confirmation

Firms should confirm that we have been notified under ~~*BIPRU* 10.5.9R~~ *SUP* 15.3.11R of all exposures that have exceeded, or will exceed, the limits set out in *BIPRU* 10.5.6R ~~or 10.5.8R~~.

Part 2 – Details of connected counterparties at the reporting date

Details of connected counterparties
This part sets out details of any *connected counterparties* reported in aggregate in Part 1, but this time showing each counterparty whose individual exposure exceeds 2.5% of the capital resources calculated under *BIPRU* 10.5.3R (data element 4A). As with Part 1, this figure should exclude exposures by a member of a *UK integrated group* to members of a wider integrated group or to members of the diverse blocks and the residual block (which are reported in FSA018**)**.
If a firm has a *core UK group*, its *exposures* should be included here.
…

7B Individual counterparty names, each individually above 2.5% of capital resources
Report here the individual counterparty names that make up a group of connected counterparties (see *BIPRU* 10.3.9R), where each counterparty's exposure is individually 2.5% or more of *capital resources* (data element 4A).

If a firm has a *core UK group*, its *exposures* should be included here.

As with Part 1, this figure should exclude exposures by a member of a *UK integrated group* to members of the diverse blocks and the residual block.

…

7F Amount of the exposure that is exempt

That part of the amount reported in column E that is an exempt under *BIPRU* 10.6 ~~and *BIPRU* 10.7~~.

…

7N Funded credit protection
Report here the portion of the *exposure* being covered by collateral and for which the *exposure* is assigned to the issuer of the collateral.

7O Unfunded credit protection
Report here the portion of the *exposure* which is guaranteed and is assigned to the protection provider.

…

Part 3 Trading book concentration risk excesses since the last reporting date

~~This part provides an analysis of those *trading book concentration risk excesses* that have occurred since the previous reporting date. It should therefore:~~

• exclude exposures to those counterparties that, at the reporting date, give rise to a *trading book concentration risk excess* (and are shown in Part 1);

• include exposures to counterparties that do not, at the reporting date, give rise to a *trading book concentration risk excess* but are nevertheless shown in Part 1 as there is a *large exposure* at that date; and

• include exposures to counterparties that do not appear in Part 1 (as they did not give rise to a *large exposure* at the reporting date).

If a counterparty gives rise to a *trading book concentration risk excess* on a number of separate occasions during the quarter, it should only be reported once in this Part. The highest gross exposure should be reported. This fulfils the requirements of *BIPRU* 10.5.13R.

8A Exposure number

Please number each large exposure consecutively.

8B Counterparty names

List here the names of the *counterparties*, *groups of connected clients*, and *connected counterparties* (as set out in *BIPRU* 10.3) that account for *trading book concentration risk excesses* that have occurred since the previous reporting date but do not exist at the current reporting date.

For those firms that are member so of a *UK integrated group*, they should report those exposures to individual members of the diverse and residual blocks that gave rise to a *trading book concentration risk excess* during the period.

8C Gross exposure

Report here the gross exposures calculated in accordance with *BIPRU* 10.2. This should be the highest value in the period.

8D % of capital resources

This is column C as a percentage of data element 4A and should be more than 25%. It should be entered to two decimal places, omitting the % sign.

8E Exposure after credit risk mitigation techniques

This is the figure reported in column D after *credit risk mitigation*.

8F Non-exempt exposures in the non-trading book

This is the amount of the non-exempt exposures that were in the non-trading book.

8G Non-exempt exposures in the trading book

This is the amount of the non-exempt exposures that were in the trading book.

8H Amount of non-exempted exposures in excess of 25% of capital resources under *BIPRU* 10.5.4R

This is the amount reported in columns F and G that was in excess of 25% of data element 4B.

8J Is it a member of a diverse block or residual block

This will only be relevant to a firm that answers Yes to data element 3A.

~~If the firm had a *trading book concentration risk excess* to a member (of the diverse blocks or residual block), it should be marked with an X to show it is a member of one of these blocks.~~ [deleted]

FSA008 – Large exposures validations
Internal validations

Data elements are referenced by row then column.

Validation number	Data element		Validation
…			
33	~~8E~~	~~≤~~	~~8C~~[deleted]
34	~~8F~~	~~≤~~	~~8E~~[deleted]
35	~~8F+8G~~	~~≤~~	~~8E~~[deleted]
36	~~8H~~	~~=~~	~~8F + 8G (4B/4)~~ [deleted]
…			

FSA046 – Securitisation – non-trading book

This data item allows a greater understanding of the prudential risk profile of the ~~firm~~ *firm* and ~~avoids~~ reduces the need for ad hoc data requests from ~~firms~~ *firms*. It also enables the FSA to lead debate on credit risk transfer in international discussions.

This data item captures information on a firm's *non-trading book securitisation positions* which fall under *BIPRU* 9 where they are acting as *originator, sponsor* or investor. *Trading book securitisations* are captured in FSA058.

…

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

Transaction level information - Where the firm is an originator or sponsor

All *securitisations* where you have acted as an *originator* or *sponsor* where the assets are held in the *non-trading book* should be shown in this section, irrespective of whether you meet *BIPRU* 9.3.1 R.

3A Programme name

Enter the common name of the programme in the market.

[COREP CR SEC Details column 2]

3B Asset class

This is the class of assets securitised in accordance with the options in FSA004 with an additional entry for "Asset Backed Commercial Paper Programme". Where the underlying *exposures* consist of different types of assets, a firm should indicate the most important type.

[COREP CR SEC Details column 9]

3C Originator's interest

For the purposes of reporting, *originator's* interest means the exposure value of the notional part of a pool of drawn amounts sold into a *securitisation*, the proportion of which in relation to the amount of the total pool sold into the structure determines the proportion of the cash-flows generated by principal and interest collections and other associated amounts which are not available to make payments to those having *securitisation positions* in the *securitisation*. The *originator's* interest may not be subordinate to the investors' interest.
~~See *BIPRU* 9.13.4R (1). The exposure value should be used.~~

3D Investors' interest

Investors' interest means the exposure value of the remaining notional part of the pool of drawn amounts.
~~See *BIPRU* 9.13.4R (3). The exposure value should be used.~~

[COREP CR SEC Details 7]

…

3G BIPRU 9.3.1 applied?

Yes/No to indicate whether the assets have been excluded from the calculation of *risk weighted exposure amounts* under *BIPRU* 9.3.1R.

[COREP CR SEC Details 25]

3H ~~BIPRU 9.13 applies~~ Conversion factor applied?

Yes/No to indicate whether the transaction is a *securitisation* of *revolving exposures* with an *early amortisation* provision to which a conversion factor is applied under *BIPRU* 9.13.

[COREP CR SEC Details 26]

Insert the following additional data elements.

3I Exposure Value before *securitisation*

Total exposure value of the *exposures* or pool of *exposures* which have been securitised.

[COREP CR SEC Details 7]

3J Capital requirement before *securitisation*

Total capital requirements held against the *exposures* or pool of *exposures* before they are securitised. For these purposes, where appropriate, firms should specify the capital requirements against the "investors' interest" as defined above.

[COREP CR SEC Details 14]

3K Exposure Value after *securitisation*

Total exposure value subject to risk weights under *BIPRU* 9.

[COREP CR SEC Details 16-26]

3L Exposure value deducted from capital resources

Exposure value applying *BIPRU* 9.10.2 R

[COREP CR SEC Details 27]

3M Capital requirement after *securitisation* before cap

Capital requirements derived from the *risk weighted exposure amount* without taking into account the provisions in *BIPRU* 9.11.5 R, *BIPRU* 9.12.8 R or *BIPRU* 9.13.9R regarding the maximum *risk-weighted exposure amounts*.

[COREP SR SEC Details 28]

3N - Capital requirement after *securitisation* after cap

Total capital requirements subject to *securitisation* treatment after applying the cap as specified in *BIPRU* 9.11.5 R, *BIPRU* 9.12.8 R or *BIPRU* 9.13.9R.

[COREP SR SEC Details 29]

3O – Retention of net economic interest (% to 2DP)

Percentage of the nominal value of the securitised *exposures* retained by an *originator* or *sponsor* as calculated under *BIPRU* 9.15.4R. Show the percentage to two decimal places (2DP).

3P – Method of retention of net economic interest

Please detail a number according to the method of retention as calculated under *BIPRU* 9.15.4R.

1. = *BIPRU* 9.15.4R(1);

2. = *BIPRU* 9.15.4R(2);

3. = *BIPRU* 9.15.4R(3);

4. = *BIPRU* 9.15.4R(4).

Risk positions – standardised exposures

All *exposures* that are treated under *BIPRU* 9.11 should be shown in this section broken down by credit quality and how the *exposure* arose.

Row 4: Originator

This is for *exposures* where the *firm* originated the underlying assets.

Row 5: Sponsor

This is for *exposures* to a*sset backed commercial paper programmes.*

Row 6: Counterparty credit risk

This is the *exposure* values generated under *BIPRU* 13~~ where the exposure is also a *securitisation position*~~.

Row 7: All other exposures

This is for any standardised *exposures* not included in *data elements* 4 – 6 above.

Columns A – ~~D~~E

Positions should be split by credit rating according to *BIPRU* 9.11.2R and *BIPRU* 9.11.3R.

Column ~~E~~F

This is for positions deducted from capital at part 1 of stage M of the capital calculations in *GENPRU* 2, Annexes 2R, 3R, 4R, 5R or 6R as appropriate.

Risk positions – IRB exposures

All *exposures* that are treated under *BIPRU* 9.12 should be shown in this section, broken down by credit quality, granularity and how the *exposure* arose.

Rows 8 – 10: Originator

This is for *exposures* where the *firm* originated the underlying *exposures*.

Rows 11 – 13: Sponsor

This is for *exposures* to a*sset backed commercial paper programmes*.

Rows 14 – 16: Counterparty credit risk

This is for exposure values generated under *BIPRU* 13 where the *exposure* is also a *securitisation position*.

Rows 17 – 19: All other exposures

This covers any IRB *exposures* not included above.

Columns ~~A~~B – M

This should be split by credit rating according to *BIPRU* 9.12.11R and *BIPRU* 9.12.12R.

Column N

~~This is for positions calculated~~ *Firms* should state the exposure value calculated under *BIPRU* 9.12.21R to *BIPRU* 9.12.23R.

Column O

This is for positions deducted from capital at part 1 of stage M of the capital calculations in *GENPRU* 2, Annexes 2R, 3R, 4R, 5R or 6R as appropriate.

Column P

Firms should state the capital requirement calculated under *BIPRU* 9.12.21R to *BIPRU* 9.12.23R.

…

FSA046 – Securitisation: non-trading book validations

There are no validations for this data item.

External validations
There are no validations for this data item.

…

Insert the following new text as a new Data Item FSA058. The text is not underlined.

FSA058 – Securitisation: trading book

This data item allows a greater understanding of the prudential risk profile of the *firm*. It also enables the *FSA* to lead debate on credit risk transfer in international discussions.

This data item captures information on the *firm's trading book securitisation positions* which fall under *BIPRU* 7.2 where they are acting as *originator*, *sponsor* or investor. *Non-trading book securitisations* are captured in FSA046.

Currency

You should report in the currency of your annual audited accounts i.e. in Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

Transaction level information - Where the firm is an originator or sponsor

All *securitisations* where you have acted as an *originator* or *sponsor* where the assets are held in the *trading book* should be shown in this section, irrespective of whether you meet *BIPRU* 9.3.1R.

3A Programme name

Enter the common name of the programme in the market.

[COREP CR SEC Details column 2]

3B Asset class

This is the class of assets securitised in accordance with the options in FSA004 with an additional entry for "Asset Backed Commercial Paper Programme". Where the underlying *exposures* consist of different types of assets, a *firm* should indicate the most important type.

[COREP CR SEC Details column 9]

3C Originator's interest

For the purposes of reporting, *originator's* interest means the exposure value of the notional part of a pool of drawn amounts sold into a *securitisation*, the proportion of which in relation to the amount of the total pool sold into the structure determines the proportion of the cash-flows generated by principal and interest collections and other associated amounts which are not available to make payments to those having *securitisation positions* in the *securitisation*. The *originator's* interest may not be subordinate to the investors' interest.

3D Investors' interest

Investors' interest means the exposure value of the remaining notional part of the pool of drawn amounts.

[COREP CR SEC Details 7]

3E Location of investor reports

Provide either a URL to the location of the investor reports published on the performance of the assets or, if not available via the internet, a description of where to find the investor reports.

3F Assets appear in FSA001?

Yes/No to indicate whether the assets appear on the balance sheet provided in FSA001.

3O– Retention of net economic interest (% to 2DP)

Percentage of the nominal value of the securitised exposures retained by an *originator* or *sponsor* as calculated under *BIPRU* 9.15.4R.

3P– Method of retention of net economic interest

Please detail a number according to the method of retention as calculated under *BIPRU* 9.15.4R.

1. = *BIPRU* 9.15.4R(1);

2. = *BIPRU* 9.15.4R(2);

3. = *BIPRU* 9.15.4R(3);

4. = *BIPRU* 9.15.4R(4).

FSA058 – Securitisation: non-trading book validations

Internal validations
There are no validations for this data item.

External validations
There are no validations for this data item.

‘Near final’ Handbook text:

Large exposures

NOTE TO READERS: The references in CP10/17 to BIPRU 10.8 are to be read as references to BIPRU 10.8A.

Amendments to the Glossary of definitions

In this section, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

core concentration risk group counterparty	(in relation to a *firm*) a counterparty which is its *parent undertaking*, its *subsidiary undertaking* or a *subsidiary undertaking* of its *parent undertaking*, provided that (in each case) both the counterparty and the *firm* are: (a) included within the scope of consolidation on a full basis with respect to the same *UK consolidation group*; and (b) (where relevant) held by one or more intermediate *parent undertaking* or *financial holding company*, all of which are incorporated in the *United Kingdom*.
core UK group	(in relation to a *firm*) all *undertakings* which, in relation to the *firm*, satisfy the conditions set out in *BIPRU* 10.8A.2R (Definition of core UK group).
core UK group waiver	a *waiver* that has the result of requiring a *firm* to apply *BIPRU* 10.8A (Intra-group exposures: core UK group), which in summary exempts all *exposures* between members of a *core UK group* from the limits described in *BIPRU* 10.5 (Limits on exposures).
non-core concentration risk group counterparty	(in accordance with Article 113(4)(c) of the *Banking Consolidation Directive*) has the meaning in *BIPRU* 10.9A.4R (Definition of non-core concentration risk group counterparty), which is in summary (in relation to a *firm*) each counterparty which is its *parent undertaking*, its *subsidiary undertaking* or a *subsidiary undertaking* of its *parent undertaking,* provided that (in each case) both the counterparty and the *firm* satisfy the conditions in *BIPRU* 10.9A.4R (Definition of non-core concentration group counterparty).
non-core large exposures group	(in relation to a *firm*) has the meaning in *BIPRU* 10.9A.3R (Definition of non-core large exposures group), which is in summary each *non-core concentration risk group counterparty* that is not a member of the *core UK group* but satisfies all the conditions for membership of the firm's *core UK group* except for *BIPRU* 10.8A.2R(1) (Core concentration risk group counterparty), *BIPRU* 10.8A.2R(5) (Establishment in the United Kingdom) and *BIPRU* 10.8A.5R(2) (Capital maintenance arrangements).
non-core large exposures group waiver	a *waiver* that has the result of requiring a *firm* to apply *BIPRU* 10.9A (Intra-group exposures: non-core large exposures), which in summary exempts partially or fully exposures between members of the *core UK group* and members of the *non-core large exposures*

	group from the limits described in *BIPRU* 10.5 (Limits on exposures).
sovereign large exposure waiver	a *waiver* that has the result of requiring the *firm* to apply *BIPRU* 10.6.35R, which in summary exempts partially or fully any of the *exposures* listed in *BIPRU* 10.6.36R constituting claims on *central banks* or central governments from the limits in *BIPRU* 10.5 (Limits on exposures).

Amend the following as shown.

capital resources	(1) in relation to a *BIPRU firm* or an *insurer*, the *firm's* capital resources as calculated in accordance with the *capital resources table*, including, in relation to a *BIPRU firm*, as that calculation is adjusted under *BIPRU* 10.5 for the purposes of *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements); or …
concentration risk capital component	the part of the *credit risk capital requirement* calculated in accordance with *BIPRU* ~~10.5.20R~~ 10.10A.8R (How to calculate the concentration risk capital component).
connected counterparty	(for the purpose of *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements) and in relation to a *firm*) has the meaning set out in *BIPRU* 10.3.8R (Connected counterparties), which is in summary a *person* to whom the *firm* has an *exposure* and who fulfils at least one of the conditions set out in *BIPRU* 10.3.8R.
credit institution	… (d) for the purpose of *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements) it means: …
exposure	… (3) (for the purpose of *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements) has the meaning in *BIPRU* 10.2 (Identification of exposures and recognition of credit risk mitigation).
group of connected clients	(in accordance with Article 4(45) of the *Banking Consolidation Directive* (Definitions)) one of the following: (a) two or more *persons* who, unless it is shown otherwise, constitute a single risk because one or more of them is the *parent undertaking*, direct or indirect, of the other or others;

		or
	(b)	two or more *persons* between whom there is no relationship as set out in (a) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would be likely to encounter funding or repayment difficulties.
individual CNCOM	the amount calculated with respect to an individual *exposure* under *BIPRU* ~~10.5.20R~~ 10.10A.8R (How to calculate the concentration risk capital component).	
individual counterparty CNCOM	has the meaning in *BIPRU* ~~10.5.20R~~ 10.10A.8R (How to calculate the concentration risk capital component), which is in summary the sum of a *firm's individual CNCOMs* with respect to ~~a *counterparty* or *group of connected clients* or to~~ its *connected counterparties*.	
trading book concentration risk excess	has the meaning in *BIPRU* ~~10.5.20R~~ 10.10A.8R (How to calculate the concentration risk capital component).	
option	…	
	but so that for the purposes of calculating capital requirements for *BIPRU firms* and *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements) it also includes any of the items listed in the table in *BIPRU* 7.6.18R (Option PRR: methods for different types of option) and any cash settled option.	
parent undertaking	…	
	(c)	(for the purposes of *BIPRU*, *GENPRU* and *INSPRU* as they apply on a consolidated basis, for the purposes *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements) and …
	…	
solo capital resources	(1)	…
	(2)	for the purpose of *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements) the definition in (1) is adjusted in accordance with *BIPRU* ~~10.8.13R~~ 10.8A.10R (Calculation of capital resources for a ~~UK integrated group~~ core UK group) so that it means *capital resources* calculated in accordance with the *rules* applicable to the category of *BIPRU firm* identified by applying the procedure in *BIPRU* 8.6.6R to *BIPRU* 8.6.9R (Consolidated capital resources).
standardised	one of the following:	

approach

…

(c) (where not expressed to relate to any risk and used in *BIPRU* 3, *BIPRU* 4 (IRB approach), *BIPRU* 5 (Credit risk mitigation), *BIPRU* 9 (Securitisation) or *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements)) it has the meaning in (a);

…

Delete the following definitions. The text is not shown struck through.

concentration risk group counterparty

consolidation concentration risk group counterparty

counterparty exposure

diverse block

issuer exposure

residual block

UK integrated group

wider integrated group

wider integrated group waiver

Amendments to the General Prudential sourcebook (GENPRU)

In this section, underlining indicates new text and striking through indicates deleted text, unless otherwise indicated.

1 Application

…

1.2 Adequacy of financial resources

…

Outline of other related provisions

…

1.2.24 G *BIPRU* ~~10.6.22R~~ 10.2.22R (Stress testing of credit risk concentrations) sets out further stress tests that a *firm* should carry out if it uses certain approaches to collateral for the purposes of the rules about ~~concentration risk~~ *large exposures*.

…

1.2.33 R (1) …

(2) In the case of a *BIPRU firm* the processes, strategies and systems relating to concentration risk must include those necessary to ensure compliance with *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements).

…

…

2 Capital

…

2.2 Capital resources

…

2.2.43 G A *BIPRU firm* may include *innovative tier one capital* in its *tier one capital resources* for the purpose of *GENPRU* 1.2 (Adequacy of financial resources) and *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements). A *firm* may also include it in its *upper tier two capital resources* under *GENPRU* 2.2.25R (Limits on the use of different forms of capital: Use of higher tier capital in lower tiers) for all purposes as long as it meets the conditions for treatment as *upper tier two capital*.

…

2.2.226 G *BIPRU* 10.3.13G (Guidance on ~~*BIPRU* 10.3.12R~~ exposures to trustees) applies to *GENPRU* 2.2.225R ~~as it applies to *BIPRU* 10.3.12R (Exposures to trustees for concentration risk purposes)~~.

…

3 Cross sector groups

3.1 Application

…

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* 3.1.35R

The most important financial sector	Applicable sectoral rules	
	Risk concentration	Intra-group transactions
Banking and investment services sector	*BIPRU* ~~8.9~~ 8.9A (Consolidated ~~concentration risk~~ large exposure requirements) including *BIPRU* TP as it applies to a *UK consolidation group*.	*BIPRU* 10 (~~Concentration Risk~~ Large exposures requirements) including *BIPRU* TP as it applies on a solo basis and relates to *BIPRU* 10.
…		

…

3.1.38 R (1) This *rule* applies for the purposes of the definitions of:

(a) a *core concentration risk group counterparty*; and

(b) a ~~*consolidated*~~ *non-core concentration risk group counterparty*;

as they apply for the purposes of the *rules* for the *banking and investment services sector* as applied by *GENPRU* 3.1.36R.

(2) For the purpose of *BIPRU* 3.2.27R(1)(a) and (b) (as they apply to the definitions in *GENPRU* 3.1.38R(1)~~(a)~~), the conditions are also satisfied if the *counterparty* and the *firm* are included within the scope of consolidated supervision on a full basis with respect to the

same *financial conglomerate* under *GENPRU* 3.1 or the relevant implementation measures in another *EEA State* for the *Financial Groups Directive*.

(3) ~~Subject to (4), for the purposes of *BIPRU* 8.9.11R(3) (as it applies to the definition in *GENPRU* 3.1.38(1)(b)), the conditions are also satisfied if the *counterparty* and the *firm* are included within the scope of consolidated supervision on a full basis with respect to the same *financial conglomerate* under *GENPRU* 3.1 or the relevant implementation measures in another *EEA State* for the *Financial Groups Directive*.~~ [deleted]

(4) ~~*BIPRU* 8.9.11R(3)(a) does not apply.~~ [deleted]

Amendments to the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)

In this section, underlining indicates new text and striking through indicates deleted text, unless otherwise indicated.

1 Application

1.1 Application

…

1.1.23 R (1) …

(2) …

(c) (in the case of a *BIPRU investment firm*) it complies with the *main BIPRU firm Pillar 1 rules* and *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements);

…

…

1.3 Application for advanced approaches and waivers

…

1.3.2 G …

(2) A *firm* should apply for a *waiver* if it wants to:

…

(d) apply the treatment in *BIPRU* 2.1 (Solo-consolidation waiver); ~~or~~

(e) apply the treatment in *BIPRU* 10.8A (Intra-group exposures: core UK group) or in *BIPRU* ~~10.9~~ 10.9A (~~Wider integrated groups~~ Intra-group exposures: non-core large exposures group); or

(f) apply the treatment in *BIPRU* 10.6.35R (Sovereign large exposure waiver).

…

2 Capital

2.1 Solo consolidation

2.1.7 R A *firm* that has a *solo consolidation waiver* must incorporate in the

calculation of its requirements under the *main BIPRU firm Pillar 1 rules* and *BIPRU* 10 (~~Concentration risk~~ Large exposure requirements) each *subsidiary undertaking* to which the *solo consolidation waiver* applies. This does not apply to the *base capital resources requirement*.

…

2.1.16 R A *firm* must apply *BIPRU* 10 (~~Concentration risk~~ Large exposure requirements) in accordance with *BIPRU* ~~8.9~~ 8.9A (Consolidated ~~concentration risk~~ large exposures requirements). Accordingly the *firm* must apply *BIPRU* 8.9 to the group made up of the *firm* and the *subsidiary undertakings* referred to in *BIPRU* 2.1.7R in the same way as *BIPRU* ~~8.9~~ 8.9A applies to a *UK consolidation group* or *non-EEA sub-group*.

2.1.17 G One effect of *BIPRU* 2.1.16R is that *BIPRU* ~~10.8~~ 10.8A (~~UK integrated groups~~ Core UK groups) and *BIPRU* ~~10.9~~ 10.9A (~~Wider integrated groups~~ Non-core large exposures groups) do not apply. The corresponding provisions of *BIPRU* ~~8.9~~ 8.9A (Consolidated ~~concentration risk~~ large exposures requirements) apply instead.

…

2.2 Internal capital adequacy standards

…

2.2.54 G In relation to ~~the~~ *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements), a *bank* or *building society* should take into account factors such as future business growth and cyclicality when it assesses the amount of capital which it will need to remain in compliance with those *rules*. A *firm* may also consider in its assessment whether any *large exposures* that it has identified are positively correlated.

…

4 The IRB approach

4.1 The IRB approach: Application, purpose and overview

…

Link to standard rules: Incorporation of the IRB output into the capital calculation

…

4.1.23 R If a provision of the *Handbook* relating to the *IRB approach* says that a *firm* may do something if its *IRB permission* allows it, a *firm* may do that thing unless its *IRB permission* expressly says that it may not do so except that:

…

(4) if a *firm* uses its own estimates of *LGD* and *conversion factors* it

may only recognise the effects of financial collateral under *BIPRU* ~~10.6.17R~~ 10.2.19R (~~Exemptions for firms~~ Firms using own estimates of LGD and conversion factors under the IRB approach) in the manner set out in its *IRB permission*;

…

…

8 Group risk consolidation

8.2 Scope and basic consolidation requirements for UK consolidation groups

Main consolidation rule for UK consolidation groups

8.2.1 R A *firm* that is a member of a *UK consolidation group* must comply, to the extent and in the manner prescribed in *BIPRU* 8.5, with the obligations laid down in *GENPRU* 1.2 (Adequacy of financial resources), the *main BIPRU firm Pillar 1 rules* (but not the *base capital resources requirement*) and *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements) on the basis of the consolidated financial position of:

…

…

8.3 Scope and basic consolidation requirements for non-EEA sub-groups

Main consolidation rule for non-EEA sub-groups

8.3.1 R (1) A *BIPRU firm* that is a *subsidiary undertaking* of a *BIPRU firm* or of a *financial holding company* must apply the requirements laid down in *GENPRU* 1.2 (Adequacy of financial resources), the *main BIPRU firm Pillar 1 rules* (but not the *base capital resources requirement*) and *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements) on a sub-consolidated basis if the *BIPRU firm*, or the *parent undertaking* where it is a *financial holding company*, have a *third country banking or investment services undertaking* as a *subsidiary undertaking* or hold a *participation* in such an *undertaking*.

…

8.5 Basis of consolidation

…

Basis of inclusion of UCITS investment firms in consolidation

8.5.7 R *GENPRU* 2.1.46R (Adjustment of the variable capital requirement calculation for UCITS investment firms) ~~and *BIPRU* 10.1.5R (Restricted application for UCITS investment firms) do~~ does not apply for the purpose of this chapter.

…

8.7 Consolidated capital resources requirements

…

Special rules for the consolidated credit risk requirement

…

8.7.18 G The *credit risk capital requirement* (on which the *consolidated credit risk requirement* is based) is split into three capital charges. One relates to credit risk in the *non-trading book* (the *credit risk capital component*). One relates to credit risk in the *trading book* (the *counterparty risk capital component*). The third is a capital charge for *exposures* in the *trading book* that exceed the limits in *BIPRU* 10.5 (Limits on exposures ~~and large exposures~~). This is called the *concentration risk capital component*. ~~*BIPRU* 8.9 (Consolidated concentration risk requirements) explains how to calculate the part of the *consolidated credit risk requirement* that corresponds to the *concentration risk capital component*.~~

8.7.19 G ~~In particular *BIPRU* 8.9 (Consolidated concentration risk requirements) says that a *firm* should calculate the part of the *consolidated credit risk requirement* that corresponds to the *concentration risk capital component* on an accounting consolidation basis. This means using method two in *BIPRU* 8.7.13R.~~ [deleted]

…

8.7.25 R A *firm* may not apply the second method in *BIPRU* 8.7.13R(3) (accounting consolidation for the whole group) or apply accounting consolidation to parts of its *UK consolidation group* or *non-EEA sub-group* under method three as described in *BIPRU* 8.7.13R(4)(a) for the purposes of the calculation of the *consolidated market risk requirement* unless the group or sub-group and the *undertakings* in that group or sub-group satisfy the conditions in this *rule*. Instead the *firm* must use the aggregation approach described in *BIPRU* 8.7.13R(2) (method one) or *BIPRU* 8.7.13R(4)(a). Those conditions are as follows:

…

(2) each of the *undertakings* referred to in (1) that is a *BIPRU firm* has *capital resources* that are equal to or in excess of its *capital resources requirement* and complies with *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements);

…

…

BIPRU 8.9 is deleted in its entirety. The deleted text is not shown struck through.

8.9 Consolidated concentration risk requirements [deleted]

After BIPRU 8.9 [deleted] insert the following new section. The text is not underlined.

8.9A Consolidated large exposure requirements

Integrated groups: core UK group and non-core large exposures group

8.9A.1 R (1) *BIPRU* 10 (Large exposures) applies to a *firm's UK consolidation group* or (subject to (2)) *non-EEA sub-group* as if it were a single *undertaking*.

(2) A *firm* may exempt the *exposures* of its *non-EEA sub-group* to its *core concentration risk group counterparty* or *non-core concentration risk group counterparty* from the limits in *BIPRU* 10.5 (Limits on exposures) that apply to the *non-EEA sub-group* on a sub-consolidated basis.

8.9A.2 G The effect of *BIPRU* 8.9A.1R(2) is that there is no limit on a sub-consolidated basis for *exposures* of a *firm's non-EEA sub-group* to its *core concentration risk group counterparty* or *non-core concentration risk group counterparty*. This is because those *exposures* are included in the *large exposure* limits that apply to the *firm's UK consolidation group*.

8.9A.3 R In relation to a *firm*, intra-group e*xposures* that are exempt under a *non-core large exposures group waiver* may be excluded when calculating the limits in *BIPRU* 10.5 (Limits on exposures) that apply to the *UK consolidation group* or *non-EEA sub-group*, provided that the total amount of such *exposures* and the other *exposures* which are exempt under a *non-core large exposures group waiver* do not exceed the limit in *BIPRU* 10.9A.7R (Non-trading book backstop large exposure limit for non-core large exposures group).

…

Amend the following as shown.

10 ~~Concentration risk~~ Large exposures requirements

10.1 Application and purpose

Application

10.1.1 R (1) This chapter applies to a *BIPRU firm* unless it is:

(a) a *BIPRU limited licence firm*; or

(b) a *BIPRU limited activity firm*.

(2) It applies irrespective of whether the *firm* adopts the *standardised approach* or the *IRB approach*. If it adopts the *IRB approach*, it applies irrespective of whether the *firm* adopts the *foundation IRB*

approach or the *advanced IRB approach*.

[**Note**: *BCD* Article 111(1) (part) and *CAD* Article 28(1)]

…

~~Restricted application for UCITS investment firms~~

10.1.5 R ~~This chapter only applies to a *UCITS investment firm* with respect to its *designated investment business*. For this purpose *scheme management activity* is excluded from *designated investment business*.~~ [deleted]

10.2 Identification of exposures and recognition of credit risk mitigation

10.2.1 R Unless *BIPRU* 10.2.2R applies, an *exposure* is:

(1) any of the items included in *BIPRU* 3.2.9R (Exposure classes for the purposes of the *standardised approach*) or the table in *BIPRU* 3.7.2R (Classification of off-balance-sheet items for the purposes of the *standardised approach*) whether held in the *trading book* or the *non-trading book*, without application of the *risk weight* or degrees of risk there provided for;

[**Note**: *BCD* Article 106(1) first paragraph]

(2) any *exposure* arising from *financial derivative instruments*;

[**Note**: *BCD* Article 106(1) second paragraph (part)]

(3) any *exposure* to an individual *counterparty* that arises in the *trading book* calculated by summing the following items:

(a) the excess – where positive – of the *firm's* long *positions* over its short *positions* in all the *CRD financial instruments* issued by the *counterparty* in question, the net position of each of the different *CRD financial instruments* being calculated in accordance with the relevant method in *BIPRU* 7;

(b) the *firm's net underwriting exposure* to that *counterparty*; and

(c) any *exposure* due to the transactions, agreements and contracts referred to in *BIPRU* 14.2.2R (List of *trading book exposures* that give rise to a *counterparty credit risk* charge).

[**Note**: *CAD* Article 29(1) first paragraph]

10.2.2 R An *exposure* does not include:

(1) an *exposure* which is entirely deducted from a *firm's capital resources*;

(2) in the case of *foreign currency* transactions, *exposures* incurred in the ordinary course of settlement during the ~~48 hours~~ two *business days* following payment; ~~or~~

(3) in the case of transactions for the purchase or sale of *securities*, *exposures* incurred in the ordinary course of settlement during the five ~~working days~~ *business days* following payment or delivery of the *securities*, whichever is the earlier;

(4) in the case of the provision of money transmission including the execution of payment services, clearing and settlement in any currency and correspondent banking or financial instruments clearing, settlement and custody services to clients, delayed receipts in funding and other *exposures* arising from client activity which do not last longer than the following *business day*; or

(5) in the case of the provision of money transmission including the execution of payment services, clearing and settlement in any currency and correspondent banking, intra-day *exposures* to *institutions* providing those services.

[**Note**: *BCD* Articles 106(1) third paragraph and 106(2)]

10.2.3 G ~~An *exposure* does not include:~~

~~(1) a transaction entered into by a *firm* as trustee or agent without personal liability on the part of the *firm*;~~

~~(2) indemnities for lost share certificates; or~~

~~(3) (where the *firm* acts as lessor, mortgagee or owner of goods under a hire purchase arrangement) contingent liabilities for injuries, damage or loss on the part of the *counterparty* to that arrangement in respect of the goods that are the subject of that arrangement.~~ [deleted]

10.2.3A G (1) An *exposure* does not include *exposures* outstanding with a *central counterparty* to which a *firm* has attributed an *exposure* value of zero for *CCR* in accordance with *BIPRU* 13.3.13R (Exposures to a central counterparty).

(2) *BIPRU* 13.3.13R applies to derivative contracts and *long settlement transactions*, or to other *exposures* arising in respect of those contracts or transactions (but excluding an *exposure* arising from collateral held to mitigate losses in the event of default of other participants in the *central counterparty's* arrangements).

10.2.4 G ~~If a *firm* takes a credit charge against an *exposure* equal to the value of that *exposure*, this can count as a capital deduction for the purposes of *BIPRU*~~

~~10.2.2R(1).~~ [deleted]

Calculation of exposures

10.2.5 R Subject to *BIPRU* 10.2.6R and *BIPRU* 10.2.7R, the value of a *firm's exposures*, whether in its *non-trading book* or its *trading book*, is the amount at risk calculated in line with *GENPRU* 1.3 (Valuation).

10.2.6 R A *firm* must calculate the value of its *exposures* in its *trading book* in the manner laid down in *BIPRU* 14 (Capital requirements for settlement and counterparty risk) for the calculation of *exposure* values. For these purposes the reference in *BIPRU* 14.2.11R (How to calculate exposure values and risk weighted exposure amounts for the purpose of calculating the counterparty risk capital component) to the provisions of the *IRB approach* does not apply.

[**Note**: *CAD* Article 29(1)(c) (part) and fourth paragraph]

10.2.7 R *Exposures* arising from *financial derivative instruments* must be calculated in accordance with one of the methods set out in *BIPRU* 13 (Financial derivatives, SFTs and long settlement transactions). For the purposes of this chapter, *BIPRU* 13.6.6R (Scope of CCR internal model method) also applies.

[**Note**: *BCD* Article 106(1) second paragraph]

10.2.8 R A *firm* must not offset *exposures* in the *non-trading book* and *trading book* for the purpose of calculating *exposures* except to the extent permitted under the *standardised approach* or, if applicable, the *IRB approach*.

Recognition of credit risk mitigation

10.2.9 R Subject to this section, *funded credit protection* or *unfunded credit protection* that complies with the eligibility requirements and other minimum requirements set out in *BIPRU* 5 (Credit risk mitigation) and, if relevant, *BIPRU* 4.10 (The IRB approach: Credit risk mitigation) is permitted to be recognised for the purposes of calculating a *firm's exposure*. A *firm* utilising the methods below must still report to the *FSA* the gross value of its *exposures*.

[**Note**: *BCD* Articles 111(1) first paragraph (part) and 112(2)]

10.2.10 R For the purposes of this section, the use of own estimates for *LGDs* and *conversion factors* under the *IRB approach* for an *IRB exposure class* is referred to as the "full IRB approach".

The financial collateral simple method under the standardised approach

10.2.11 G As indicated in *BIPRU* 5.4.15R (The financial collateral simple method), the *financial collateral simple method* is available only to *firms* using the *standardised approach* and only in relation to *exposures* for which they

adopt the *standardised approach*.

10.2.12 R A *firm* may only recognise collateral for the purpose of *BIPRU* 10.2.9R (Recognition of credit risk mitigation) if the collateral complies with the eligibility requirements and other minimum requirements set out in *BIPRU* 5 (Credit risk mitigation) for the purposes of calculating the *risk weighted exposure amounts* under the *standardised approach* using the *financial collateral simple method* or, if applicable, the method in *BIPRU* 5.5 (Other funded credit risk mitigation). In particular a *firm* may not recognise collateral for that purpose if it is not eligible under the *financial collateral simple method* or other applicable method.

[**Note**: *BCD* Article 112(2) (part)]

10.2.13 G For the purpose of *BIPRU* 10.2.9R (Recognition of credit risk mitigation):

(1) the requirements set out in *BIPRU* 5 (Credit risk mitigation) include:

(a) the *securities* used as collateral should be valued at market price and should be either traded or effectively negotiable and regularly quoted on a *recognised investment exchange* or a *designated investment exchange*; and

(2) where there is a mismatch between the maturity of the *exposure* and the maturity of the credit protection, the collateral must not be recognised; and

(2) where the issuer of *securities* used as collateral is an *institution*, that collateral may not constitute the *institution's capital resources*.

The financial collateral comprehensive method

10.2.14 R A *firm* which uses the *financial collateral comprehensive method* (but not under the full IRB approach (see *BIPRU* 10.2.10R)) may calculate the value of its *exposures* to a *counterparty* or to a *group of connected clients* or to *connected counterparties* as being the fully-adjusted value of the *exposures* to the *counterparty* or *group of connected clients* or *connected counterparties* calculated in accordance with the *financial collateral comprehensive method* under *BIPRU* 5 (Credit risk mitigation) and, if relevant, *BIPRU* 4.10 (The IRB approach: Credit risk mitigation) taking into account the *credit risk mitigation*, volatility adjustments and any maturity mismatch (E*) in accordance with those *rules*.

[**Note**: *BCD* Article 114(1) first paragraph]

10.2.15 G The *rules* setting out the calculation of the effects of *credit risk mitigation* under the *financial collateral comprehensive method* are set out in *BIPRU* 5.4.24R to *BIPRU* 5.4.66R.

10.2.16 R For the purposes of *BIPRU* 10.2.9R (Recognition of credit risk mitigation), a *firm* may use both the *financial collateral comprehensive method* and the *financial collateral simple method* where it is permitted to use both those

methods under *BIPRU* 5.4.16R.

[**Note**: *BCD* Article 117(1) last paragraph]

10.2.17 G As indicated in *BIPRU* 5.4.16R, a *firm* may be permitted to use both the *financial collateral comprehensive method* and the *financial collateral simple method* when such use is for the purposes of carrying out the sequential implementation of its *IRB approach* in accordance with *BIPRU* 4.2.17R to *BIPRU* 4.2.19R (Implementation of the internal ratings based approach) and in relation to an *IRB exposure class* or *exposures* which is exempt from the *IRB approach* in accordance with *BIPRU* 4.2.26R (Combined use of methodologies), and such use is expressly permitted by the *firm's IRB permission*.

10.2.18 R A *firm* may only recognise collateral for the purpose of *BIPRU* 10.2.14R (Financial collateral comprehensive method) if the collateral complies with the eligibility requirements and other minimum requirements set out in *BIPRU* 5 (Credit risk mitigation) and, if relevant, *BIPRU* 4.10 (The IRB approach: Credit risk mitigation) for the purposes of calculating *risk weighted exposure amounts* under the *standardised approach* or, if applicable, the *IRB approach* using the *financial collateral comprehensive method*. In particular a *firm* may not recognise collateral for that purpose if it is not eligible under the *financial collateral comprehensive method*.

Firms using full IRB approach

10.2.19 R A *firm* that uses the full IRB approach (see *BIPRU* 10.2.10R) may recognise the effects described in (1) in calculating the value of its *exposures* to a *counterparty* or to a *group of connected clients* or to *connected counterparties* for the purposes of *BIPRU* 10.5 (Limits on exposures) if:

(1) the *firm* is able to satisfy the *FSA* that it can estimate the effects of financial collateral on its *exposures* separately from other *LGD*-relevant aspects;

(2) the *firm* is able to demonstrate the suitability of the estimates produced; and

(3) the *firm's IRB permission* specifically allows it (also see *BIPRU* 4.1.23R(4)).

[**Note**: *BCD* Article 114(2) first and second paragraphs]

10.2.20 R If a *firm* that uses the full IRB approach (see *BIPRU* 10.2.10R) uses its own estimates of the effects of financial collateral on its *exposures* for *large exposures* purposes, it must do so on a consistent basis and on a basis consistent with the approach adopted in the calculation of capital requirements. A *firm* may only use one of *BIPRU* 10.2.14R (Financial collateral comprehensive method under standardised approach and IRB approach) and *BIPRU* 10.2.19R (Own estimates of effects of financial collateral).

[**Note**: *BCD* Article 114(2) third and fourth paragraphs]

10.2.21 R If a *firm* relies on *BIPRU* 10.2.19R (Own estimates of effects of financial collateral) the recognition of credit protection is subject to the relevant requirements of the *IRB approach*.

[**Note**: *BCD* Article 112(3)]

Stress testing of credit risk concentrations

10.2.22 R (1) A *firm* which:

(a) uses the *financial collateral comprehensive method*; or

(b) calculates the value of its *exposures* in accordance with *BIPRU* 10.2.19R (Own estimates of effects of financial collateral);

must conduct periodic stress tests of its credit risk concentrations including in relation to the realisable value of any collateral taken.

(2) The stress tests required by this *rule* must address:

(a) risks arising from potential changes in market conditions that could adversely impact the *firm's* adequacy of *capital resources*; and

(b) risks arising from the realisation of collateral in stressed situations.

(3) A *firm* must be able to satisfy the *FSA* that the stress tests it carries out under this *rule* are adequate and appropriate for the assessment of such risks.

(4) In the event that a stress test carried out in accordance with this *rule* indicates a lower realisable value of collateral taken than would be permitted to be taken into account under *BIPRU* 10.2.14R (Financial collateral comprehensive method) or *BIPRU* 10.2.19R (Own estimates of effect of financial collateral) as appropriate, the value of collateral permitted to be recognised in calculating the value of *exposures* for the purposes of *BIPRU* 10.5 (Limits on exposures) is the lower value.

(5) A *firm* to which this *rule* applies must include in its strategy to address concentration risk:

(a) policies and procedures to address risks arising from maturity mismatches between *exposures* and any credit protection on those *exposures*;

(b) policies and procedures in the event that a stress test indicates a lower realisable value of collateral than taken into account

under *BIPRU* 10.2.14R (Financial collateral comprehensive method) or *BIPRU* 10.2.19R (Own estimates of effects of financial collateral); and

(c) policies and procedures relating to concentration risk arising from the application of *credit risk mitigation* techniques, and in particular large indirect credit *exposures* (for example to a single issuer of *securities* taken as collateral).

[**Note**: *BCD* Article 114(3)]

10.2.23 R Unless, and to the extent, permitted under *BIPRU* 10.6.3R(11) (Residential mortgages and leasing transactions) or *BIPRU* 10.6.3R (12) (Commercial mortgages and leasing transactions), a *firm* must not take into account the following collateral for the purposes of this section:

(1) amounts receivable linked to a commercial transaction or transactions with an original maturity of less than or equal to one year;

(2) a physical item of a type other than those types indicated in *BIPRU* 4.10.6R to *BIPRU* 4.10.12R (Eligibility of real estate collateral); and

(3) property leased under a leasing transaction.

[**Note**: *BCD* Article 112(4)]

10.2.24 G A *firm* should determine the frequency needed for the stress testing of its credit risk concentrations with emphasis on having sufficient frequency to maintain the currency of its capital calculations. In any case such testing should be carried out at least once a year.

10.3 Identification of counterparties

…

Identification of counterparties for guaranteed and collateralised exposures

10.3.3 R (1) Where an *exposure* to a *counterparty* is:

(a) guaranteed by a third party, a *firm* may ~~treat the *exposure* as an *exposure* to the third party and not to the *counterparty*~~ treat the portion of the *exposure* which is guaranteed as having been incurred to the guarantor rather than to the *counterparty*, provided that the unsecured *exposure* to the guarantor would be assigned an equal or lower *risk weight* than a *risk weight* of the unsecured *exposure* to the *counterparty* under the *standardised approach*; or

(b) secured by collateral issued by a third party, a *firm* may treat the portion of the *exposure* collateralised by the market value

of recognised collateral as having been incurred to the third party rather than to the *counterparty*, provided that the collateralised portion of the *exposure* would be assigned an equal or lower *risk weight* than a *risk weight* of the unsecured *exposure* to the *counterparty* under the *standardised approach*.

[**Note**: *BCD* Article 117(1)(a) and (b)]

(2) …

(3) ~~Where the guarantee is denominated in a currency different from that in which the *exposure* is denominated, the amount of the *exposure* deemed to be covered must be calculated in accordance with the provisions on the treatment of currency mismatch for *unfunded credit protection* in *BIPRU* 5 (Credit risk mitigation) and, if applicable, *BIPRU* 4.10 (The IRB approach: Credit risk mitigation).~~ [deleted]

(4) ~~A mismatch between the maturity of the *exposure* and the maturity of the protection must be treated in accordance with the provisions on the treatment for maturity mismatch in *BIPRU* 5 and, if applicable, *BIPRU* 4.10.~~ [deleted]

(5) ~~Partial coverage must be treated in accordance with *BIPRU* 5 and, if applicable, *BIPRU* 4.10.~~ [deleted]

(6) A guarantee or collateral may only be treated in accordance with (1) if the *firm* complies with the eligibility requirements and other minimum requirements set out in *BIPRU* 5 (Credit risk mitigation) and if, applicable, *BIPRU* 4.10 (The IRB approach: Credit risk mitigation) for the purposes of calculating *risk weighted exposure amounts*.

(7) For the purpose of this *rule*, guarantee includes a credit derivative recognised under *BIPRU* 5 and, if applicable, *BIPRU* 4.10, other than a credit linked note.

[**Note**: *BCD* Article 112(1)]

10.3.4 G (1) If a *firm* treats an *exposure* to a *counterparty* as guaranteed, or secured by collateral issued, by a third party for the purposes of *BIPRU* 5 (Credit risk mitigation), it should apply the same approach on a consistent basis when identifying a *counterparty* for the purposes of this chapter.

(2) An example of the eligibility requirements and other minimum requirements set out in *BIPRU* 5 as referred to in *BIPRU* 10.3.3R(6) is the requirement for a legal review in *BIPRU* 5.2.3R.

(3) Where the guarantee is denominated in a currency different from that

in which the *exposure* is denominated, the provisions on the treatment of currency mismatch for *unfunded credit protection* in *BIPRU* 5.7 (Unfunded credit protection) and, if applicable, *BIPRU* 4.10 (The IRB approach: Credit risk mitigation) are applicable for the calculation of the amount of the *exposure* deemed to be covered.

[**Note**: *BCD* Article 117(2)(a)]

(4) Where there is a mismatch between the maturity of the *exposure* and the maturity of the protection provided by guarantee, *BIPRU* 5.8 (Maturity mismatches) and, if applicable, *BIPRU* 4.10 (The IRB approach: Credit risk mitigation) are applicable for the treatment for mismatch.

[**Note**: *BCD* Article 117(2)(b)]

(5) For the purpose of *BIPRU* 10.3.3R(1)(b), where there is a mismatch between the maturity of the *exposure* and the maturity of the protection provided by collateral, *BIPRU* 5.8.7R (Valuation of protection: Transactions subject to funded credit protection – financial collateral simple method) requires that the collateral must not be recognised.

[**Note**: *BCD* Article 117(1) second paragraph]

(6) In relation to a guarantee, *BIPRU* 5.7 (Unfunded credit protection) and, if applicable, *BIPRU* 4.10 (The IRB approach: Credit risk mitigation) are applicable for the treatment of partial coverage.

[**Note**: *BCD* Article 117(2)(c)]

…

Exposures to trustees

10.3.12 ~~R~~ G If a *firm* has an *exposure* to a *person* ('A') when A is acting on his own behalf, and also an *exposure* to A when A acts in his capacity as trustee, custodian or general partner of an investment trust, unit trust, venture capital or other investment fund, pension fund or a similar fund (a "fund"), the *firm* may treat the latter *exposure* as if it was to the fund, unless such a treatment would be misleading.

10.3.13 G When considering whether the treatment described in *BIPRU* ~~10.3.12R~~ 10.3.12G is misleading, factors a *firm* should consider include:

…

…

Exposures to underlying assets

10.3.15 R Where under a transaction or scheme (for example, *securitisation positions*

or claims in the form of *CIUs*) there is an *exposure* to underlying assets, a *firm* must assess the *exposure* to the transaction or scheme or, its underlying *exposures*, or both, in order to determine the existence of a *group of connected clients*. For the purpose of this *rule*, a *firm* must evaluate the economic substance and the risks inherent in the structure of the transaction.

[**Note**: *BCD* Article 106(3)]

BIPRU 10.4 is deleted in its entirety. The deleted text is not shown struck through.

10.4 Measurement of exposures to counterparties and issuers [deleted]

Amend the following as shown.

10.5 Limits on exposures ~~and large exposures~~

Definition of large exposure

10.5.1 R A *large exposure* of a *firm* means its *total exposure* to a *counterparty*, *connected counterparties* or a *group of connected clients*, whether in the *firm's non-trading book* or *trading book* or both, which in aggregate equals or exceeds 10% of the *firm's capital resources*.

[**Note**: *BCD* Article 108]

…

10.5.4 R For the purposes of monitoring against the *trading book* limits and charge regime, as set out in *BIPRU* ~~10.5.11R~~ 10.10A.2R to *BIPRU* ~~10.5.22R~~ 10.10A.11R (Intra-group exposures: Trading book limits), and calculating a *firm's CNCOM*, a *firm's capital resources* may include *tier three capital resources*, in which case a *firm's capital resources* mean *capital resources* calculated at stage (T) of the *capital resources table* (Total capital after deductions).

10.5.5 R A *firm* must not take into account the following items:

(1) surplus provisions (see *GENPRU* 2.2.190R to *GENPRU* 2.2.193R); or

(2) *expected loss* amounts and other negative amounts (see *GENPRU* 2.2.236R); or

(3) *securitisation positions* (see *GENPRU* 2.2.237R).

[**Note**: *BCD* Article 66(3)]

~~Non-trading book~~ Large exposure limits

10.5.6 R A *firm* must ensure that the total amount of its *exposures* to the following does not exceed 25% of its *capital resources* (as determined under *BIPRU* 10.5.2R, *BIPRU* 10.5.3R and *BIPRU* 10.5.5R):

(1) a *counterparty*; or

(2) a *group of connected clients*; or

(3) its *connected counterparties*.

[**Note**: *BCD* Article 111(1) first paragraph]

…

10.5.8 R ~~A *firm* must not incur *large exposures* which in total exceed 800% of its *capital resources* (as determined under *BIPRU* 10.5.2R, *BIPRU* 10.5.3R and *BIPRU* 10.5.5R).~~ [deleted]

10.5.9 R ~~If a *firm* exceeds (or is aware that it will exceed) the limits in *BIPRU* 10.5.6R or *BIPRU* 10.5.8R it must notify the *FSA* without delay.~~ [deleted]

10.5.10 G ~~A report under *BIPRU* 10.5.9R should be made in exceptional circumstances only. A *firm* which makes such a report should also provide the *FSA* with an explanation as to how the limits came to be exceeded, and a plan of action for bringing its *exposures* within the limits. The *FSA* may, where the circumstances warrant it, allow a *firm* a limited period of time in which to comply with the limits.~~ [deleted]

The following provisions are deleted. The deleted text is not shown struck through.

Trading book limits

10.5.11 R [deleted]

10.5.12 R [deleted]

10.5.13 R [deleted]

10.5.14 R [deleted]

10.5.15 G [deleted]

10.5.16 G [deleted]

10.5.17 R [deleted]

10.5.18 R [deleted]

10.5.19 G [deleted]

10.5.20 R [deleted]

10.5.21 R [deleted]

10.5.22 R [deleted]

10.5.23 G [deleted]

10.5.24 G [deleted]

10.6 Exemptions

General exemptions

10.6.1 R ~~The *exposures* listed in *BIPRU* 10.6.3R, whether *trading book exposures* or *non-trading book exposures*, are exempt from the limits described in *BIPRU* 10.5 (Limits on exposures and large exposures), provided that the *exposures* are~~ This section only applies to *exposures*, whether in the *trading book* or *non-trading book*, to *counterparties* which are not *connected counterparties*.

10.6.2 R (1) In *BIPRU* 10.6.3R and *BIPRU* 10.6.4R, references to guarantees include credit derivatives recognised under *BIPRU* 5 (Credit risk mitigation) and, if applicable, *BIPRU* 4.10 (The IRB approach: Credit risk mitigation), other than credit linked notes.

[**Note**: *BCD* Article 112(1)]

…

10.6.3 R The following *exposures* ~~referred to in *BIPRU* 10.6.1R~~ are ~~as follows~~ exempt from the limits described in *BIPRU* 10.5 (Limits on exposures):

…

(4) other *exposures* attributable to, or guaranteed by, central governments, *central banks*, *international organisations* ~~or~~ , *multilateral development banks* or *public sector entities* where unsecured claims on the entity to which the *exposure* is attributable or by which it is guaranteed would receive a 0% *risk weight* under the *standardised approach*;

(5) ~~asset items constituting claims on and other *exposures* to central governments or *central banks* not within (1) which are denominated and, where applicable, funded in the national currencies of the borrowers;~~ [deleted]

(6) ~~asset items constituting claims on and other *exposures* to *institutions*, with a maturity of one year or less, but not constituting such *institutions' capital resources*;~~ [deleted]

(7) asset items constituting claims on *EEA States*' regional governments ~~and~~ or local authorities which claims would receive a 0% *risk weight*

under the *standardised approach*;

(8) other *exposures* to or guaranteed by *EEA States'* regional governments ~~and~~ or local authorities claims on which would receive a 0% *risk weight* under the *standardised approach*;

(9) ~~asset items constituting claims and other *exposures* on *recognised third country investment firms*, *recognised clearing houses*, *designated clearing houses*, *recognised investment exchanges* and *designated investment exchanges* in *CRD financial institutions*, with a maturity of one year or less, but not constituting such institutions' *capital resources*;~~ [deleted]

(10) ~~*covered bonds* within the meaning of the second paragraph of that definition;~~ [deleted]

…

(12) the following, where they would receive a 50% *risk weight* under the *standardised approach*, and only up to 50% of the value of the commercial property concerned:

…

(b) *exposures* related to property leasing transactions concerning offices or other commercial premises; ~~and~~

(13) ~~bill endorsements on bills with a maturity of 1 year or less already endorsed by another *firm*.~~ [deleted]

(14) asset items and other *exposures* secured by collateral in the form of cash deposits placed with the *lending firm* or with a *credit institution* which is the *parent undertaking* or a *subsidiary undertaking* of the *lending firm*;

(15) asset items and other *exposures* secured by collateral in the form of certificates of deposit issued by the *lending firm* or by a *credit institution* which is the *parent undertaking* or a *subsidiary undertaking* of the *lending firm* and lodged with either of them; and

(16) *exposures* arising from undrawn credit facilities that are classified as low risk off-balance sheet items in *BIPRU* 3.7.2R and provided that an agreement has been concluded with the *counterparty* or *group of connected clients* under which the facility may be drawn only if it has been ascertained that it will not cause the limit in *BIPRU* 10.5.6R (Limits on exposures) to be exceeded.

[**Note**: *BCD* Articles 113(3), 115(1) sub-paragraphs (a) and (b) and 115(2) sub-paragraphs (a) and (b)]

10.6.4 R For the purposes of *BIPRU* 10.6.3R(11) (Loan secured by residential

mortgages and leasing transactions)~~,~~:

(1) the requirements set out in *BIPRU* 3.4.64R to *BIPRU* 3.4.73R (Requirements for recognition of real estate collateral) apply;

(2) the value of the property must be calculated on the basis of ~~strict~~ prudent valuation standards laid down by law, regulation or administrative provisions~~.~~;

(3) ~~Valuation~~ valuation must be carried out at least once ~~a year~~ every three years~~.~~;

(4) the valuation *rules* set out in *BIPRU* 3.4.77R to *BIPRU* 3.4.80R apply; and

(5) ~~For these purposes,~~ residential property means a residence to be occupied or let by the borrower.

[**Note**: *BCD* Article 115(1) second to fourth paragraphs]

The following provisions are deleted. The deleted text is not shown struck through.

10.6.5	R	[deleted]
10.6.6	R	[deleted]
10.6.7	R	[deleted]
10.6.8	G	[deleted]
10.6.9	R	[deleted]
10.6.10	R	[deleted]
10.6.11	R	[deleted]
10.6.12	R	[deleted]
10.6.13	G	[deleted]
10.6.14	R	[deleted]
10.6.15	R	[deleted]
10.6.16	R	[deleted]
10.6.17	R	[deleted]
10.6.18	G	[deleted]
10.6.19	R	[deleted]
10.6.20	R	[deleted]

10.6.21 R [deleted]

10.6.22 R [deleted]

10.6.23 R [deleted]

10.6.24 R [deleted]

10.6.25 R [deleted]

10.6.26 R [deleted]

10.6.27 G [deleted]

After BIPRU 10.6.27G [deleted], insert the following new paragraphs. The new text is not underlined.

10.6.28 R For the purposes of *BIPRU* 10.6.3R(12) (Loans secured by commercial mortgages and leasing transactions):

(1) the value of the property must be calculated on the basis of prudent valuation standards laid down by law, regulation or administrative provisions; and

(2) the commercial property concerned must be fully constructed, leased and produce appropriate rental income.

[**Note**: *BCD* Article 115(2) second and third paragraphs]

10.6.29 G For the purposes of *BIPRU* 10.6.3R(12), a 50% *risk weight* is not allowed under the *standardised approach* for commercial property based in the *UK*.

10.6.30 R For the purposes of *BIPRU* 10.6.3R(14) (Cash deposits) and *BIPRU* 10.6.3R(15) (Certificates of deposit), a *firm* may only treat the asset items or other *exposures* as secured if the collateral complies with the eligibility requirements and other minimum requirements set out in *BIPRU* 5 (Credit risk mitigation) and, if relevant, *BIPRU* 4.10 (The IRB approach: Credit risk mitigation) for the purposes calculating a *firm's exposure*.

10.6.31 G In relation to *BIPRU* 10.6.3R(14) (Cash deposits) and *BIPRU* 10.6.3R(15) (Certificates of deposit), the collateral may in some cases give rise to an *exposure* between the *lending firm* and the *credit institution*. Where this is the case, the *exposure* is considered to be an intra-group *exposure*. A *firm* may apply *BIPRU* 10.8A (Intra-group exposures: core UK group) or *BIPRU* 10.9A (Intra-group exposures: non-core large exposures group), as appropriate.

Institutional exemption

10.6.32 R Where a *counterparty* is an *institution* or where a *group of connected clients* includes one or more *institutions*:

(1) the total amount of a *firm's exposures* to the same *counterparty* or *group of connected clients* may exceed 25% of the *firm's capital resources* so long as the total amount of such *exposures* does not exceed €150 million; and

(2) the *firm* must ensure that the total amount of its *exposures*, after taking into account the effect of *credit risk mitigation*, to other *persons* in that *group of connected clients* which are not *institutions* does not exceed 25% of the *firm's capital resources*; and

(3) where the amount of €150 million in (1) is higher than an amount equivalent to 25% of the *firm's capital resources*, the *firm* must ensure the following:

(a) the total amount of those *exposures* in (1) in relation to the same *counterparty* or *group of connected clients* does not exceed a reasonable limit in terms of the *firm's capital resources*; and

(b) in any case, the limit in this *rule* must not exceed 100% of the *firm's capital resources*; and

capital resources are as determined under *BIPRU* 10.5.2R, *BIPRU* 10.5.3R and *BIPRU* 10.5.5R (Stage (N) of the calculation in the *capital resources table* (Total tier one capital plus tier two capital after deductions)); and

(4) for the purpose of (3), the *firm* must determine the limit consistently with the policies and procedures required under *BIPRU* 10.12.3R (Concentration risk policies).

[**Note**: *BCD* Article 111(1) second to fourth paragraphs]

10.6.33 G Article 111(4) of the *Banking Consolidation Directive* allows the *FSA* to waive the 100% limit on a case-by-case basis in exceptional circumstances. The *FSA* will consider an application for such a *waiver* in the light of the criteria in section 148 of the *Act* (Modification or waiver of rules).

Sovereign large exposure waiver

10.6.34 R *BIPRU* 10.6.35R to *BIPRU* 10.6.37G apply to a *BIPRU firm* if it has a *sovereign large exposure waiver*.

10.6.35 R A *firm* that has a *sovereign large exposure waiver* must exempt from the limits described in *BIPRU* 10.5 (Limits on exposures) the *exposures* as specified in the *sovereign large exposure waiver*. It must do so to the extent specified in that waiver.

10.6.36 R For the purpose of the *sovereign large exposure waiver*, and in relation to a *firm*, the *exposures* referred to in *BIPRU* 10.6.35R are limited to the following:

(1) asset items constituting claims on *central banks* not within *BIPRU* 10.6.3R(1), which are in the form of required minimum reserves held at those *central banks* which are denominated and funded in their national currencies; and

(2) asset items constituting claims on central governments not within *BIPRU* 10.6.3R(1), which are in the form of statutory liquidity requirements held in government securities denominated and funded in their national currencies.

[**Note**: *BCD* Article 113(4)(g) and (h)]

10.6.37 G As part of the process of applying for a *sovereign large exposure waiver*, a *firm* should agree with the *FSA* the amount of the *exposures* that may be exempted. In general, the *FSA* will expect the likelihood of the *firm's* liabilities (that fund the particular exempt *exposure*) falling alongside a fall in that *exposure* in an event of default to form one of the key considerations in discussions with the *firm* regarding the total amount of such exempt *exposures*. For this purpose, the *FSA* will expect the *firm* to demonstrate that, taking into account the aggregate of all *exposures* exempted under other *sovereign large exposure waivers* granted to the *firm*, the criteria in section 148 of the *Act* (Modification or waiver of rules) are satisfied in relation to the *sovereign large exposure waiver* under consideration.

BIPRU 10.7 is deleted in its entirety. The deleted text is not shown struck through.

10.7 Treasury concession and intra-group securities financing transactions [deleted]

BIPRU 10.8 is deleted in its entirety. The deleted text is not shown struck through.

10.8 **UK integrated groups** [deleted]

After BIPRU 10.8 [deleted], insert the following new section. The new text is not shown underlined.

10.8A Intra-group exposures: core UK group

Application

10.8A.1 R This section applies to a *firm* if:

(1) it is a member of a *core UK group*; and

(2) it has a *core UK group waiver*.

Definition of core UK group

10.8A.2 R An *undertaking* is a member of a *firm's core UK group* if, in relation to the *firm*, that *undertaking* satisfies the following conditions:

(1) it is a *core concentration risk group counterparty*;

(2) it is an *institution*, *financial holding company*, *financial institution*, *asset management company* or *ancillary services undertaking*;

(3) (in relation to a *subsidiary undertaking*) 100% of the voting rights attaching to the *shares* in its capital is held by the *firm* or a *financial holding company* (or a *subsidiary undertaking* of the *financial holding company*), whether individually or jointly, and that *firm* or *financial holding company* (or its *subsidiary undertaking*) must have the right to appoint or remove a majority of the members of the board of *directors*, committee of management or other governing body of the *undertaking*;

(4) it is subject to the same risk evaluation, measurement and control procedures as the *firm*;

(5) it is incorporated in the *United Kingdom*; and

(6) there is no current or foreseen material practical or legal impediment to the prompt transfer of *capital resources* or repayment of liabilities from the *counterparty* to the *firm*.

10.8A.3 G In relation to *BIPRU* 10.8A.2R(3), a *subsidiary undertaking* should generally be 100% owned and controlled by a single shareholder. However, if a *subsidiary undertaking* has more than one shareholder, that *undertaking* may be a member of the *core UK group* if all its shareholders are also members of that same *core UK group*.

10.8A.4 G If a *core concentration risk group counterparty* is of a type that falls within the scope of the Council Regulation of 29 May 2000 on insolvency proceedings (Regulation 1346/2000/EC) and it is established in the *United Kingdom* other than by incorporation, a *firm* wishing to include that *counterparty* in its *core UK group* may apply to the *FSA* for a *waiver* of *BIPRU* 10.8A.2R(5) if it can demonstrate fully to the *FSA* that the *counterparty's* centre of main interests is situated in the *United Kingdom* within the meaning of that Regulation.

Minimum standards

10.8A.5 R (1) For the purpose of *BIPRU* 10.8A.2R(6), a *firm* must be able to demonstrate fully to the *FSA* the circumstances and arrangements, including legal arrangements, by virtue of which there are no material practical or legal impediments, and none are foreseen, to the prompt transfer of *capital resources* or repayment of liabilities from the *counterparty* to the *firm*.

(2) In relation to a *counterparty* that is not a *firm*, the arrangements referred to in (1) must include a legally binding agreement with each *firm* that is a member of the *core UK group* that it will promptly on demand by the *firm* increase that *firm's capital resources* by an amount required to ensure that the *firm* complies with *GENPRU* 2.1 (Calculation of capital resources requirements), *BIPRU* 10 (Large exposures requirements) and any other requirements relating to *capital resources* or concentration risk imposed on a *firm* by or under the *regulatory system*.

10.8A.6 G The *FSA* will consider the following criteria when assessing whether the condition in *BIPRU* 10.8A.2R(6) is going to be met:

(1) the speed with which funds can be transferred or liabilities repaid to the *firm* and the simplicity of the method for the transfer or repayment;

(2) whether there are any interests other than those of the *firm* in the *core concentration risk group counterparty* and what impact those other interests may have on the *firm's* control over the *core group concentration risk group counterparty* and the ability of the *firm* to require a transfer of funds or repayment of liabilities;

(3) whether there are any tax disadvantages for the *firm* or the *core concentration risk group counterparty* as a result of the transfer of funds or repayment of liabilities;

(4) whether the purpose of the *core concentration risk group counterparty* prejudices the prompt transfer of funds or repayment of liabilities;

(5) whether the legal structure of the *core concentration risk group counterparty* prejudices the prompt transfer of funds or repayment of liabilities;

(6) whether the contractual relationships of the *core concentration risk group counterparty* with the *firm* and other third parties prejudices the prompt transfer of funds or repayment of liabilities; and

(7) whether past and proposed flows of funds between the *core concentration risk group counterparty* and the *firm* demonstrate the ability to make prompt transfer of funds or repayment of liabilities.

10.8A.7 G (1) *Firms* are referred to the guidance relating to 0% *risk weights* for *exposures* within a *core UK group* under the *standardised approach* as follows:

(a) *BIPRU* 3.2.28G in respect of *BIPRU* 10.8A.2R(3) on same risk evaluation, measurement and control procedures; and

(b) *BIPRU* 3.2.30G and *BIPRU* 3.2.31G in respect of *BIPRU*

10.8A.2R(6) on prompt transfer of *capital resources* and repayment of liabilities.

(2) For the purpose of *BIPRU* 10.8A.5R(2), the obligation to increase the *firm's capital resources* may be limited to capital resources available to the *counterparty* and may reasonably exclude such amount of capital resources that, if transferred to the *firm,* would cause the *counterparty* to become balance sheet insolvent in the manner contemplated in section 123(2) of the Insolvency Act 1986.

Exemption for a core UK group

10.8A.8 R If this section applies, *exposures* between members of the *core UK group* are exempt from the limits described in *BIPRU* 10.5 (Limits on exposures).

10.8A.9 G The *FSA* will expect a *firm* to which this section applies not to use any member of its *core UK group* which is not a *firm* to route lending or to have *exposures* to any third party in excess of the limits in *BIPRU* 10.5 (Limits on exposures).

Calculation of capital resources for a core UK group

10.8A.10 R For the purposes of this section, a *firm* must calculate the capital resources of the *core UK group* in accordance with *GENPRU* 3 Annex 1R Part 2 (Method 2 of Annex 1 of the Financial Groups Directive (Deduction and aggregation Method) and apply the limits set out in this section to those capital resources rather than the *capital resources* of the *firm*. For these purposes the definition of *solo capital resources* is adjusted so that the *rules* on which the calculation for each member of the *core UK group* is based are the ones that would apply under the procedure in *BIPRU* 8.6.6R to *BIPRU* 8.6.9R (Consolidated capital resources).

10.8A.11 G The calculation of capital resources under *GENPRU* 3 Annex 1R Part 2 (Method 2 of Annex 1 of the Financial Groups Directive (Deduction and aggregation Method) is based on the *solo capital resources* of members of a *financial conglomerate*. The definition of *solo capital resources* depends on what type of *undertakings* the *financial conglomerate* contains. For instance, if a *financial conglomerate* contains a *bank* the *solo capital resources* calculation for every group member in the *banking sector* and the *investment services sector* is based on the *capital resources* calculation for *banks*. The purpose of *BIPRU* 10.8A.10R is to apply the corresponding procedure that applies under *BIPRU* 8.6 (Calculation of capital resources on a consolidated basis for BIPRU firms).

Notification

10.8A.12 R A *firm* must immediately notify the *FSA* in writing it if becomes aware that any *exposure* that it has treated as exempt under this section or any *counterparty* that it has been treating as a member of its *core UK group* has ceased to meet the conditions for application of the treatment in this section.

BIPRU 10.9 is deleted in its entirety. The deleted text is not shown struck through.

10.9 **Wider Integrated Group** [deleted]

After BIPRU 10.9 [deleted], insert the following new section. The new text is not shown underlined.

10.9A Intra-group exposures: non-core large exposures group

Application

10.9A.1 R This section applies to a *firm* if it has:

(1) a *non-core large exposures group*; and

(2) a *non-core large exposures group waiver*.

10.9A.2 G A *firm* must treat the *exposures* to its *connected counterparties* that are not members of its *non-core large exposures group* as *exposures* to a single undertaking and must ensure that the total amount of its *exposures* to such *connected counterparties* does not exceed the 25% limit in *BIPRU* 10.5.6R (large exposure limit) and, if applicable, the *trading book* limits in *BIPRU* 10.10A (Connected counterparties: trading book limits).

Definition of non-core large exposures group

10.9A.3 R The *non-core large exposures group* of a *firm* consists of each *non-core concentration risk group counterparty* of the *firm* that is not a member of its *core UK group* but satisfies all other conditions for membership of the *firm's core UK group* except for the following:

(1) *BIPRU* 10.8A.2R(1) (Core concentration risk group counterparty);

(2) *BIPRU* 10.8A.2R(5) (Establishment in the United Kingdom); and

(3) *BIPRU* 10.8A.5R(2) (Capital maintenance arrangements).

Definition of non-core concentration risk group counterparty

10.9A.4 R A *non-core concentration risk group counterparty* (in relation to a *firm*) is a counterparty which is its *parent undertaking*, its *subsidiary undertaking* or a *subsidiary undertaking* of its *parent undertaking*, provided that (in each case) both the counterparty and the *firm* satisfy one of the following conditions:

(1) they are included within the scope of consolidation on a full basis with respect to the same *UK consolidation group* and *BIPRU* 8.3.1R applies to the *firm* with respect to that *UK consolidation group*; or

(2) they are included within the scope of consolidation on a full basis with respect to the same *group* by a *competent authority* of an *EEA State* other than the *United Kingdom* under the *CRD implementation*

measures about consolidated supervision for that *EEA State*; or

(3) they are included within the scope of consolidation on a full basis with respect to the same *group* by a *third country competent authority* under prudential rules for the *banking sector* or *investment services sector* of or administered by that *third country competent authority* and the *firm* or another *EEA firm* in that *group* has been notified in writing by the *FSA* or a *competent authority* of another *EEA State* pursuant to Article 143 of the *Banking Consolidation Directive* that that *group* is subject to equivalent supervision.

Revised large exposure limits for a non-core large exposures group

10.9A.5 R A *firm* to which this section applies must ensure that the *rules* listed in *BIPRU* 10.9A.6 R are complied with on a consolidated basis subject to the following modifications:

(1) (if the *firm* is not a member of a *core UK group*) the *rules* apply in relation to *exposures* of the *firm* to its *non-core large exposures group* as if it is a single undertaking;

(2) if the *firm* is a member of a *core UK group*:

(a) the *rules* apply in relation to its *core UK group* rather than in relation to the *firm*; and

(b) the *core UK group* and the *non-core large exposures group* must each be treated as a single undertaking.

10.9A.6 R The *rules* referred to in *BIPRU* 10.9A.5R are:

(1) *BIPRU* 10.5.6R (25% *large exposures* limit);

(2) *BIPRU* 10.10.2R (*trading book* limits) other than *BIPRU* 10.10.2R(2) (*CNCOM*); and

(3) *BIPRU* 10.10A.3R (500% limit for *trading book* excess *exposures*).

Non-trading book backstop limit for a non-core large exposures group

10.9A.7 R A *firm* must ensure that the total amount of *non-trading book* e*xposures* between:

(1) itself and members of its *non-core large exposures group* does not exceed 100% of the *firm's capital resources*; or

(2) if it is a member of a *core UK group*, the members of its *core UK group* and members of its *non-core large exposures group* does not exceed 100% of the capital resources of the *firm's core UK group*.

Concentrated exposures in a non-core large exposures group

10.9A.8 R (1) Subject to the limit in *BIPRU* 10.9A.7R (Back-stop large exposures limit), a *firm* may concentrate its intra-group *exposure* to a particular member of its *non-core large exposures group* in excess of 25% of the capital resources of the *firm's core UK group*.

(2) A *firm* may not apply (1) unless it has given prior written notice to the *FSA* that it intends to do so.

(3) The written notice referred to in (2) must contain the following:

(a) an explanation on how the *firm* will ensure that it will still meet the requirement in *BIPRU* 10.9A.7R (Backstop large exposures limit) on a continuing basis when applying (1);

(b) details of the *counterparty*, the size of the *exposure* and the expected duration of the *exposure*; and

(c) an explanation of the reason for the *exposure*.

(4) If a *firm* stops applying (1) it may start to apply it again if it notifies the *FSA* under (2) that it intends to do so.

Calculation of capital resources for a core UK group

10.9A.9 R *BIPRU* 10.8A.10R (Calculation of capital resources for a core UK group) applies for the purposes of this section in the same way that it applies for the purposes of *BIPRU* 10.8A (Intra-group exposures: core UK group).

Exemption for intra-group exposures on a solo basis

10.9A.10 R If this section applies to a *firm*, then subject to *BIPRU* 10.10A.12R (Core UK group and non-core large exposures group: treatment of the trading book concentration risk excess), it may, on a solo basis, treat an *exposure* to a member of its *non-core large exposures group* as exempt from the limits in *BIPRU* 10.5 (Limits on exposures).

10.9A.11 G The purpose of *BIPRU* 10.9A.10R is to reflect the fact that the limits in *BIPRU* 10.5 (Limits on exposures) so far as they apply to a member of a *firm's non-core large exposures group* are calculated on a consolidated basis with respect to a *firm's core UK group*. It is therefore necessary to switch them off on a purely solo basis.

Notification

10.9A.12 R A *firm* must immediately notify the *FSA* in writing it if becomes aware that any *exposure* that it has treated as exempt under this section or any *counterparty* that it has been treating as a member of its *non-core large exposures group* has ceased to meet the conditions for application of the treatment in this section.

BIPRU 10.10 is deleted in its entirety. The deleted text is not shown struck through.

10.10 Treatment of the trading book concentration risk excess under the integrated groups regime [deleted]

After BIPRU 10.10 [deleted], insert the following new section. The new text is not shown underlined.

10.10A Connected counterparties: trading book limits

Application

10.10A.1 R This section only applies to *exposures* in a *firm's trading book* to its *connected counterparties*.

Trading book limits

10.10A.2 R *Exposures* in a *firm's trading book* to its *connected counterparties* are exempt from the 25% limit in *BIPRU* 10.5.6R (large exposures limit) if:

(1) the total amount of the *exposures* on the *firm's non-trading book* to its *connected counterparties* does not exceed the limit laid down in that *rule*, calculated with reference to the definition of *capital resources* calculated at stage (N) of the calculation in the *capital resources table* (Total tier one capital plus tier two capital after deductions) as set out in *BIPRU* 10.5.2R, *BIPRU* 10.5.3R and *BIPRU* 10.5.5R, so that the excess arises entirely on the *trading book*; and

(2) the *firm* meets the additional capital requirements relating to the *concentration risk capital component* (*CNCOM*) in relation to the relevant *trading book exposures*.

10.10A.3 R A *firm* must ensure that the total amount of its *trading book exposures* to its *connected counterparties* does not exceed 500% of the *firm's capital resources* calculated at stage (T) of the *capital resources table* (Total capital after deductions).

How to calculate the concentration risk capital component

10.10A.4 G A *firm's CNCOM* should be calculated as part of its *credit risk capital requirement* (CRCR) in accordance with *GENPRU* 2.1 (Calculation of capital resources requirements).

10.10A.5 R A *firm's CNCOM* is the sum of its *individual counterparty CNCOMs.*

10.10A.6 R An *individual counterparty CNCOM* is the amount a *firm* must calculate in accordance with *BIPRU* 10.10A.8R with respect to its *exposures* to its *connected counterparties*.

10.10A.7 G A *CNCOM* calculation on a *trading book exposure* is in addition to, and not instead of, any capital requirement arising under the *market risk capital requirement* or *counterparty risk capital component*.

10.10A.8 R A *firm* must calculate its *individual counterparty CNCOM* for its *exposures* to its *connected counterparties* as follows:

(1) break down its *total exposure* into its *trading book* and *non-trading book* components;

(2) calculate 25% of the *firm's capital resources* calculated at stage (N) of the calculation in the *capital resources table* (Total tier one capital plus tier two capital after deductions) to determine the total amount of the *exposures* in the *firm's non-trading book* does not exceed this limit in accordance with *BIPRU* 10.10A.2R(1);

(3) calculate 25% of the *firm's capital resources* calculated at stage (T) of the *capital resources table* (Total capital after deductions) and deduct those parts of the *total exposure* which are in the *non-trading book* falling within the limit in (2);

(4) a *firm* must allocate (in the order set out in (6)) *trading book exposures* to its *connected counterparties* to the unutilised portion of the 25% limit of the *firm's capital resources* calculated at stage (T) of the *capital resources table* (Total capital after deductions) remaining after deducting the *non-trading book exposures* in accordance with (3);

(5) no further *trading book exposures* can be allocated once the 25% limit in (4) has been reached; the remaining *trading book exposures* constitute the *trading book concentration risk excess* with respect to its *connected counterparties*;

(6) for the purposes of (4), a *firm* must allocate the *trading book exposures* in the order of the level of capital requirements, starting with the lowest capital requirements for *specific risk* under the *market risk capital requirement* and/or the lowest capital requirements under the *counterparty risk capital component* and moving towards those *trading book exposures* with the highest capital requirements last;

(7) the *individual counterparty CNCOM* is the sum of the capital requirements for each individual *exposure* included in the *trading book concentration risk excess* in accordance with (8) and (9) (each such capital requirement being an *individual CNCOM*);

(8) if the *trading book concentration risk excess* has persisted for 10 *business days* or less (irrespective of the age of each component part), the *individual CNCOMs* must be calculated in accordance with this formula:

each *individual CNCOM* = capital requirement referred to in (6) × 200%;

(9) if the *trading book concentration risk excess* has persisted for more than 10 *business days* (irrespective of the age of each component part), the *individual CNCOM*s must be calculated in accordance with this formula:

each *individual CNCOM* = capital requirement referred to in (6) × appropriate percentage in *BIPRU* 10.10A.9R.

10.10A.9 R The appropriate percentage referred to in *BIPRU* 10.10A.8R(9) must be established in accordance with the following:

(1) the individual *exposures* included in the *trading book concentration risk excess* must be assigned to the bands in the first column of the table in *BIPRU* 10.10A.10R;

(2) the maximum amount that may be put in any band other than the last equals the percentage of the *firm's capital resources* in column 1 of that table;

(3) no amount may be allocated to the second or any later band unless the one before has been filled;

(4) *exposures* must be assigned to the bands in the order established by *BIPRU* 10.10A.8R(6); and

(5) for the purposes of (4), those *exposures* with the lowest capital requirements (as referred to in *BIPRU* 10.10A.8R(6)) must be assigned first and those with the highest last.

Percentages applicable under BIPRU 10.10A.9R

10.10A.10 R This table belongs to *BIPRU* 10.10A.9R

Excess exposure (as a percentage of the *firm's capital resources* calculated at stage (T) of the *capital resources table* (Total capital after deductions))	Percentage
25% up to 40%	200%
Portion from 40% - 60%	300%
Portion from 60% - 80%	400%
Portion from 80% - 100%	500%
Portion from 100% - 250%	600%
Portion over 250%	900%

How CNCOM applies to the non-core large exposures group

10.10A.11 R A *firm* that has a *non-core large exposures group waiver* must meet the *CNCOM* in relation to *exposures* to members of its *non-core large exposures group* in accordance with this section, subject to the following:

(1) in *BIPRU* 10.10A.8R, "25%" is substituted with "100%"; and

(2) the excess *exposures* for the purpose of *BIPRU* 10.10A.8R(9) must be assigned to the bands in the first column of the table in *BIPRU* 10.10A.10R beginning with the portion from 100% - 250%.

Core UK group and non-core large exposures group: treatment of the trading book concentration risk excess

10.10A.12 R (1) This *rule* applies to a *firm* that has a *core UK group waiver* or a *non-core large exposures group waiver*.

(2) A *firm* must calculate the *CNCOM* in relation to the *core UK group* in question in accordance with *BIPRU* 10.10A.2R (Trading book limits).

(3) A *firm* must then calculate the percentage of the amount calculated under (2) which is attributable to *exposures* of the *firm*.

(4) A *firm* must add the result of the calculation in (3) to the *CNCOM* applied to the *firm* on a solo basis in accordance with *BIPRU* 10.10A.5R to *BIPRU* 10.10A.11R (How to calculate the concentration risk capital component).

Examples

10.10A.13 G (1) The table in *BIPRU* 10.10A.14G sets out an example of a *CNCOM* calculation under *BIPRU* 10.10A.8R.

(2) *BIPRU* 10 Annex 2G (Examples of treatment of exposures under BIPRU 10) sets out examples of how the *large exposures* limits apply, particularly in relation to a *core UK group* and *non-core large exposures group*, taking into account various examples of *firms' exposure* profiles.

Example of a CNCOM calculation (all numbers £000s)

10.10A.14 G This table belongs to *BIPRU* 10.10A.13G(1)

	Capital resources position		
(1)	An *firm's capital resources* comprises:		
			£
	Tier one and *tier two capital resources*		1000
	Eligible *tier three capital resources*		100
	Amended *capital resources*		1100
(2)	The components of the *large exposure* comprise:		
			£
	(a) *Non-trading book exposure*		200
	(b) Mark to market value of *trading book* securities:		
		% *specific risk* weight	
	Short: qualifying bond	1.00	(20)
	Long: qualifying commercial paper	0.25	100
	Long: equity	4.00	150
	Long: qualifying convertible	1.60	30
	Total net long securities position:		260
	Total net large exposures position [(a) + (b)]		460
Calculating the exposure for which incremental capital is needed			
(3)	The short position in the qualifying bond is offset against the highest specific risk weight items - in this case equities:		
			£

	Net long equity position (£150- £20)		130
(4)	The remaining items are ranked according to specific risk weight.		
	% *specific risk* weight	Security	£
	0.25	Qualifying commercial paper	100
	1.60	Qualifying convertible	30
	4.00	Equity (net)	130
(5)	The 'headroom' between the *non-trading book* exposure and 25% of the amended *capital resources* is calculated.		
			£
	25% of amended capital base (1100)		275
	Non-trading book exposure		200
	Headroom		75
(6)	Applying the securities positions in ascending order of specific *risk weight*, £75 of the £100 qualifying commercial paper may be counted before 25% of the amended capital base is reached. The remaining £25 of qualifying commercial paper, along with £30 qualifying convertible and £130 equity (net) are traded securities *exposures* in excess of the limit and should therefore be covered by incremental capital. The amount of incremental capital should be included in the calculation for determining how much *trading book* capital a *firm* should have.		
(7)	If the excess *exposure* has been outstanding for 10 days or less, the specific *risk weights* for the elements over 25% of amended *capital resources* should be doubled. The 25% limit (£275) is taken up by £200 *non-trading book exposure* and £75 *trading book exposure* within the limit. These two items, when added to the items in bold below, total £460. £460 is the total net *large exposures* position as set out in (2) above.		
			£
	Qualifying commercial paper	**£25** x 0.25% x 200% =	0.125
	Qualifying convertible	**£30** x 1.60% x 200% =	0.960
	Equity	**£130** x 4% x 200% =	10.400

	Additional capital requirement		11.485
(8)	If the excess *exposure* has been outstanding for more than 10 days, the 25% limit (£275) is taken up by £200 *non-trading book exposure* and £75 *trading book exposure* within the limit. These two items, when added to the items in bold below, total £460. £460 is the total net *large exposures* position as set out in (2) above.		
			£
	(a)	Over 25% and up to 40% of amended capital base at 200% (40% of £1100 = £440)	
		Amount of *trading book concentration risk excess* = £185 Appropriate % Multiplier Band = 200%	
		£25 x 0.25% x 200% =	0.125
		£30 x 1.60% x 200% =	0.960
		£110 x 4.00% x 200% =	8.800
	(b)	Excess exposure 40% - 60% of amended capital base at 300%	
		£20 x 4.00% x 300% =	2.400
	Additional capital requirement [(a)+(b)]		12.285

BIPRU 10.11 is deleted in its entirety. The deleted text is not shown struck through.

10.11 Notification procedure for BIPRU 10.7 to 10.10 [deleted]

…

BIPRU 10 Annex 1G is deleted in its entirety. The deleted text is not shown struck through.

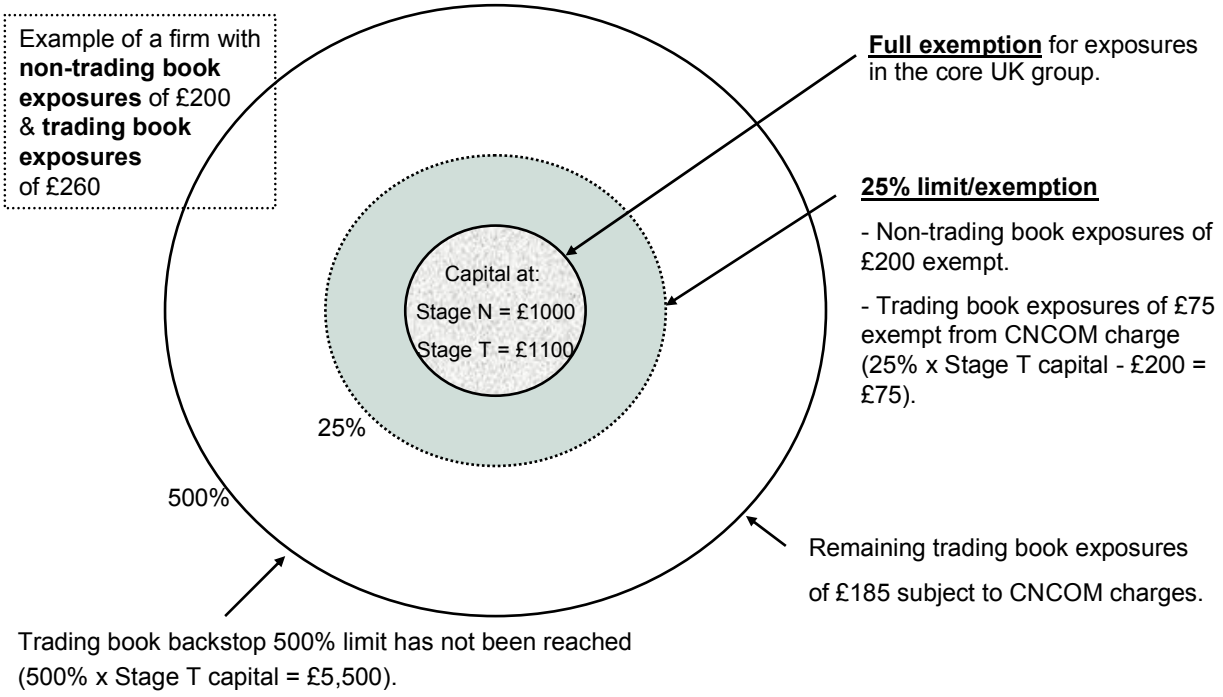
10 Annex 1G **Treatment of exposures under the integrated groups regime for concentration risk** [deleted]

After BIPRU 10 Annex 1G [deleted], insert the following new annex:

10 Annex 2 G Examples of treatment of intra-group exposures under BIPRU 10

Example 1

Intra group large exposures: CNCOM calculation
(example of BIPRU 10.10A.14 G)



CNCOM charges as follows:

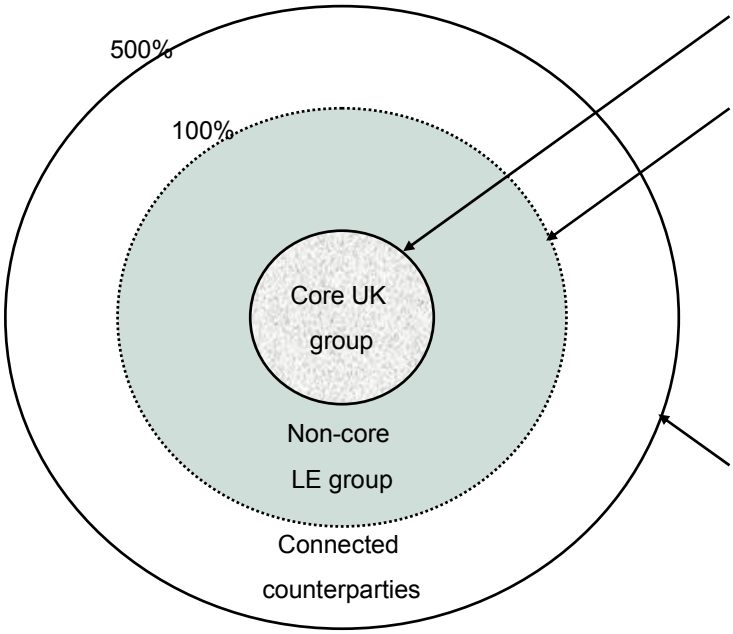
Trading book exposures of £75 exempt from CNCOM,
CNCOM band charges start at 25%,

If excess exposures are >10 days, CNCOM bands calculated as:

25% - 40%	(£275 - £440)	=	£165	@ 200%
40% - 60%	(£ remainder)	=	£ 20	@ 300%
			£185	

Example 2

Intra group large exposures: Overview of interaction between BIPRU 10.8A (Core UK group), BIPRU 10.9A (Non-core LE group) & BIPRU 10.10A (Trading book limits)



Full exemption for exposures in the core UK group.

Non-core large exposures group - 100% limit/exemption

- Non-trading book exposures are subject to a 100% limit (capital of core UK group at Stage N).

- Trading book exposures equal to difference between 100% capital of core UK group at Stage T and non-trading book exposures may be exempt from CNCOM charge.

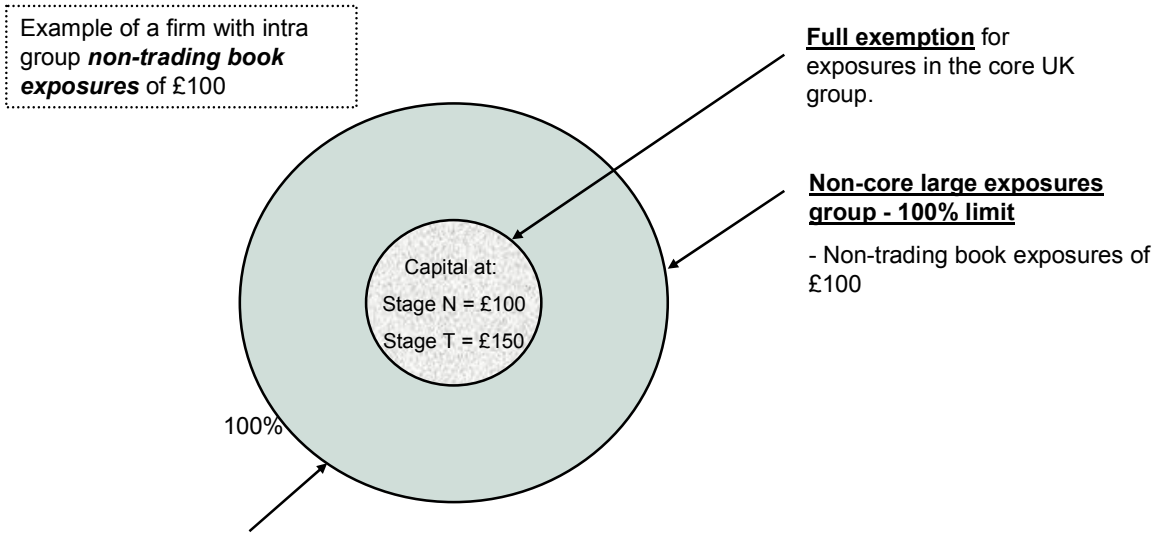
Connected counterparties (not core UK group / non-core LE group)

-Trading book exposures subject to 500% limit (capital of core UK group at Stage T). CNCOM charges apply.

- Non-trading book exposures subject to 25% limit.

Example 3

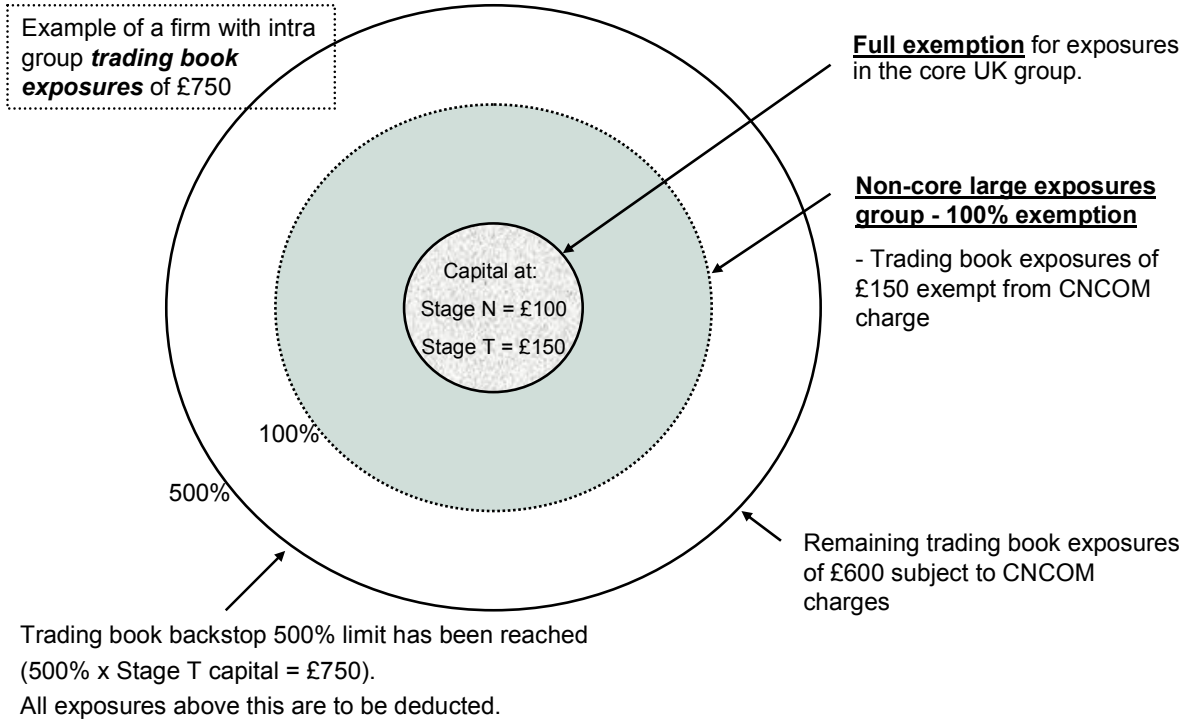
Intra group large exposures: example of non-trading book exposures



Non-trading book backstop of 100% limit has been reached (100% x Stage N capital = £100).
All exposures above this are to be deducted.

Example 4

Intra group large exposures: example of trading book exposures



CNCOM charges as follows:

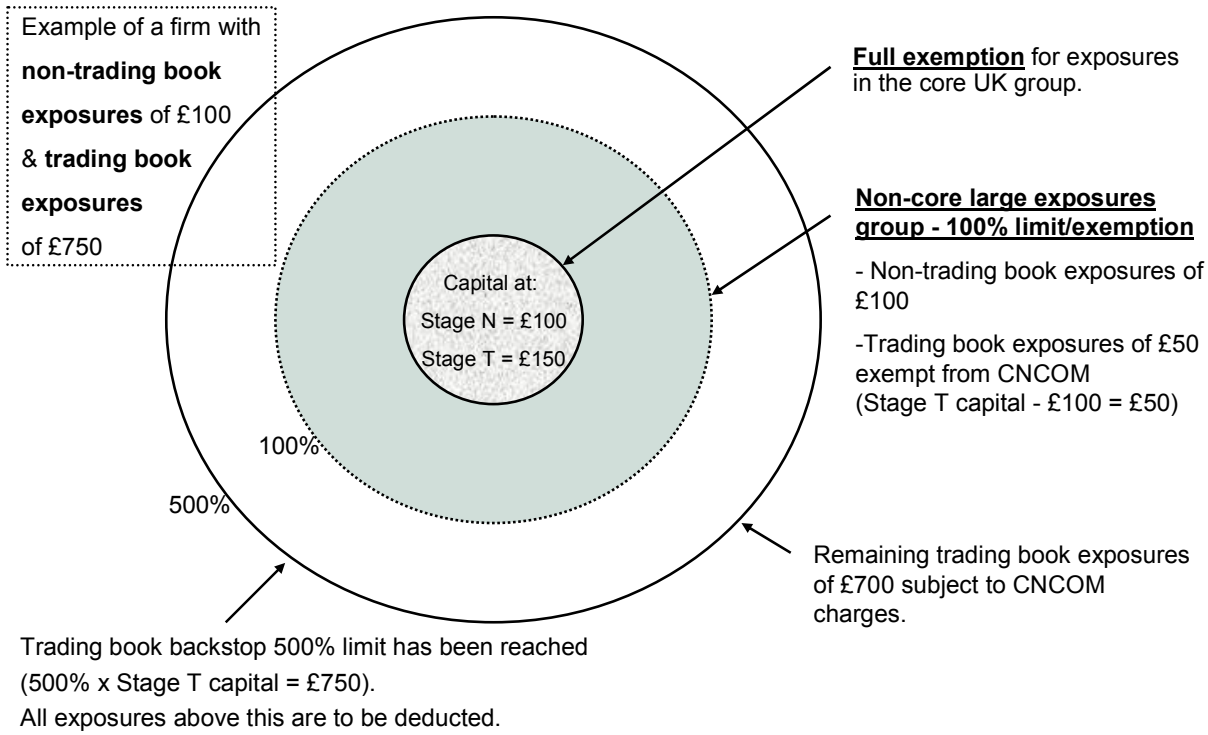
Trading book exposures of £150 exempt from CNCOM,
CNCOM band charges start at 100%,

If excess exposures are >10 days, CNCOM bands calculated as:

100% - 250%	(£150 - £375)	=	£225	@ 600%
>250%	(£ remainder)	=	£375	@ 900%
			£600	

Example 5

Intra group large exposures: example of non-trading book & trading book exposures



CNCOM charges as follows:

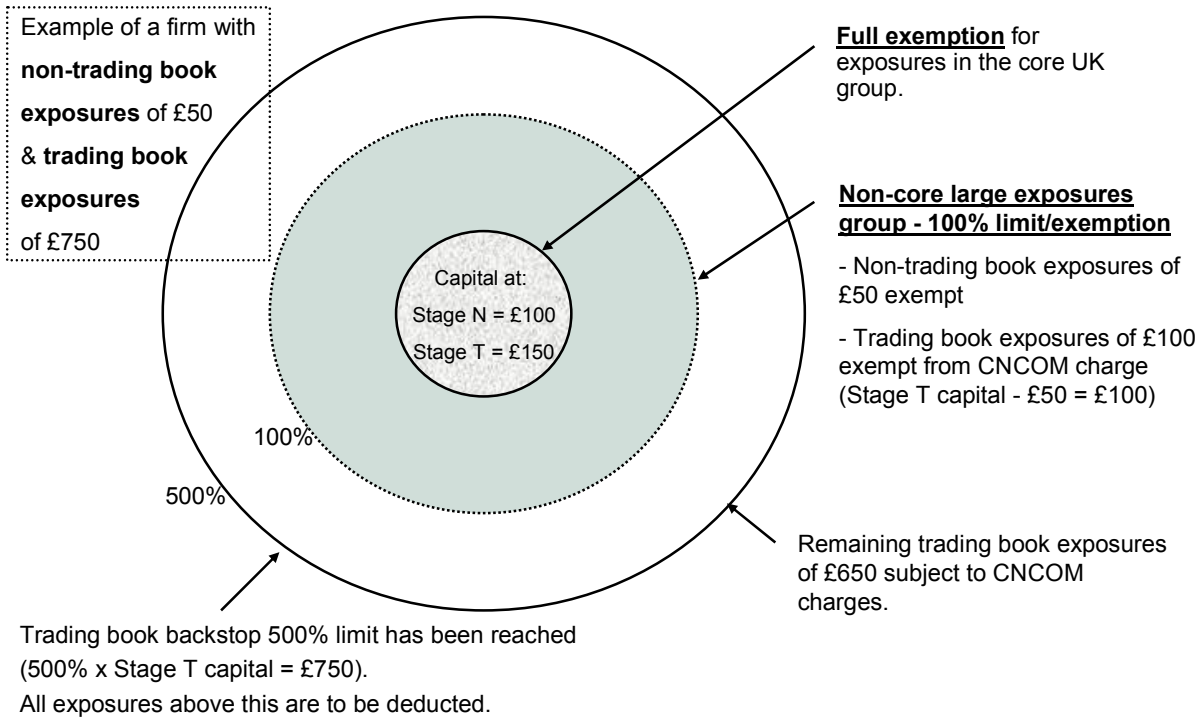
Trading book exposures of £50 exempt from CNCOM,
CNCOM band charges start at 100%,

If excess exposures are >10 days, CNCOM bands calculated as:

100% - 250%	(£150 - £375)	=	£225	@ 600%
>250%	(£ remainder)	=	£475	@ 900%
			£700	

Example 6

Intra group large exposures: example of non-trading book & trading book exposures



CNCOM charges as follows:

Trading book exposures of £100 exempt from CNCOM,
CNCOM band charges start at 100%,

If excess exposures are >10 days, CNCOM bands calculated as:

100% - 250%	(£150 - £375)	=	£225	@ 600%
>250%	(£ remainder)	=	£425	@ 900%
			£650	

Amend the following as shown.

TP 2 Capital floors for a firm using the IRB or AMA approaches

…

How to apply IPRU

2.26 R For the purpose of calculating the part of the *IPRU* capital resources requirement that corresponds to the *concentration risk capital component* a *firm* may identify the *trading book exposures* on which that requirement is based using *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements) except to the extent that *BIPRU* 10 involves the *IRB approach*.

2.27 G The *concentration risk capital component* is the capital requirement for a *firm* that chooses to have *trading book exposures* that exceed the ~~concentration risk~~ *large exposure* limits for the *non-trading book*. In most cases *IPRU* has a similar capital requirement. The purpose of *BIPRU* TP 2.26R is to allow a *firm* to calculate the amount of the excess *trading book exposures* for which it calculates the additional capital charge using *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements) in order to avoid having to apply the *IPRU* large exposure requirements for this purpose only.

…

TP 15 Commodities firm transitionals: Exemptions from capital requirements

…

Exemption

15.6 R The provisions of *GENPRU* and *BIPRU* on capital requirements and *GENPRU* 1.2 (Adequacy of financial resources) do not apply to a *firm* to which *BIPRU* TP 15 applies. However *BIPRU* 10 (~~Concentration risk~~ Large exposures requirements) continues to apply, including the *CNCOM*.

…

15.10 G Table: Parts of GENPRU and BIPRU that apply to exempt BIPRU commodities firms

This table belongs to *BIPRU* TP 15.9G

GENPRU and *BIPRU* provisions	…	…
…	…	…
BIPRU 10 (~~Concentration~~	…	…

~~risk~~ Large exposures)		
…	…	…

…

TP 16 Commodities firm transitionals: large exposure

…

Duration of transitional

16.4 R The treatment in *BIPRU* TP 16 is available until 31 December ~~2010~~ 2014.

…

Exemption

16.6 R (1) A *firm* may exceed the limits concerning *large exposures* in *BIPRU* 10.5.6R (25% limit)~~, *BIPRU* 10.5.8R (800% limit), *BIPRU* 10.5.12R (500% limit) and *BIPRU* 10.5.13R (600% limit)~~.

…

16.7 G Broadly speaking the effect of *BIPRU* TP 16.6R is that *BIPRU* 10 (~~Concentration risk~~ Large exposures) does not apply to a *firm* that meets the conditions in *BIPRU* TP 16.1R. However *BIPRU* 10.12 (Systems and controls and general) continues to apply.

…

BIPRU TP17 is deleted in its entirety. The deleted text is not shown struck through.

TP 17 Large exposures: Exemptions for intra-group exposures for banks and investment firms [deleted]

BIPRU TP18 is deleted in its entirety. The deleted text is not shown struck through.

TP 18 Large exposures: Exemptions for intra-group exposures for building societies [deleted]

BIPRU TP19 is deleted in its entirety. The deleted text is not shown struck through.

TP 19 Large exposures: Exemptions for intra-group exposures on a consolidated basis [deleted]

…

After BIPRU TP 32, insert the following new transitional provisions. The text is not underlined.

TP 33 Large exposures: Exemptions for intra-group exposures

Application

33.1 R This section applies to a *BIPRU firm* that on 30 December 2010 was applying the exemptions from the *large exposure* limits in accordance with any of the following provisions in force on that date:

(1) *BIPRU* 10.6.5R to *BIPRU* 10.6.7R (Parental guarantees and capital maintenance arrangements);

(2) *BIPRU* 10.7 (Treasury concession and intra-group securities financing transactions);

(3) *BIPRU* 10.8 (UK integrated group); or

(4) *BIPRU* 10.9 (Wider Integrated Group), if it has a *wider integrated group waiver* that expires after 31 December 2010.

Duration of transitional

33.2 R This section applies until 31 December 2012.

General rule

33.3 R A *firm* may, to the extent permitted by this section, treat an *exposure* to a *concentration risk group counterparty* as exempt or partially exempt in accordance with *BIPRU* 10 (Concentration risk requirements) in the version in force on 30 December 2010.

33.4 G The term *concentration risk group counterparty* broadly covers group members if they and the *firm* are subject to consolidated supervision by the *FSA*, another *EEA competent authority* or certain non-*EEA* regulators. The full definition can be found in the *Glossary* in the version in force on 30 December 2010.

33.5 G If the context requires, *BIPRU* 8.9 (Consolidated concentration risk requirements) in force on 30 December 2010 continues to apply to a *firm* that applies *BIPRU* TP 33.3R.

Effect of this section on intra-group exemptions in BIPRU 10

33.6 R If a *firm* applies this section, *BIPRU* 10.8A (Intra-group exposures: core UK group) to *BIPRU* 10.9A (Intra-group exposures: exposures outside of the core UK group) do not apply.

33.7 G The effect of *BIPRU* TP 33.6R is that a *firm* should not apply *BIPRU* 10.8A (Intra-group exposures: core UK group) to *BIPRU* 10.9A (Intra-group exposures: exposures outside the core UK group) to some *exposures* to *core concentration risk group counterparties*, *non-core concentration risk group counterparties* or *connected counterparties* and this section to others. The purpose of *BIPRU* TP 33.6R is that a *firm* should choose between treating intra-group *exposures* under *BIPRU* 10.8A (Intra-group exposures: core UK group) to *BIPRU* 10.9A (Intra-group exposures: exposures outside the core UK group) and treating them under this section but that it should not mix the approaches.

Notice to the FSA

33.8 R A *firm* may only apply the treatment in *BIPRU* TP 33.3R to a *concentration risk group counterparty* if the *firm* has notified the *FSA* in writing that it intends to apply that *rule* to the *concentration risk group counterparty*.

33.9 R The notice in *BIPRU* TP 33.8R must comply with the following requirements:

(1) the *FSA* was notified on or before 31 December 2010;

(2) the notice must give the following:

(a) the name of the *concentration risk group counterparty* concerned and the intra-group exemption or exemptions that apply to it; and

(b) details of the *firm's* initial plans on how and when it intends to comply with the *large exposures* limits that apply to a *core UK group* or *non-core large exposures group*.

TP 34 Large exposures: General transitional provisions

Application

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

Purpose

34.2 G This section implements the intra-group exemption in Article 113(3)(f) and the national discretion for exemptions in Articles 113(4)(a) and (c) of the *Banking Consolidation Directive* and the national discretion for *trading book concentration risk excess* in Article 31 of the *Capital Adequacy Directive*.

Duration of transitional

34.3 R This section applies until 31 December 2010.

Version of BIPRU to be used

34.4 R Any reference in this section to *BIPRU* is to the version in force on 30 December 2010.

Rules in BIPRU that apply until 31 December 2010

34.5 R The following *rules* apply until 31 December 2010:

(1) *BIPRU* 10.6.3R(10) (Exemption for covered bonds from the large exposure limit);

(2) *BIPRU* 10.5 (Limits on exposures and large exposures);

(3) *BIPRU* TP 17 (Large exposures: Exemptions for intra-group exposures for banks and investment firms), if a *firm* has a *waiver* that expires on 31 December 2010 which has the effect of allowing it to apply the exemptions in *BIPRU* TP 17; and

(4) *BIPRU* TP 19 (Large exposures: Exemptions for intra-group exposures on a consolidated basis), if a *firm* has a *waiver* that expires on 31 December 2010 which has the effect of allowing it to apply the exemptions in *BIPRU* TP 17 on a consolidated basis.

34.6 G The [Capital Requirements Directive (Large Exposures)] Instrument 2010 (FSA 2010/XX) comes into force on 31 December 2010. The effect of *BIPRU* TP 34.5R is that the *BIPRU* provisions contained in that instrument that amend, delete or replace, the *rules* set out in *BIPRU* TP 34.5R are disapplied until 1 January 2011.

Schedule 1 Record keeping requirements

…

3 Table

Handbook reference	Subject of Record	Contents of Record	When record must be made	Retention Period
…				
~~*BIPRU* 10.4.47R~~	~~*Exposure* to undisclosed *counterparties*~~	~~A record of the steps taken by the *firm* to satisfy itself that it will continue to meet the limits in *BIPRU* 10.5 for *non-trading book exposures* and *trading book exposures*~~	~~Not specified~~	~~Not specified~~

Handbook reference	Subject of Record	Contents of Record	When record must be made	Retention Period
…				

…

Schedule 2 Notification and reporting requirements

…

3 Table

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
…				
~~*BIPRU* 8.9.4R, *BIPRU* 8.9.27R~~	~~Use of Treasury concession in *BIPRU* 10.7 on a consolidated basis~~	~~See *BIPRU* 10.11~~	~~Intention to use Treasury concession~~	~~See *BIPRU* 10.11~~
~~*BIPRU* 8.9.8R, *BIPRU* 8.9.27R~~	~~Creation of a *consolidation UK integrated group*~~	~~See *BIPRU* 10.11~~	~~Intention to form *consolidation UK integrated group*~~	~~See *BIPRU* 10.11~~
…				
~~*BIPRU* 10.5.9R~~	~~Breaching the *large exposures* limits in *BIPRU* 10.5.6R or *BIPRU* 10.5.8R~~	~~Fact of breach or expectation of breach~~	~~Breach or expectation of breach~~	~~Immediately~~
~~*BIPRU* 10.5.14R~~	~~*Trading book concentration risk excesses* over a three month period~~	~~All cases in the three month period of each *trading book concentration risk excess* that existed in that period, giving the amount of the excess and the name of the *counterparty*~~	~~End of three month period~~	~~Not specified~~
~~*BIPRU* 10.6.7R~~	~~Intention to use capital maintenance agreement~~	~~Fact of intention and details of the~~	~~Intention to enter into~~	~~One month before~~

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
~~(2)~~		~~terms and conditions of capital maintenance agreement~~	~~agreement~~	~~entering agreement~~
~~*BIPRU* 10.11.1R (1) and (4)~~	~~Intention to use concession in *BIPRU* 10.7.1R, or *BIPRU* 10.7.4R or the *UK integrated groups* concession in *BIPRU* 10.8~~	~~Fact of intention~~	~~Intention to use *BIPRU* 10.7.1R, or *BIPRU* 10.7.4R, or *BIPRU* 10.8~~	~~One month prior to using the concessions in *BIPRU* 10.7.1R, or *BIPRU* 10.7.4R, or *BIPRU* 10.8~~
~~*BIPRU* 10.11.1R (3)~~	~~Intention to stop applying *BIPRU* 10.7 or *BIPRU* 10.8~~	~~Fact of intention~~	~~Intention to stop using *BIPRU* 10.7.1R, or *BIPRU* 10.7.4R, or *BIPRU* 10.8~~	~~One month prior to using the concessions in *BIPRU* 10.7.1R, or *BIPRU* 10.7.4R, or *BIPRU* 10.8~~
BIPRU ~~10.11.2R~~ 10.8A.11 R	*Exposure* being treated as exempt under ~~*BIPRU* 10.7.1R or *BIPRU* 10.7.4R or~~ *BIPRU* 10.8A (Core UK group) ~~or *BIPRU* 10.9~~ ceases to meet the conditions for application of the treatment	Fact or expectation of any ~~exposure~~ *exposure* to which it has applied the treatment ceases to meet the conditions for application of the ~~relevant~~ treatment	Awareness of situation	~~Not specified~~ Immediately
BIPRU 10.9A.8R (2)	Intention to use *BIPRU* 10.9A.8R (1) to concentrate an *exposure* to a particular member of the *non-core large exposures group* that exceeds 25% of the capital resources of the *firm's core UK group*	Fact of intention and the information in *BIPRU* 10.9A.8R (3)	Intention to use *BIPRU* 10.9A.8R (1)	Not specified

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
BIPRU 10.9A.12 R	*Exposure* being treated as exempt under *BIPRU* 10.9A (Intra-group exposures: exposures outside the core UK group) ceases to meet the conditions for application of the treatment	Fact or expectation of any *exposure* to which it has applied the treatment ceases to meet the conditions for application of the treatment	Awareness of situation	Immediately
…				

Appendix 3

Draft Handbook text:

CEBS guidance – Core tier one capital

Amendments to the General Prudential sourcebook (GENPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

[NOTE TO READERS: The amendments in this Annex are based on the text of GENPRU as amended by Annex B to the Capital Requirements Directive (Handbook Amendments) Instrument 2010, which was made on 22 July 2010 and comes into force on 31 December 2010. It is intended that amendments in this Annex will also come into force on 31 December 2010].

2.2.6 G This table belongs to *GENPRU* 2.2.5G

Topic	Location of text
…	…
Core tier one capital: permanent share capital	*GENPRU* 2.2.83R to *GENPRU* 2.2.84G
General conditions for eligibility of *capital instruments* as *core tier one capital* (*BIPRU firm* only)	*GENPRU* 2.2.83AR to *GENPRU* 2.2.83DG; *GENPRU* 2.2.84AG
Core tier one capital: exception to eligibility criteria (*building societies* only)	*GENPRU* 2.2.83ER to *GENPRU* 2.2.83GG
…	…
Purchases of *tier one instruments*: *BIPRU firm* only	*GENPRU* 2.2.79AR to *GENPRU* 2.2.79HG; 2.2.79LG
…	…

…

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:

…

(6) it is able to absorb losses to allow the *firm* to continue trading and:

…

(b) in the case of a *BIPRU firm*, it does not, through appropriate mechanisms, hinder the recapitalisation of the *firm*, and in

particular it complies with:

(i) *GENPRU* 2.2.80R to *GENPRU* 2.2.81R (Loss absorption); ~~and~~

(ii) ~~in the case of *hybrid capital*, *GENPRU* 2.2.116R to *GENPRU* 2.2.118R (Other tier one capital: loss absorption);~~ in the case of *core tier one capital*, *GENPRU* 2.2.83AR(9) to (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* 2.2.116R to *GENPRU* 2.2.118R (Other tier one capital: loss absorption).

…

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) ~~it is on or after the fifth anniversary of the date of issue of the instrument; and~~ [deleted]

(3) the *firm* has given notice to the *FSA* in accordance with *GENPRU* 2.2.79GR; 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(2)~~ *GENPRU* 2.2.79AR(4) under section 148 (Modification or waiver of rules) of the *Act*.

2.2.79C R ~~*GENPRU* 2.2.79AR(2)~~ *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(2)~~ *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; and

(b) 3% of the *firm's* total issued *hybrid 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 *FSA* in accordance with *GENPRU* 2.2.79GR and it has not, during the period of one month from the date of giving notice, received an objection from the *FSA*.

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* 2.2.79GR and for which the offer to purchase has been declined by the instrument holders unless the purchase offer period has expired.

...

2.2.82 G There are additional loss absorption requirements for (in the case of an *insurer*) *innovative tier one capital*, and (in the case of a *BIPRU firm*) *hybrid capital* in *GENPRU* 2.2.116R to *GENPRU* 2.2.118R (Other tier one capital: loss absorption) and (in the case of a *BIPRU firm*) 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 (*BIPRU firm* only)).

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* 2.2.64R) 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) a *deferred share*;

(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; ~~and~~

(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* 2.2.83AR (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* 2.2.83R(4) or that a *BIPRU firm's eligible partnership capital* or *eligible LLP members' capital* must comply with under *GENPRU* 2.2.95R 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 is not able to petition for the winding up or administration of the *firm* or for any similar procedure in relation to the *firm*;

(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 any items of capital that are not eligible for inclusion in stage A of the *capital resources table*;

(11) the *firm* has not provided the holder of it 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* 2.2.83R and *GENPRU* 2.2.83AR but have differences in voting rights, unless it has notified the *FSA* 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) will 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* 2.2.83R to *GENPRU* 2.2.83AR;

(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 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) are subject to the same *coupon* limit; or

(b) meet the conditions set out in *GENPRU* 2.2.83R(2), *GENPRU* 2.2.83R(3) and *GENPRU* 2.2.83AR (General conditions for eligibility of capital instruments as core tier one capital (BIPRU firm only)); 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* 2.2.83ER unless it has notified the *FSA* of its intention to do so at least one month before the date of issue.

2.2.83G 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.

Core tier one capital: additional information

2.2.84 G In the case of an *insurer*, *GENPRU* ~~2.2.83R~~ 2.2.83R(2) and *GENPRU* 2.2.83R(3) have ~~has~~ the effect that the *firm* should be under no obligation to make any payment in respect of a *tier one instrument* if it is to form part of its *permanent share capital* unless and until the *firm* is wound up. A *tier one instrument* that forms part of *permanent share capital* should not therefore count as a liability before the *firm* is wound up. The fact that relevant company law permits the *firm* to make earlier repayment does not mean that the *tier one instruments* are not eligible. However, the *firm* should not be required by any contractual or other obligation arising out of the terms of that capital to repay *permanent share capital*. Similarly, a *tier one instrument* may still qualify if company law allows dividends to be paid on this capital, provided the *firm* is not contractually or otherwise obliged to pay them. There should therefore be no fixed costs. *GENPRU* 2.2.83AR to

GENPRU 2.2.83FR impose more specific conditions on *coupon* payment and winding up which are applicable to *BIPRU firms*.

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 it fails to meet those requirements when other transactions are taken into account. Examples of such 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*.

…

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* 2.2.62R (General conditions relating to *tier one capital*) it complies with *GENPRU* 2.2.83R(2) (Coupons should not be cumulative or mandatory) and *GENPRU* 2.2.83AR to *GENPRU* 2.2.83CR (General conditions for eligibility of capital instruments as core tier one capital (BIPRU firm only). However, *GENPRU* 2.2.64R(3) (Redemption), ~~and~~ *GENPRU* 2.2.83AR(5) (Capital repayment) and *GENPRU* 2.2.83AR(12) (Characteristics in contract) are ~~is~~ replaced by *GENPRU* 2.2.93R or *GENPRU* 2.2.94R.

After GENPRU TP 8A, insert the following new transitional provisions. The text is not underlined.

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, in the same manner that, the provision in *GENPRU* to which it relates applied on a consolidated basis.

8B.3 R The Royal Bank of Scotland plc may treat a *share* falling within *GENPRU* TP 8B.4R as eligible for inclusion within stage of A of the *capital resources table* (Core tier one capital) if it would not otherwise be eligible provided that:

(1) the *share*:

(a) had been issued on or before 30 December 2010; or

(b) if issued after that date, is issued pursuant to a contractual obligation requiring its issued it entered into or or before 30 December 2010;

(2) as at 30 December 2010 The Royal Bank of Scotland plc was entitled (or would have been entitled, had the *share* then been issued) to include it in the calculation of its *capital resources* under *GENPRU* as *permanent share capital* and, in the case of a *share* which had been issued as at that date, did so include it; and

(3) the *share* is held by or on behalf of the Government of the *United Kingdom*.

8B.4 R The *shares* referred to in *GENPRU* TP 8B.3R are as follows:

(1) The Royal Bank of Scotland Group plc Series 1 Class B Shares of 1p each; and

(2) The Royal Bank of Scotland Group plc Series 1 Dividend Access Share of 1p,

either as separate instruments or considered together as connected instruments.

Voting rights

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 *FSA* under *GENPRU* 2.2.83BR 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 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 its *capital resources* under *GENPRU* as *permanent share capital*,

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

Draft Handbook text:

CEBS guidance – Operational risk

Amendments to the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)

In this section, underlining indicates new text.

6.5.30A	G	A *firm* that recognises the impact of insurance and operational risk mitigation techniques for the purposes of its *operational risk* measurement system should be able to show that it has considered the Commission of European Banking Supervisors' guidelines on operational risk mitigation techniques published in December 2009. This can be found at http://www.c-ebs.org/documents/Publications/Standards---Guidelines/2009/Operational-risk-mitigation-techniques/Guidelines.aspx.

Draft Handbook text:

CEBS guidance – Large exposures

Amendments to the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text.

[NOTE TO READERS: The amendments in this Annex are based on the 'near final' rules on the large exposures regime referred to in Part I – Response to CP09/29 and set out in Appendix 2, intended to be made into rules in September 2010 as part of the implementation of Directive 2009/111/EC (CRD 2) intended to come into force on 31 December 2010.]

10 Large exposures requirements

…

10.2 Identification of exposures and recognition of credit risk mitigation

…

10.2.2A G The Committee of European Banking Supervisors (CEBS) has issued guidelines on the conditions applicable to the short-term *exposures* referred to in *BIPRU* 10.2.2R(4) and *BIPRU* 10.2.2R(5) in order to be exempted from the *large exposures* limits in *BIPRU* 10.5 (Limits on exposures). These guidelines can be found at: http://www.c-ebs.org/Publications/Standards-Guidelines/CEBS-Guidelines-on-XXXXXX.

…

10.3 Identification of counterparties

…

Groups of connected clients …

10.3.8 R …

10.3.8A G The Committee of European Banking Supervisors (CEBS) has issued guidelines in relation to the definition of a *group of connected clients*, in particular with reference to the concepts of "control" and "economic interconnection". These guidelines can be found at: http://www.c-ebs.org/Publications/Standards-Guidelines/CEBS-Guidelines-on-the-revised-large-exposures-reg.aspx - Part I.

…

Exposures to underlying assets

10.3.15 R …

10.3.16 G The Committee of European Banking Supervisors (CEBS) has issued guidelines in relation to the treatment for *large exposures* purposes of schemes with *exposures* to underlying assets. These guidelines can be found

at: http://www.c-ebs.org/Publications/Standards-Guidelines/CEBS-Guidelines-on-the-revised-large-exposures-reg.aspx - Part II.

…

Appendix 6

Draft Handbook text: Credit risk amendments

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text.

[NOTE TO READERS: The definitions below are part of the 'near final' rules on the large exposures regime referred to in Part I – Response to CP09/29 and set out in Appendix 2, intended to be made into rules in September 2010 as part of the implementation of Directive 2009/111/EC (CRD 2) to come into force on 31 December 2010.]

core UK group	(in relation to a *firm*) all *undertakings* which, in relation to the *firm*, satisfy the conditions set out in *BIPRU* 3.2.25R (Zero risk-weighting for intra-group exposures: core UK group) and *BIPRU* 10.8A.2R (Definition of core UK group).
core UK group waiver	a *waiver* that has the result of requiring a *firm* to apply:

(a) (in relation to the *credit risk capital requirement*) *BIPRU* 3.2.25R (Zero risk-weighting for intra-group exposures: core UK group), which in summary allows a *firm* to assign a *risk weight* of 0% to *exposures* to members of its *core UK group* instead of complying with *BIPRU* 3.2.20R (Calculation of risk-weighted exposure amounts under the standardised approach); or

(b) (in relation to *large exposures*) *BIPRU* 10.8A (Intra-group exposures: core UK group), which in summary exempts all *exposures* between members of a *core UK group* from the limits described in *BIPRU* 10.5 (Limits on exposures).

Amendments to the General Prudential sourcebook (GENPRU)

In this section, underlining indicates new text and striking through indicates deleted text, unless otherwise indicated.

[NOTE TO READERS: The definitions below are part of the 'near final' rules on the large exposures regime referred to in Part I – Response to CP09/29 and set out in Appendix 2, intended to be made into rules in September 2010 as part of the implementation of Directive 2009/111/EC (CRD 2) to come into force on 31 December 2010.]

…

3 Cross sector groups

3.1 Application

…

3.1.38 R (1) This *rule* applies for the purposes of the definitions of:

(a) a *core concentration risk group counterparty*; and

(b) a ~~*consolidated*~~ *non-core concentration risk group counterparty*;

as they apply for the purposes of the *rules* for the *banking and investment services sector* as applied by *GENPRU* 3.1.36R.

(2) For the purpose of *BIPRU* ~~3.2.27R(1)(a) and (b)~~ 10.9A.4R(1) and (2) (as they apply to the definitions in *GENPRU* 3.1.38R(1)), the conditions are also satisfied if the *counterparty* and the *firm* are included within the scope of consolidated supervision on a full basis with respect to the same *financial conglomerate* under *GENPRU* 3.1 or the relevant implementation measures in another *EEA State* for the *Financial Groups Directive*.

(3) [deleted]

(4) [deleted]

…

Amendments to the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text.

[NOTE TO READERS: The amendments in this Annex are based on the 'near final' rules on the large exposures regime referred to in Part I – Response to CP09/29 and set out in Appendix 2, intended to be made into rules in September 2010 as part of the implementation of Directive 2009/111/EC (CRD 2) intended to come into force on 31 December 2010.]

1 Application

…

1.3 Application for advanced approaches and waivers

…

1.3.2 G …

(2) A *firm* should apply for a *waiver* if it wants to:

…

(e) apply the treatment <u>for a *core UK group* in *BIPRU* 3.2.25R (Zero risk-weighting for intra-group exposures) or</u> in *BIPRU* 10.8A (Intra-group exposures: core UK group)<u>,</u> or <u>for a *non-core large exposures group* in *BIPRU* 10.9A (Intra-group exposures: non-core large exposures group)</u>; or

…

…

3 Standardised credit risk

…

3.2 The central principles of the standardised approach to credit risk

…

Zero risk-weighting for intra-group exposures<u>: core UK group</u>

3.2.25 R (1) Subject to *BIPRU* 3.2.35R, with the exception of *exposures* giving rise to liabilities in the form of the items referred to in *BIPRU* 3.3.26R, a *firm* is not required to comply with *BIPRU* 3.2.20R (Calculation of risk-weighted exposure amounts under the standardised approach) in the case of the *exposures* of the *firm* to a counterparty which is its *parent undertaking*, its *subsidiary undertaking* or a *subsidiary undertaking* of its *parent undertaking* ~~or to which the *firm* is linked by a *consolidation Article 12(1)*~~

~~*relationship*~~ provided that the following conditions are met:

(a) the counterparty is~~:~~

(i) ~~an *institution* whose head office is in an *EEA State*; or~~ a *core concentration risk group counterparty*; and

(ii) an *institution* ~~not within (a)(i)~~, *financial holding company*, *financial institution*, *asset management company* or *ancillary services undertaking* subject to appropriate prudential requirements;

(b) ~~the condition in *BIPRU* 3.2.27R is satisfied;~~ [deleted]

(ba) (in relation to a *subsidiary undertaking*) 100% of the voting rights attaching to the *shares* in the counterparty's capital is held by the *firm* or a *financial holding company* (or a *subsidiary undertaking* of the *financial holding company*), whether individually or jointly, and that the *firm* or *financial holding company* (or its *subsidiary undertaking*) must have the right to appoint or remove a majority of the members of the board of *directors*, committee of management or other governing body of the counterparty;

(c) the counterparty is subject to the same risk evaluation, measurement and control procedures as the *firm*;

(d) the counterparty is ~~established in the *United Kingdom* and either it is~~ incorporated in the *United Kingdom* ~~or (if that counterparty is of a type that falls within the scope of that Regulation) the centre of its main interests is situated within the *United Kingdom* within the meaning of the Council Regulation of 29 May 2000 on insolvency proceedings (Regulation 1346/2000/EC)~~; and

(e) there is no current or foreseen material practical or legal impediment to the prompt transfer of *capital resources* or repayment of liabilities from the counterparty to the *firm*.

(2) Where a *firm* chooses under (1) not to apply *BIPRU* 3.2.20R, it must assign a *risk weight* of 0% to the *exposure*.

(3) A *firm* need not apply the treatment in (1) and (2) to every *exposure* that is eligible for that treatment.

[**Note**: *BCD* Article 80(7)~~, part~~]

3.2.25A G (1) *Firms* are referred to *BIPRU* 10.8A (Intra-group exposures: core UK group) under which *exposures* within the *core UK group* are exempt from the limits described in *BIPRU* 10.5 (Limits on exposures) if they would be assigned a *risk weight* of 0% under *BIPRU* 3.2.25R.

(2) Therefore, a *firm* that is applying for a *core UK group waiver* should demonstrate that it meets the conditions in *BIPRU* 3.2.25R and *BIPRU* 10.8A for establishing a *core UK group*. A *firm* that is granted a *core UK group waiver* may rely on it for the purpose of assigning a *risk weight* of 0% to *exposures* within its *core UK group* and for the purpose of exempting the *exposures* within the *core UK group* from the 25% *large exposure* limit.

…

3.2.27 R ~~(1) The condition referred to in *BIPRU* 3.2.25R(1)(b) is that both the *counterparty* and the *firm* are:~~

~~(a) included within the scope of consolidation on a full basis with respect to the same *UK consolidation group* and *BIPRU* 8.3.1R applies to the *firm* with respect to that *UK consolidation group*;~~

~~(b) included within the scope of consolidation on a full basis with respect to the same *group* by a *competent authority* of an *EEA State* other than the *United Kingdom* under the *CRD implementation measures* about consolidated supervision for that *EEA State*; or~~

~~(c) (provided that this consolidation is carried out to standards equivalent to those in (a) and (b)) included within the scope of consolidation on a full basis with respect to the same *group* by a *third country competent authority* under prudential rules for the *banking sector* or *investment services sector* of or administered by that *third country competent authority*.~~

~~(2) A *group* is subject to consolidation to equivalent standards for the purpose of (1)(c) only of the *firm* or another *EEA firm* in that *group* has been notified in writing by the *FSA* or a *competent authority* of another *EEA State* pursuant to Article 143 of the *Banking Consolidation Directive* that the *group* is subject to equivalent supervision.~~

~~[**Note**: *BCD* Article 80(7), part]~~ [deleted]

3.2.27A R (1) For the purpose of *BIPRU* 3.2.25R(1)(e), a *firm* must be able on an ongoing basis to demonstrate fully to the *FSA* the circumstances and arrangements, including legal arrangements, by virtue of which there are no material practical or legal impediments, and none are foreseen, to the prompt transfer of *capital resources* or repayment of liabilities from the counterparty to the *firm*.

(2) In relation to a counterparty that is not a *firm*, the arrangements referred to in (1) must include a legally binding agreement with each *firm* that is a member of the *core UK group* that it will promptly on

demand by the *firm* increase the *firm's capital resources* by an amount required to ensure that the *firm* complies with *GENPRU* 2.1 (Calculation of capital resources requirements), *BIPRU* 10 (Large exposures) and any other requirements relating to *capital resources* or concentration risk imposed on a *firm* by or under the *regulatory system*.

…

3.2.29 G ~~An~~ In relation to a *core concentration risk group counterparty*, an *undertaking* is included within the scope of consolidation of a group on a full basis ~~as referred to in *BIPRU* 3.2.27R(1)~~ if it is at the head of the group or if its assets and liabilities are taken into account in full as referred to in *BIPRU* 8.5.2G (Basis of inclusion of undertakings in consolidation).

3.2.29A G (1) In relation to *BIPRU* 3.2.25R(1)(ba), a *subsidiary undertaking* should generally be 100% owned and controlled by a single shareholder. However, if a *subsidiary undertaking* has more than one shareholder, that *undertaking* may be a member of the *core UK group* if all its shareholders are also members of the same *core UK group*.

(2) For the purpose of *BIPRU* 3.2.25R(1)(d) (Incorporation in the UK), if a counterparty is of a type that falls within the scope of the Council Regulation of 29 May 2000 on insolvency proceedings (Regulation 1346/2000/EC) and it is established in the *United Kingdom* other than by incorporation, a *firm* wishing to include that counterparty in its *core UK group* may apply to the *FSA* for a *waiver* of this condition if it can demonstrate fully to the *FSA* that the counterparty's centre of main interests is situated in the *United Kingdom* within the meaning of that Regulation.

3.2.30 G For the purpose of *BIPRU* 3.2.25R(1)(e) (Prompt transfer of capital resources):

(1) ~~In~~ in the case of an *undertaking* that is a *firm* the requirement in *BIPRU* 3.2.25R(1)(e) for the prompt transfer of *capital resources* refers to *capital resources* in excess of the capital and financial resources requirements to which it is subject under the *regulatory system*; and

(2) the following guidance relating to the condition in *BIPRU* 10.8A.2R(6) requiring the prompt transfer of *capital resources* within a *core UK group* as applicable for the exemption from *large exposure* limits is also relevant:

(a) *BIPRU* 10.8A.6G in respect of the criteria that the *FSA* will consider when assessing whether the condition requiring the prompt transfer of *capital resources* is going to be met; and

(b) *BIPRU* 10.8A.7G(2) in respect of the counterparty's

obligation to increase the *firm's capital resources* and the limitations that may be permitted.

…

3.2.35 R (1) A *firm* may not apply *BIPRU* 3.2.25R unless it has ~~given one month's prior notice to the *FSA* that it intends do so~~ a *core UK group waiver*.

(2) ~~A *firm* need only give the *FSA* the notice required in (1) once rather than with respect to each exposure.~~ [deleted]

(3) A *firm* may stop applying *BIPRU* 3.2.25R or may stop applying it to some *exposures*.

(4) ~~If a *firm* stops applying *BIPRU* 3.2.25R it may start to apply it again if it notifies the *FSA* under (1) that it intends do so.~~ [deleted]

(5) A *firm* must notify the *FSA* if it becomes aware that any *exposure* that it has treated as exempt under *BIPRU* 3.2.25R has ceased to meet the conditions for exemption or if the *firm* ceases to treat an *exposure* under that *rule*.

3.2.36 G ~~The *FSA* may discuss with a *firm* that makes the notification required in *BIPRU* 3.2.25R(1) the reasons why the *firm* believes it meets the conditions in *BIPRU* 3.2.25R(1).~~ [deleted]

…

4 The IRB approach

…

4.2 The IRB approach: High level material

…

4.2.34 G (1) …

(2) *Exposures* excluded under (1) will be eligible for a 0% *risk weight* under the *standardised approach* if they satisfy the conditions in *BIPRU* 3.2.25R to *BIPRU* ~~3.2.27R~~ 3.2.27AR (Zero risk weight for certain intra-group exposures).

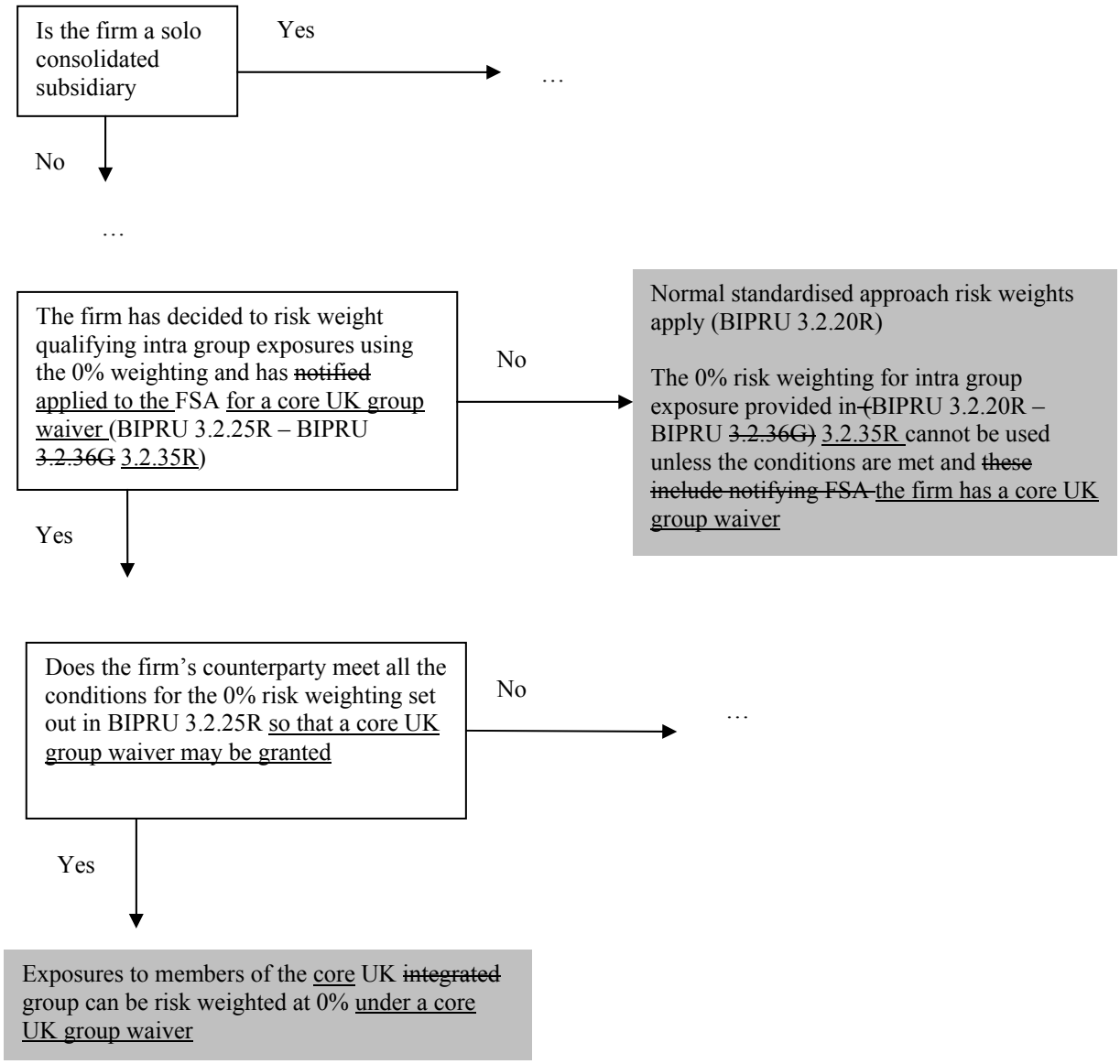
…

…

3 Annex 1G Guidance on the standardised approach zero risk weighting for intra-group exposures

This flow chart belongs to *BIPRU* 3.2.25R – *BIPRU* 3.2.35R

Flowchart – zero risk weighting for intra-group exposures


Is the firm a solo consolidated subsidiary
Yes
…
No
…
The firm has decided to risk weight qualifying intra group exposures using the 0% weighting and has ~~notified~~ applied to the FSA for a core UK group waiver (BIPRU 3.2.25R – BIPRU ~~3.2.36G~~ 3.2.35R)
No
Normal standardised approach risk weights apply (BIPRU 3.2.20R)
The 0% risk weighting for intra group exposure provided in ~~(~~BIPRU 3.2.20R – BIPRU ~~3.2.36G)~~ 3.2.35R cannot be used unless the conditions are met and ~~these include notifying FSA~~ the firm has a core UK group waiver
Yes
Does the firm's counterparty meet all the conditions for the 0% risk weighting set out in BIPRU 3.2.25R so that a core UK group waiver may be granted
No
…
Yes
Exposures to members of the core UK ~~integrated~~ group can be risk weighted at 0% under a core UK group waiver

…

10.8A Intra-group exposures: core UK group

Application

10.8A.1 R This section applies to a *firm* if:

(1) it is a member of a *core UK group* (under *BIPRU* 3.2.25R and this section); and

(2) it has a *core UK group waiver*.

…

TP 33 ~~Large exposures: Exemptions for intra-group exposure~~ Intra-group exposures: Transitional provisions for core UK group and large exposures

Application

33.1 R (1) This section applies to a *BIPRU firm* that on 30 December 2010 was applying any of the exemptions ~~from the *large exposure* limits in accordance with~~ under ~~any of~~ the following provisions in the version in force on that date:

~~(1)~~ (a) *BIPRU* 3.2.25R (Zero risk-weighting for intra-group exposures);

~~(1)~~ (b) *BIPRU* 10.6.5R to *BIPRU* 10.6.7R (Parental guarantees and capital maintenance arrangements);

~~(2)~~ (c) *BIPRU* 10.7 (Treasury concession and intra-group securities financing transactions);

~~(3)~~ (d) *BIPRU* 10.8 (UK integrated group); or

~~(4)~~ (e) *BIPRU* 10.9 (Wider integrated group), if it has a *wider integrated group waiver* that expires after 31 December 2010.

(2) In order to continue applying any of the exemptions in (1), a *firm* must be able on an ongoing basis to demonstrate to the *FSA* that it continues to comply fully with the provisions applicable to that exemption.

…

Zero risk-weighting for intra-group exposures

33.3 R A *firm* may assign a *risk weight* of 0% to *exposures* that are eligible for that

treatment under the criteria in *BIPRU* 3.2.25R in the version in force on 30 December 2010.

Exemptions from large exposures limits for intra-group exposures

~~33.3~~ 33.4 R A *firm* may, to the extent permitted by this section, treat an *exposure* to a *concentration risk group counterparty* as exempt or partially exempt in accordance with *BIPRU* 10 (Concentration risk requirements) in the version in force on 30 December 2010.

~~33.4~~ 33.5 G The term *concentration risk group counterparty* broadly covers group members if they and the *firm* are subject to consolidated supervision by the *FSA*, another *EEA competent authority* or certain non-*EEA* regulators. The full definition can be found in the *Glossary* in the version in force on 30 December 2010.

~~33.5~~ 33.6 G If the context requires, *BIPRU* 8.9 (Consolidated concentration risk requirements) in force on 30 December 2010 continues to apply to a *firm* that applies *BIPRU* TP ~~33.3~~ 33.4R.

Effect of this section on intra-group exemptions in BIPRU 10

~~33.6~~ 33.7 R If a *firm* applies this section, *BIPRU* 10.8A (Intra-group exposures: core UK group) to *BIPRU* 10.9A (Intra-group exposures: exposures outside of the core UK group) do not apply.

~~33.7~~ 33.8 G The effect of *BIPRU* TP ~~33.6~~ 33.7R is that a *firm* should not apply *BIPRU* 10.8 (Intra-group exposures: core UK group) to *BIPRU* 10.9A (Intra-group exposures: exposures outside the core UK group) to some *exposures* to *core concentration risk group counterparties*, *non-core concentration risk group counterparties* or *connected counterparties* and this section to others. The purpose of *BIPRU* TP ~~33.6~~ 33.7R is that a *firm* should choose between treating intra-group *exposures* under *BIPRU* 10.8A (Intra-group exposures: core UK group) to *BIPRU* 10.9A (Intra-group exposures: exposures outside the core UK group) and treating them under this section but that it should not mix the approaches.

Notice to the FSA

~~33.8~~ 33.9 R A *firm* may only apply the treatment in *BIPRU* TP 33.3R or *BIPRU* TP 33.4R ~~to a *concentration risk group counterparty*~~ if the *firm* has notified the *FSA* in writing that it intends to apply ~~that~~ the relevant *rule* to the particular counterparty or *concentration risk group counterparty* respectively.

~~33.9~~ 33.10 R The notice in *BIPRU* TP ~~33.8~~ 33.9R must comply with the following requirements:

(1) the *FSA* was notified on or before 31 December 2010;

(2) the notice must give the following:

(a) in the case of the treatment in *BIPRU* TP 33.3R:

(i) the name of the counterparty concerned; and

(ii) details of the *firm's* initial plans on how and when it will ensure that *exposures* that will not be within its *core UK group* are treated in accordance with the relevant *rules* in *BIPRU* 3;

(b) in the case of the treatment in *BIPRU* TP 33.4R:

(i) the name of the *concentration risk group counterparty* concerned and the intra-group exemption or exemptions that apply to it; and

(ii) details of the *firm's* initial plans on how and when it intends to comply with the *large exposures* limits that apply to a *core UK group* or *non-core large exposures group*.

…

Schedule 2 Notification and reporting requirements

…

3 Table

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
…				
BIPRU 3.2.35R ~~(1), (4) and~~ (5)	~~Intention to apply *BIPRU* 3.2.35R~~ Fact of *exposure* or *firm* ceasing to meet the conditions in *BIPRU* 3.2.25R	~~(1) and (4): Fact of intention~~ (5): Fact of *exposure* or *firm* ceasing to meet the conditions in *BIPRU* ~~3.2.35R~~ 3.2.25R	~~(1) and (4): Intention to apply~~ (5): Ceasing to meet conditions	~~(1) and (4): One month's prior notice~~ (5): First report date after the obligation to notify becomes due
…				

PUB REF: 002091

The Financial Services Authority
25 The North Colonnade Canary Wharf London E14 5HS
Telephone: +44 (0)20 7066 1000 Fax: +44 (0)20 7066 1099
Website: http://www.fsa.gov.uk